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MONEY-CAPITAL and COMPANY LAW: a historical analysis.

Thesis for the degree of Ph.D.

David Kelly

1990

Abstract

The essential contention of this thesis is that the joint-stock company, as an organisational form of capital, and Company law, as the means of regulating that capital form, can be properly understood only on the basis of an analysis of the distinct forms assumed by capital over time. More specifically, it is suggested that the emergence and development of the share as a distinct property form, in the nature of fictitious money-capital, offers the essential explanatory insight into the historical process which saw the formulation of the doctrines and rules which together constitute the distinct legal corpus Company Law as it is now understood.

In support of this contention the thesis establishes the existence of the share as a particular form of the general category fictitious money-capital. On that basis it proceeds to consider the historical process through which the joint-stock company and Company Law emerged, especially in the course of the nineteenth century, as distinctly money-capital forms.

In respect of this latter aim, particular attention is focussed on the following phenomena: the reconceptualisation of the share during the nineteenth century; the increased importance of the doctrine of Goodwill as existing businesses were converted into public joint-stock companies; the change in the rules relating to dividend payments, reflecting a shift in attention from the rights of creditors to the rights of shareholders; and the development of the doctrine of Ultra Vires, as a means of protecting the integrity of the share as a form of money-capital. Finally it is demonstrated that the contemporary doctrine of separate personality was a product of these various developments, reflecting the money-capitalist nature of typical shareholders, and not, as is usually suggested, the automatic consequence of incorporation.

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Chapter One: Towards a Marxist Theory of Company Law.

I. Introduction.

It has been claimed that Marxist economic and legal theory has been unable to come to terms with the joint-stock company as a form of economic organisation within capitalism.[1] There is some truth in the claim and the criticism it implies, particularly with regard to failings of Marxist legal theory. Given the centrality of the joint-stock company within the Capitalist mode of production it is surprising that company law has not constituted an essential focus for critical legal theory.[2] Equally surprising, however, is the extent to which writers, even professedly Marxist ones, have limited Marx's treatment of the joint-stock company and the share to chapter 27 of volume 3 of Capital, instead of making use of the insights into the nature of credit, money-capital and the share that are to be found throughout his work.[3] It is the intention of this thesis to demonstrate how a critical approach, which is essentially of a traditional Marxist nature[4], provides the necessary basis for an understanding and explanation of that historical process which saw the emergence and development of Company Law as a discrete legal corpus with its own distinct doctrines and principles. It is recognised that non-Marxist writers have made valuable contributions to understanding companies as both legal and economic forms. Indeed many such scholars,

whilst lacking any specific critical framework within which to locate their particular insights, have generally shared the critical approach of Marxist theory in regard to the nature assumed by capital in the modern company; or have recognised the need for, and the emergence of, an appropriate and specific form of legal regulation for such institutions.[5] It is contended, however, that a Marxist theoretical foundation is a prerequisite for a complete understanding of not only the evolution of the joint-stock company, but also of the various company forms in contemporary society; from the one-man company to the multi-national concern.
The intention is to relate changes in the legal regulation of joint-stock companies to underlying changes in the economic structure of business organisations and in particular to the change in the form in which capital was made available for introduction into the process of production. To this end attention will be focussed, firstly on the distinction between money-capital and industrial-capital, in order to demonstrate how the share can best be understood as a distinct form of money-capital. It is only an understanding of the nature of the share at the economic level that enables one to make sense of the difficulties which lawyers, both academic and judicial, have experienced in conceptualising the share: and a clear understanding of the nature of the share, as a form of money-capital, provides the key which unlocks the general mysteries of Company Law.

It is generally agreed that the share represents some form of property[6], the difficulty lies in determining the exact nature of that property. As C.B. Macpherson observes, the 20th century has seen a change in the preponderant nature of property from the historically specific idea of property as an actual thing, to the idea of property as a right to a revenue[7], and he cites the emergence of the corporation as the dominant form of business organisation as one of the major causes of this change. For Macpherson the share represents the right to an income.[8] From the legal perspective, however, it might be more accurate to say that two types of property right are conflated in the concept of the share. The first, which appertains while the company continues to operate, can be understood in Macpherson's terminology as the right to an income. As he correctly suggests this is the appropriate way of conceptualising the share in the contemporary joint-stock company. It must be remembered, however, that on the winding up of the company the shareholder retains a second right: the right to have any remaining assets of the company distributed in proportion to his shareholding. It follows that there is always a contingent property right which links the shareholder to the value of the actual assets of the company. This latter right, however, is of little practical importance in the contemporary public joint-stock company, which would be

unlikely to provide much in the way of residual value in the event of its being wound up.[9]

The fact of the matter is that shares in public companies are seen as investments, as continuing sources of income, by the majority of shareholders[10]; and the underlying asset value is merely seen as a factor pointing to the efficiency of such companies as generators of an income flow. The typical investor in such companies does not consider himself the owner of the concrete assets owned by his company and does not look to those assets as representing the value of his investment. Nor does the typical shareholder invest his capital directly in the company but buys his shares on the stock market; and looks to the stock market for the valuation of his investment.

This ideal-typical investor remains external to the day to day running of the company and it is this externality to the process of production that constitutes the share a form of money-capital, and the shareholder a money-capitalist rather than an industrial-capitalist.[11]

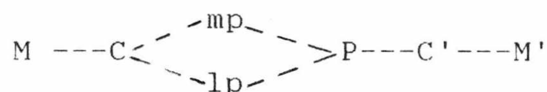
II. Forms of Capital: Industrial-capital and money-capital.[12]

The distinction between, and the relationship of, industrial-capital and money-capital is fundamental to understanding the share and the contemporary joint-stock company form.

The immediate function of money is to act as the measure of abstract value, thereby permitting the exchange of commodities embodying differing magnitudes of value. Money is capable, however, of being transformed from this universal value equivalent form into concrete value in the form of the material means of production, which, through their command of labour, provide the mechanism for the appropriation of surplus value.[13] This potential to act as capital constitutes a use-value inherent in money additional to its more obvious use-value as the means of appropriating commodities in exchange.

In order to highlight the distinct form of capital designated money-capital it is necessary to consider the general circuit of capital. The underlying motion which typifies the capitalist mode of production is the circular movement of capital from the capitalist through the process of production and circulation back to its starting point in the hands of the capitalist who originally set it in motion. The point of the exercise is that the capital returns in an expanded form.

This procedure can be expressed diagrammatically as follows;



where:

M = money; C = commodities; mp = means of production

lp = labour power; P = production process; C' > C; and M' > M.

Thus the capitalist expends a sum of money in purchasing certain commodities C which consist of the means of production m.p. and labour power l.p. These commodities are utilised in the process of production P in such a way as to produce other commodities C', the value of which is greater than the value of the commodities used in the production process. These latter commodities are then sold for the sum of money represented by M'. This sum M' being greater than the original sum of money expended M. The difference in magnitude between M and M' constitutes profit and accrues to the capitalist when he sells the commodities produced.

This process can be expressed more simply thus:

M---P---M'

Although that which returns to the capitalist at the end of the circuit is money, his original capital M plus an incremental proportion of M; the essential feature of this circular movement of capital is P, the production process. For it is only in the process of production that surplus labour is appropriated, and surplus value, and hence profit, is created.

The distinct forms assumed by capital at the various stages of its circulation are designated; money-capital, commodity-capital, and productive-capital. The capital which successively assumes these distinct forms in the course of its total circuit is termed industrial-capital.[14] The essential point is that for the industrial-capitalist his capital assumes the form of money-capital as one stage in its continuing circuit. The money form is merely one transitory form of value in the circuit of capital for the industrial capitalist, and one which must be transcended if his capital is to continue to function as such. Money is here merely facilitating the process of exchange, although, at the same time, it operates as capital <u>within</u> the process of production.[15]

From the foregoing it can be seen that the movement of capital in the hands of the industrial-capitalist cannot be accurately expressed as:

$$M--M'$$

Yet, paradoxically, that is precisely the form assumed by capital under the control of money-capitalists: those who dispose of capital in its liquid form, money.

It is essentially the different forms in which they hold capital that distinguishes the money-capitalist from the industrial-capitalist. The former retains his capital in the form of money, and is not interested in transforming it from this liquid state into concrete embodiments as the latter

does. The value that is concretised in the means of production is locked into that form for the possibly protracted period of their active life. Such tieing up of capital is by its very nature antithetical to money-capital. The money-capitalist lends out his capital in the form of money and receives it back in the same form, only increased in amount. There is apparently no change of form involved, nor does the process of production appear to intervene in this particular category of capital expansion. Such an apparently anomalous phenomenon requires explanation.
Given the existence of capitalist relations of production[16], it may be said that money generally possesses the latent potential to be transformed into industrial-capital and thus to appropriate a portion of total surplus value. This potential constitutes a use-value of money which can be transferred from one person to another.
In the loan, when the money-capitalist temporarily transfers his money to an industrial-capitalist, the money is not simply converted into capital <u>in</u> the process of production, but actually enters that process as capital. The loan represents the transfer, not just of money, but of capital from one person to another. For the latter, the borrower, it serves as capital <u>within</u> the process of production, whilst for the former, the lender, it serves as capital <u>outside</u> the process of production.[17]

Both lender and borrower extend the same sum of money as capital, but it can only command a share of total surplus value, in line with the average rate of profit, by successfully completing the process of production. The apparent double existence of the capital, the fact that it acts as expanding value for two individuals, is only made possible by the division of the total profit generated in the process of production into two distinct parts; profit of enterprise, which accrues to the industrial-capitalist, and interest which accrues to the money-capitalist.

The money-capitalist does not transfer his money in all its aspects, but merely disposes of its potential to act as self expanding value. With the passage of time the money returns to him and with it a portion of the surplus value actually claimed by it in the process of production, in the form of interest.[18]

What distinguishes interest-bearing capital, in so far as it is an essential feature of the capitalist mode of production, from usurer's capital is not the actual form of the capital, for they are both constituted by money, but lies in the economic conditions under which they operate. The difference lies in the altered nature of the borrower who confronts the money lender, and in the subordination of the interest-bearing capital to the conditions and requirements of the capitalist mode of production. Under the latter system the level of profit determines the level of return on money-

capital, and not vice versa, as in pre-capitalist modes of production, and this subjugation of interest-bearing capital is a consequence of the development of the credit system.[19] In the above way money-capital assumes the form of a commodity which commands a price; but it constitutes a commodity **sui generis**, in that its price is not determined by reference to the law of value. Interest cannot be properly understood as simply representing the price of commodity capital, for as Marx observed:

> "Interest, signifying the price of capital, is from the outset quite an irrational expression. The commodity in question has a double value, first a value, and then a price different from this value, while price represents the expression of value in money...A price which differs from value in quality is an absurd contradiction."[20]

None the less capital appears in its money form to have two different values - a face value as money and a second higher value as capital.[21] The explanation of this anomaly is that the value of money employed as capital depends on the quantity of surplus value it produces for its owner. It is thus the only commodity that is actually valued on the basis of its concrete use-value, rather than in terms of abstract exchange-value.

> "As interest, capital itself appears in the character of a commodity, but a commodity

> specifically distinct from all other commodities; capital as such - not as a mere sum of exchange-values - enters into circulation and becomes a commodity. Here the character of the commodity (i.e the specific use-value of capital) is itself present as an economic, specific determinant, not irrelevant as in simple circulation...The commodity as capital, or capital as commodity, is therefore not exchanged for an equivalent in circulation; by entering into circulation, it obtains its being for itself, it retains its original relation to its owner, even when it passes into the possession of another. It is therefore merely loaned. For its owner, its use-value as such is its valorisation; money as money, not as a medium of circulation; its use-value as capital."[22]

The actual rate of interest cannot be determined by reference to any natural or normal rate of interest, but is purely the product of the interaction of the supply and the demand for it.[23] The division of the capitalist class into money-capitalists, who provide "commodity" capital, and industrial-capitalists who actually put the capital through the process of production, gives rise to conflict as to the division of the surplus value commanded by the capital. This competition between money-capitalists and industrial-capitalists, which is in effect an intra-class struggle over

the distribution of surplus value, determines the "price" of money as capital.

This competitive struggle between money and industrial capital appears to be, and in the individual case is, determined in the money market prior to the actual transfer of money-capital. In this way interest confronts the industrial-capitalist operating on the basis of borrowed money-capital as a cost of production rather than as a portion of profit generated in production. As a consequence the rate of interest appears as the pre-determined price that has to be paid for capital before it can be used productively.[24]

What appears as merely a struggle over the quantitative division of profit, is, in reality, a qualitative division between the two distinct categories of revenue; profit of enterprise and interest.

The money-capitalist stands outside of the process of production and extracts interest as a consequence of the mere ownership of capital. The industrial-capitalist on the other hand derives his return from the operation of capital in the production process.[25]

Interest, therefore, is that part of surplus value which the industrial-capitalist has to pay to the money-capitalist for the use of his money, and appears as the reward for the mere ownership of capital.

Even where the roles of money-capitalist and industrial-capitalist are united in the person of one individual the qualitative distinction between profit of enterprise and interest is maintained.

> "The employer of capital - even when working with his own capital splits into two personalities - the owner of capital and the employer of capital; with reference to the categories of profit, which it yields, his capital also splits into capital property, capital outside the production process, and yielding interest of itself, and capital in the production process which yields a profit of enterprise through its function."[26]

Although a diagrammatic representation of the circulation of money capital may appear to be adequately represented in the formula:

M---M'

this fails to take into consideration what actually happens to the money when it is in the hands of the industrial-capitalist. The overall movement would better be represented by the following formula which includes the movement of capital in the process of production:

M--[M--P--M']--M''

That which is outside the brackets represents the apparent movement of money-capital, while that which is inside the brackets represents the typical movement of industrial-

capital. The whole formula represents the real movement of money capital and in its extended form can be represented thus:

$$M-[M--C<{mp \atop lp}>P--C'--M']<{I \atop P.E.}$$

Where I = interest, and PE = profit of enterprise.
Attention previously has been focussed on the loan because it represents the ideal-typical form of money-capital transaction. It is not suggested that the shareholder's relationship to the company is one of lender to borrower. This view of the share as a type of loan was held in the nineteenth century and is still current, but it is misleading to the extent that it fails to consider sufficiently the distinct features and mechanisms which make the share a distinct form of the general category money-capital.[27]
In order for the share to operate as a form of money-capital the holder must be able to realise its value as money, at will. Invested in shares however, money-capital appears to be transformed into industrial-capital under the control of a company. And much of it apparently assumes the form of concrete commodity-capital which, at least in respect of the fixed capital means of production, is necessarily tied up in the process of production for an extended period of time. Nor, once he has parted with his money in return for shares, can the investor claim the return of his money from his company. The shareholder, therefore, appears destined to be

locked into the process of production, and as a consequence to forego his role as a money-capitalist.

The facility to realise investment, however, is available to the shareholder. To this end the share must have no restrictions on its transferability[28], but the actual mechanism whereby the value of shares is realised is the stock exchange. As Paul Sweezy perceptively pointed out:

> "It is not the corporate form as such which transforms the industrial capitalist into a money-capitalist; a private firm can go through the legal procedure of incorporation without changing anything essential from an economic standpoint. What is decisive is the growth of a reliable market for corporate securities...only through the securities market does the capitalist attain independence of the fate of the particular enterprise in which he has invested his money. To the extent that the securities market is perfected the shareholder resembles less the old-fashioned capitalist-operator and more and more a lender of money who can regain possession of his money on demand."[29]

It is only as a consequence of the existence of the specialised market in titles to revenue, that is the stock exchange, that the shareholder is enabled to retain his status as a money-capitalist, external and indifferent to the

process of production, receiving his dividend as the payment for the mere ownership of capital, whilst retaining the ability to realise his capital almost instantly.

III. Fetishisation.

The circuit of money in the hands of the industrial-capitalist borrower is a consequence of economic factors. The circuit of the money extended by the money-capitalist, on the other hand, is dependent on a juridical relationship between lender and borrower. It returns to him because he has not alienated it completely; he has simply loaned it out for a particular time. The legal relationship which links the money-capitalist to the industrial-capitalist is important in that it emphasises the apparent inherent ability of money to command interest; to increase as a mere matter of course. The link between interest and the process of production is severed, and interest appears to accrue to money as a consequence of a legal agreement between two individuals. In this way the circuit of money-capital assumes a form which appears not only external to the circuit of industrial-capital, but also indifferent to the relations of capital to labour.

The payment of interest to money-capital

> "presents this character of capital as something belonging to it apart from the production process itself...Interest presents capital not in

> opposition to labour, but, on the contrary, as having no relation to labour, and merely as a relation of one capitalist to another; consequently as a category which is quite extrinsic to, and independent of the relation of capital to labour...it expresses merely relations between capitalists, and by no means relations between capital and labour."[30]

This apparent ability of money-capital to command interest outside the process of production is the consequence of a particular form of fetishised perception.

Just as the concept of alienation runs through and unites Marx's work[31], so the concept of fetishisation performs the same role in his works on political economy.[32] Indeed the two concepts are intimately connected, fetishisation being an aspect of labour's alienated condition within the capitalist mode of production. As Marx wrote:

> "interest in itself expresses precisely the existence of the conditions of labour as capital in their social contradiction and in their transformation into personal forces which confront labour and dominate labour. <u>It sums up the alienated character of the conditions of labour in relation to the activity of the subject.</u> It represents the ownership of capital or mere capital property as the means of appropriating the

products of other people's labour, as the control over other people's labour."[33]

Fetishisation is the process whereby objects are invested with powers they do not actually possess, and Marx identified several fetishes within the economic sphere.[34] The most famous of these is the commodity fetish whereby commodities appear to have exchange value inherently, without reference to labour and the social relationship of people which generate that value in reality. Of equal importance, although less considered, is capital fetishism, which can in turn be divided into two categories: the fetishism of industrial-capital, and the fetishism of money-capital.

With regard to industrial-capital fetishism arises from two sources.

Firstly within capitalism, production only takes place as a consequence of the movement of capital through its productive circuit. Capital initiates the process of production, animates it, and appears to be, and within the capitalist mode of production is, the prerequisite without which labour cannot engage in any productive activity. The fetishised appearance, therefore, is that the production process requires, and is itself the product of, capital, The reality, however, is that capital requires production, and cannot function as such without exploiting labour power in the process of production.[35]

The fetishised appearance that capital is the source of productivity is confirmed and emphasised when concrete capital, in the form of the means of production increasingly appears as the source of new value. In the first stage of the productive circuit of industrial-capital, money is converted into commodities; labour power and the means of production. What from the Marxist perspective is variable and constant capital is, in bourgeois theory, translated into fixed and circulating capital, with labour power appearing as merely part of the latter.[36] In advanced capitalism, exploitation assumes the form of the appropriation of relative, rather than absolute, surplus value.[37] As the productivity of labour-power is only enhanced by advances in the physical means of production, living labour power finds itself increasingly confronted by massive embodiments of its own alienation; past labour power in the form of fixed capital. Given the value and complexity of the fixed capital in relation to the labour-power used to operate it, the true relationship is reversed in the fetishistic appearance that it is the means of production rather than labour power that produce new value.[38]

Fetishisation reaches a peak in relation to interest-bearing, or money, capital.[39] As has been stated previously interest is the return that accrues to the capitalist for the mere ownership of capital apart from, and apparently without reference to, the process of production; as such it is:

> "...the most complete fetish ...the original starting-point of capital - money - and the formula M - C - M' is reduced to its two extremes - M - M'- money which creates more money. It is the original and general formula of capital reduced to a meaningless resume...interest bearing capital is the perfect fetish...the consummate automatic fetish, the self expanding value, the money making money, and in this form it no longer bears any trace of its origin. The social relation is consummated as a relation of things (money, commodities) to themselves...It is clear that capital, as the mysterious and automatically generating source of interest, that is, source of its own increase, finds its consummation in capital and interest. It is therefore especially in this form that capital is imagined. It is capital par excellence."[40]

Although money-capital appears to command interest in and of itself, and whether it is used productively or not, it cannot in general be separated from the process of production. As has been demonstrated, within the capitalist mode of production interest is that part of total surplus value that is derived from the mere ownership of capital; but capital must still function as such, and can only command surplus value within the production process.[41]

As will be seen in regard to the share, as it approximates to pure money-capital so it assumes the latter's fetishistic appearances with dividends appearing as the return for the mere ownership of shares. These fetishistic appearances are intensified in relation to capital gains on shareholdings; the increase in share values appearing as simply the product of changes in stock-market perceptions and valuation without having any direct relationship to the underlying productive activity of the company.

IV. The General Concept of Fictitious Capital.

As a corollary of the fetishised appearance of interest-bearing capital, money apparently able to derive a revenue from its mere existence, every regular money revenue appears to be the return on some capital, whether it actually does derive from capital or not. This process of calculating a capital value for a stream of income is termed capitalisation, and the capital which is calculated in line with the appropriate return on money-capital, the prevailing rate of interest, is known as fictitious capital. The procedure involved is set out in the following example:

> "Every periodic income is capitalised by calculating it, on the basis of the prevailing rate of interest, as an income which would be realised by a capital loaned at this rate of interest. For example, if the annual income is £100 and the rate

> of interest is 5%, then the £100 would represent the annual interest on £2,000, and the £2,000 is regarded as the capital value of the legal title on the ownership of the £100 annually."[42]

The illusory nature of fictitious capital is best demonstrated by a consideration of Government bonds. Where the state is required to borrow money in order to finance its activities it issues promissory notes to its creditors which represent a fixed future revenue of so many per cent. The state does not, as a general rule, use the money borrowed as capital, by inserting it into the process of production, but dissipates it in the course of its normal expenditure. The return received by the creditor in the form of interest on his loan, is actually a portion of the annual taxes raised by the state.

Although the money has ceased to exist for the purposes of the state, it apparently continues to exist for the lender as a consequence of his continued receipt of revenue .

The illusory nature of this particular form of fictitious capital is readily apparent, but the clarity of perception becomes more uncertain when a market for the bonds exists and they become freely transferable. The original owner of the money may have lost immediate access to it but the existence of a market for such paper permits him the possibility of realising his investment. The sum of money received for the bond is clearly not the same money as was originally lent. It

may not even be of the same magnitude, depending on changes in the prevailing rate of interest; but where the fictitious capitalisation is no less than the sum originally loaned the original lender is in no worse situation. He lent his capital to the state in its universal value equivalent form as money, and he receives it back in that same form. He is thus returned to his original situation.

In this way the existence of a market confers potential reality to that which is purely fictitious.[43]

V. The Share as Fictitious Capital.

It is immediately apparent that the share is not fictitious capital in the same way as government bonds are. It is not totally illusory, for there is clearly some relationship between shares and the concrete capital owned and operated by companies.[44] It is suggested, however, that the share is a **form** of fictitious capital. It is a representation, in terms of fictitious money-capital, of the profit generated by the concrete industrial-capital of a company in the process of production.[45]

The procedure for capitalising company profit is similar to that considered previously in relation to government bonds. The fictitious share capital is represented by that sum of money which would command, at the prevailing rate of interest, a return equivalent to the income actually accruing to the shares.

This purely fictitious capitalisation, assuming the general form of money-capital, gives the market value of the shares. An example of this procedure is given in Capital as follows:

> "[Assuming a rate of interest of 5% then,]...if the nominal value of a share....is £100 and the enterprise pays 10%....then its market value....rises to £200....for when capitalised at 5%, it now represents a fictitious capital of £200. Whoever buys if for £200 receives a revenue of 5% on this investment of capital. The converse is true where the proceeds of the enterprise diminish.....If the rate of interest rises from 5% to 10%, then securities guaranteeing an income of £5 will now represent a capital of only £50."[46]

This example clearly demonstrates the inter-relationship of profit to the prevailing rate of interest which together determine the market value of fictitious share capital. It does, however, assume that there is no risk involved in the investment.

It is usual, however, for dividends paid on shares to contain an element of what can be called risk premium. This additional payment is demanded in compensation for the fact that share-capital is not as liquid as money-capital in its pure form, and involves a greater element of risk than the loan.[47] As the share approximates to the pure money-capital form of the loan so the return it commands approaches the

level of interest. As, however, the share can never assume the pure money form it continues to command a risk premium. Once created, fictitious share capital has its own distinct sphere of circulation. Within this sphere of circulation capital is treated as a commodity, and the claim over the productive capacity of industrial-capital, which is represented in the form of the share, is given exchange-value. As a consequence of this process capital apparently assumes a twofold existence. At one level it consists of the concrete industrial-capital which is operated by the company. On that foundation, however, is constructed an illusory structure of fictitious share-capital representing the exchange-value of that industrial-capital as capital: a valuation dependent, not on the size of that industrial-capital, but on the amount of surplus value commanded by it.[48] The fallacious nature of this secondary, epiphenominal, manifestation of functioning industrial-capital was emphasised by Marx, thus:

> "...this capital does not exist twice, once as the capital value of the title of ownership (stocks) on the one hand and on the other hand as the actual capital invested, or to be invested, in those enterprises. It exists only in the latter form, and a share of stock is merely a title of ownership to a corresponding portion of surplus value to be realised by it. ."[49]

The sale and purchase of shares in their market is not a turnover of industrial-capital but represents merely the sale of titles to the income generated by such industrial-capital. Fluctuations in the price of such titles to revenue do not relate to any change in the commodity value of a company's underlying assets, but merely relate to the productivity of those assets as capital. As purchases of shares are made on the basis of projected performance and interest rate, the price paid is necessarily speculative.[50]

Share capitalisation may be illusory, and represent nothing more than the price of a revenue,[51] but that does not prevent its existence in either an accounting or a legal sense; although it does cause major difficulties for the practitioners in both of these fields in developing any clear understanding of its precise nature.[52]

Having considered the general nature of fictitious share-capital, it remains to consider the precise nature of the return that accrues to the shareholder. A consequence of the development of the joint-stock company was the:

> "Transformation of the actually functioning capitalist into a mere manager, an administrator of other people's capital, and of the owner of capital into a mere owner, a mere money-capitalist. Even if the dividends they receive include the interest and the profit of enterprise, i.e. the total profit, this total profit is henceforth received only in

the form of interest, i.e. as mere compensation for owning capital that is now entirely divorced from the function in the actual process of production, just as this function in the person of the manager is divorced from ownership of capital."[53]

From the foregoing passage it can clearly be seen that in Marx's view dividend payments assumed the form of interest. There is, however, less certainty as to the content of such payment. Did shares merely command a return in line with the prevailing rate of interest, or did dividends constitute a new category, whose form was interest but whose content subsumed both interest and profit of enterprise? It is clear from other passages in Capital that Marx was of the former opinion; shares merely received interest:

"With the progress of capitalist production...a portion of capital is calculated and applied only as interest-bearing capital. Not in the sense that in which every capitalist who lends out capital is satisfied with interest, while the industrial capitalist pockets the investor's profit...But in the sense that these capitals, although invested in large productive enterprises, yield only large or small amounts of interest, so called dividends, after all costs have been deducted."[54]

For Marx the joint-stock company represented a form of associated capitalist property.[55] Previously independent

units of money-capital were brought together under its auspices and, henceforward, operated as a single unit of industrial-capital. Because the providers of the capital were, from the outset, money-capitalist it was accepted that they would be content with a return equivalent to the rate of interest. Underlying Marx's analysis, therefore, is the assumption that the concrete industrial-capital operated by joint-stock companies does not participate in the average rate of profit.[56]

Hilferding agreed that shares only received interest, but for essentially different reasons. According to his analysis the concrete industrial-capital of joint-stock companies did participate in average profit. The yield on shares was only reduced to the level of interest as a consequence of the historical process which saw the full development of the joint-stock company, the share form, and the stock-exchange. As long as the company was not the dominant form of business organisation, and the negotiability of shares was not fully developed, dividends would continue to include an element of entrepreneurial profit of enterprise as well as interest. From this perspective it was only increased competition on the part of money-capital for investment opportunities which reduced the return on shares to a level approaching bare interest.[57]

As the return commanded by shares is reduced towards the level of interest, the question arises as to what happens to

that part of average profit which previously constituted profit of enterprise. The explanation of the apparently mysterious disappearance of a part of total profit is that future profit of enterprise is capitalised and is appropriated in the form of promoter's profit when the company is first floated.

An example will best serve to demonstrate this procedure.[58] Take, for example, an already functioning industrial enterprise operating on the basis of an industrial-capital of £1,000,000. Assuming that the enterprise operates at normal levels of efficiency then average profit accrues to enterprises on the basis of the concrete capital operated by it. Assuming that the average rate of profit is 15%, the industrial-capital will generate an annual return of £150,000.

Assume that the prevailing rate of interest to be 5%. A yield of £150,000 will appear as the product of a fictitious capital of £3,000,000. If, however, perfectly secure stocks are only able to command a return of 5% then the return for the less liquid, and hence less secure, shares in this example will have to contain some compensatory risk premium of, for example, 3%.

In addition there will be an increase in administrative costs in running the business, due to the need to employ efficient managers. This can be estimated at, again for example, 2%.

Thus it can be seen that the return necessary to induce the investment of available money-capital is 10%. Using this as the basis of capitalisation, rather than the basic rate of interest, it can be seen that the income of £150,000 would be sufficient to service a money-capital sum of £1,500,000. Yet this yield is generated by only £1,000,000 of functioning industrial-capital.

The outcome of this is that an industrial enterprise operating on the basis of only £1,000,000 concrete industrial-capital can be converted into a money-capitalist structure commanding a fictitious capitalisation of £1,500,000. The difference between the concrete and fictitious capitals of £500,000, the product of the conversion of profit bearing industrial-capital into interest bearing money-capital, is collected by the individuals who carry out the conversion: the promoters of the new joint-stock company.[59]

Although there would appear to be conflict between the views of Marx and Hilferding[60], the two analyses are not necessarily irreconcilable. Which process was actually operative depended on the economic context in which companies were formed and operated.

When Marx was considering the phenomenon[61], the joint-stock company was predominant in enterprises involved in constructing the economic infra-structure; waterways, public utility companies and the railways. These projects were

established on the basis of a centralised money-capital fund, which when transformed into industrial-capital did not necessarily participate in average profit.

Hilferding, on the other hand, was writing during a period when already established industrial enterprises were being converted into joint-stock companies.[62] Assuming that these enterprises had previously participated in average profit, the concrete industrial-capital continued to generate a flow of income equal to the rate of profit; but that income now had to service a superstructure of fictitious share capital of such a magnitude as to apparently reduce it to the level of interest.

VI. Shares and the General Return on Capital.

While the movement of concrete industrial-capital is the fundamental process which leads to the emergence of the general rate of profit; the existence of fictitious share capital greatly facilitates the process whereby capital appears as aggregate social capital commanding total surplus value and distributing it, pro rata, to the owners of capital.[63]

The "incessant equilibration of constant divergence" that is the process whereby the general rate of profit emerges is accomplished the more quickly, the more easily can capital be moved from one productive sphere to another[64]; and as concrete industrial-capital assumes the form of abstract

fictitious-capital so the individual capitalist is given greater freedom to disengage from one particular investment in favour of another. This procedure involves the realisation of money-capital in order for it to be introduced into the productive circuit of capital, at least partly, in the form of new industrial-capital. The money once invested, assumes the form of fictitious share capital and enters its own distinct sphere of circulation.

Fluctuations in the value of fictitious capital, within its independent sphere of circulation, also have an important, if essentially less fundamental, effect on the equalisation of the rate of return on capital.

As the magnitude of the constant capital operated by modern enterprises increases, both absolutely and in relation to variable capital, the movement of industrial-capital becomes less responsive to differences in rates of return. This inertia is due to the fact that the fixed constant capital is locked into a particular sector of production until its value is either transmitted to other commodities, or is destroyed. As a consequence, a process which is, in any case, a slow and gradual one, becomes even slower and more gradual.

During the time it takes to redeploy concrete industrial-capital, individual capitalists compete for revenues in the stock market in such a way as tends to equalise the return on fictitious capital. This competition may take the form of a search for access to above normal profits, or the flight from

lower than normal profits. In either case the market value of shares will alter in such a way as to tend to bring about an equality of return on shares. In this way differential returns on concrete industrial-capital are cancelled out by movements at the level of fictitious share-capital.

In the case of industrial-capital enjoying an above average return this will continue to accrue until sufficient additional concrete capital is invested in that particular sector of production to force down the level of the return to the prevailing general rate of profit. Meanwhile the value of the fictitious share capital, which is the reflex of the profitability of the industrial-capital, increases and affords existing investors the opportunity to make a capital profit by selling their shares.

In the opposite case fluctuations in the value, and hence the amount, of fictitious capital will permit concrete industrial-capital to continue to function, even where it is not sufficiently efficient to command the general rate of profit. In this instance existing shareholders will sustain a capital loss, but new shareholders will receive the general return on the value of their investment.

Such gains and losses were correctly designated marginal by Hilferding, on the grounds that they are not in themselves directly a part of the profit which flows from the successful operation of capital.[63] They do not arise directly from any increase in the volume of surplus-value actually realised,

but flow merely from the fluctuations in the current value of claims over the distribution of surplus-value. As such they are a product of intra-class conflict between capitalists, and arise merely from changes in the distribution, amongst members of the capitalist class, of that particular form of private property represented by the share.

VII. Money-Capital and Company Law.

The foregoing has shown how the share can best be understood as essentially a form of fictitious money-capital, and the typical shareholder as a money-capitalist.[66] It is contended that it is only on the basis of the insights provided from such a perspective that the history, fundamental principles, and conceptual problems, of Company Law are rendered amenable to critical analysis and explanation. It is the intention of the remainder of this thesis to demonstrate the effectiveness of such an approach.

Chapter 1: Endnotes.

1.Paul Hirst, On Law and Ideology, 1979, p. 99.

2.This point originally was made in a review article by the writer in the Law Teacher, 1986, vol. 20, and was expanded upon in a joint article ,The Conceptual Foundations of Company Law, Ireland, Grigg-Spall and Kelly. Journal of Law and Society, Spring 1987, vol. 14.1.

3.Paul Sweezy is guilty of such a failure in his Theory of Capitalist Development, ch.14; and, as will be shown, Paul Hirst is simply wrong in his claim, in Law and Ideology, p.132, that: "Marx failed to analyse the share as a legal-economic form." Even Rudolph Hilferding, Finance Capital p.115, did Marx a disservice in his contention that the latter had failed to conceive "dividends as a distinct economic category".
Such treatment smacks of treating Marxism as a body of doctrine rather than a way of understanding society.

4.This thesis is essentially an exercise in the application of the Marxist perspective to Company law. It is written from within that perspective and does not seek to justify it from first principles. As a matter of course, therefore, it must make large assumptions as to the nature and validity of the concepts which constitute the Marxist approach to understanding social institutions. To do otherwise would alter the nature of the work engaged upon.
The introduction to David Harvey's excellent book "The Limits of Capital" demonstrates the temptation/need to "write a treatise on Marxian theory in general" when engaged in an application of that theoretical perspective to a particular area of study.

5.Foremost amongst these is Thorstein Veblen, who recognised, and was highly critical of, what he saw as the domination of financial interests over business enterprise in such works as: "The Theory of Business Enterprise"; "Absentee Ownership"; and "The vested Interests and the Common Man". From the legal perspective can be cited: J.R. Commons, "The Legal Foundations of Capitalism"; R.R. Formoy, "The Historical Foundations of Modern Company Law"; and perhaps pre-eminently C.A. Cooke, "Corporation Trust and Company".

6.Company law textbooks, whilst recognising the difficulty in stating what a share is, usually are satisfied by stating in categorical terms what a share is not: it is not a claim over the concrete assets of the company. See e.g., Pennington R., Company Law, 5th ed. pp.67-69; and Gower L.C.B., Modern Company Law, 4th ed., pp.397 et seq.
The legal nature of the share, and the changes it has

undergone over time will be considered in chapter 2 infra.

7.Macpherson C.B., Property. See also Capitalism and the Changing Concept of Property, in Feudalism Capitalism and Beyond, Eds. Kamenka and Neale, 1975, p.104.

8.According to Macpherson, op cit, the market value of a modern corporation lies not in concrete assets but in the ability to produce a revenue. This view corresponds with the approach of Karl Marx and Rudolph Hilferding, and that of many other non-marxists whose theories will be considered in detail infra.

9.Matters are somewhat different in the case of the private limited company. As in re Yenidje Tobacco Co. Ltd. [1916] 2 Ch. 426, in the case of the winding-up of a quasi-partnership made on the just and equitable ground under section 122 Insolvency Act 1986, previously s. 517 of the 1985 Companies Act, there may well be valuable assets available to the previous members of the company.
This possibility simply highlights the fact that private and public companies are essentially distinct economic forms of business organisation. See Ch.2 infra.

10.There is a difference between investment and speculation. The aim of latter is to appropriate large unforeseen, and therefore unpredictable capital gains rather than to secure the relatively secure and steady flow of income and capital appreciation, that characterises the former type of shareholding.

11.This externality leads to the problem of the separation of ownership and control, considered infra. It can almost be said to reach the level of indifference in the majority of cases. J.H. Farrar summarisies the report of K. Midgley in 1974, Lloyds Bank Review 114, p. 24, thus: "A survey of attendance at annual general meetings in 1969 found that the average (mean) attendance was 80 and the median attendance was 47 i.e. half the companies surveyed had attendances of less than and half more than 47. The survey also found that it was unusual for the shareholders present to represent more than 1% of the total voting capital and the average length of annual general meeting was 23 minutes."; Company Law. pp.270-271.

12.Capital is a social relationship of production. The quality of acting as capital is not an inherent attribute of either the material means of production or money, but is an exploitative relationship between people with regard to those objects, which only assume the role of capital within the historically specific relations of production that operate within the capitalist mode of production.
Thus: "A negro is a negro. In certain circumstances he

becomes a slave. A mule is a machine for spinning cotton. Only under certain circumstances does it become capital. Outside these circumstances, it is no more capital than gold is intrinsically money, or sugar the price of sugar." Marx, Wage Labour and Capital, cited in a footnote in Capital vol.1 p. 717.

13.The means of production, or constant capital do not create new value in the process of production, but simply pass on their value piecemeal as they are consumed in that process. Only labour power possesses the capacity to generate new value, but within the capitalist mode of production it can only do so as variable capital, with the consequence that any new value appears to be the product of, and is appropriated by, capital. This point will be considered further when the concept of fetishisation is examined infra.

14. K. Marx, Capital, vol 2. p. 50.

15.Capital, vol. 3, p.375.

16.The enormity of what is taken as given is not lost on the writer, but see note 4 supra.

17.In the collaborative article produced by the writer for the Journal of Law and Society, cited supra, the terms former and latter as used here are unfortunately reversed, leading to a reversal of roles between money and industrial capitalists. See p. 155.
Whether the potential of the money lent to act as capital is actually realised by the borrower or is expended on consumption is a matter of indifference for the individual money-capitalist, although it cannot be so for money-capitalists as a class. See consideration of fetishisation infra.

18.See Marx, Theories of Surplus Value, part 3, p.455.

19.Theories of Surplus Value, pp.468-469; Capital, vol.3 ch.36; and Economic and Philosophic Manuscripts of 1844, pp.127-128.

20.Capital, vol.3, p.354.
As Harvey puts this point: "Money is the representative of value and cannot possibly be more valuable than the value it represents. Yet the use value of the money is that it can be used to produce greater value in the form of surplus value. We then arrive at what Marx considers to be a totally irrational expression: the value of value is that it produces greater value!" ibid. p. 259.

21.Derek Sayer, Marx's Method, 2nd ed. p.60.

22.Marx, Grundrisse, pp.318-319.
See also Theories of Surplus Value, part 3, p.455, and Capital vol.3 p. 355.

23.As John Weeks writes: "Since the capital commodity has no value but represents value, there is no centre of gravity around which the market interest rate fluctuates. There are no laws determining the rate of interest other than competition itself. The capital commodity is not produced but exists because of the division of the capitalist class into two functional groups.", Capital and Exploitation, 1981, p. 135.
And see Marx, Capital vol.3 pp.355-356; and p. 364.
The fact of state determination of minimum rates of interest interferes with but does not invalidate this process.

24.See Theories of Surplus Value, part 3, p.509-510. This apparent existence of an objective price of money intensifies the fetishisatic properties of money-capital. See infra.

25.As a consequence of the division of capital, and the existence of money-capitalists claiming interest on the basis of the mere ownership of capital, profit of enterprise appears as the product of the industrial capitalist's activity and he appears as merely an agent of production. Thus his labour appears akin to that of wage labour and his profit of enterprises appears to be the wage equivalent of his specialised labour. In reality the industrial-capitalist does not perform a merely neutral technocratic function, but represents functioning capital. His relationship to wage labour is no less exploitative and antagonistic than that of money-capital. See Capital, vol.3, ch.23.

26.Capital, vol.3 p. 379.
This point will be considered further under the topic of fetishisation, infra.

27.For example see The Bankers Magazine, 1860,vol.XX,p.411.
Grahame Thompson, The Relationship Between the Financial and Industrial Sector in the United Kingdom Economy, 1977, Economy and Society, vol.6, pp.235-283 at p.259, states that "A share is thus a non-redeemable loan made to the company and hence it falls within the definition of banking-capital.."
On the other hand the fact that company does not have to pay back the value of the share leads Falken Wilken, The Liberation of Capital, to make the equally mistaken assertion that: "The share is not a loan but a "cut" in the ownership of a firm, in the form of a fraction of the ownership of the means of production".

The share is neither of these. It is a distinct form of fictitious money-capital. See infra.

28.The transferability of shares will be considered in Ch.3 infra.

29.The Theory of Capitalist Development, 1956 ed, p.258.
The distinction between private and public companies will be considered infra; for the moment it only requires to be stated that the share must be freely transferable in order for it to assume the form of money-capital. The articles of private companies usually prevent such free alienation, although they are no longer required to restrict transfer by law.

30.Theories of Surplus Value, part 3, p.494.

31.I. Meszaros, Marx's Theory of Alienation.
Meszaros demonstrates that alienation is central to Marx's whole theory and is just as important in his mature works, such as the Grundrisse and Capital, as it is in the earlier Economic and Philosophic Manuscripts.

32.Tom Kemp, Marx's Capital Today, p.23.

33.Marx op. cit., emphasis added.
For a further consideration of the alienated nature of contemporary society and company law see Ireland, Grigg-Spall, and Kelly, supra, pp.162-163.

34.G.A. Cohen, in Karl Marx's Theory of History A Defence, devotes a chapter, no.5, to a consideration of fetishism within Marx's theory. As he points out what distinguishes the economic from the religious fetish is that the power which appears as the emanation of the material object is not the result of a thought process, but arises from the process of production. The mind registers the fetish it does not create it. See pp.115-116.
See also Tom Kemp, Capital Today, pp.23-26, and Derek Sayer, Marx's Method, pp.30-33;58-74.

35.The apparent ability of money-capital to function outside the process of production will be considered infra.

36.This transformation itself serves to disguise the productivity of labour-power. See Capital vol 2, pp 216-219, and Harvey's treatment of it in ch. 8 of The Limits to Capital.

37.For a consideration of absolute and relative surplus value see Capital vol.1 p.299.

38." The special skill of each individual insignificant factory operative vanishes as an infinitesimal quantity before the science, the gigantic physical forces, and the mass of labour that are embodied in the factory mechanism and, together with that mechanism, constitute the power of the master " Capital, vol.1 p 399.

39.Marx considered this particular fetish extensively in his consideration of revenue and its sources in the addenda to part 3 of The Theories of Surplus Value, some of which was reproduced in vol.3 of Capital.

40.Theories of Surplus Value, part 3, pp.453-455.
In Capital, Marx states that " The relations of capital assume their most externalised and most fetish-like form in interest-bearing capital...It is a relationship of magnitudes, a relationship of the principal sum as a given value to itself as self-expanding value, as a principal sum which has produced a surplus-value. And capital as such...assumes this form of a directly expanding value for all capitalists, whether they operate on their own or borrowed capital." vol.3 p.391.

41.Marx scornfully dismissed the acceptance of mere appearance with regard to the effect of the fetishisation of money-capital as follows:
"The idea of converting all the capital into money-capital, without there being people who buy and put to use means of production, which make up the total capital outside of a relatively small portion of it existing in money, is, of course, shere nonsense." Capital, vol.3,pp.377/8.

42.Capital, vol.3 p.466.

43.If the original creditor has been able to sell his bond and realise its value as capital, then this spurious reality is compounded for the person who replaces him in regard to the interest. For the latter the annual income represents the interest on his capital invested as such.

44.See supra.

45.The value of the individual share represents a proportion of the capitalised value of the profit produced by a company, expressed in the form of fictitious capital.

46.Capital, vol.3,p.467.

47.According to Hilferding: "Generally speaking the, the somewhat greater insecurity of the shareholder by comparison with the money capitalist will bring him a certain risk premium...The risk premium is simply a result of the fact

that the supply of free money capital, which the founders of companies are seeking, which is available for investment in shares, will normally be smaller, other things being equal, than that for particularly safe, fixed interest investments." Finance Capital, p.108.
The mechanism through which the risk premium appears is the alteration of the rate of at which the profit is capitalised to a level above the pure interest rate commensurate with the level of risk.

48.The similarity between this procedure and the valuation of money as capital is too obvious to need more comment.

49.Capital, vol.3. p.466.
And later at p. 477: "...these titles [to a portion of surplus value] likewise become paper duplicates of real capital...They come to nominally represent non existent capital. For the real capital exists side by side with them and does not change hands as a result of the transfer of these duplicates from one person to another...as commodities...their value may fall or rise quite independently of the movement of value of the real capital for which they are titles."

50.See Capital, vol.3, p.467.
This type of speculation must be distinguished from speculative gambling on the stock exchange; although the latter is only possible as consequence of the necessarily lack of certainty involved in the former process.
In ch. 27 of vol. 3 of Capital Marx in a rhetorical flourish states that the "movement and transfer [of shares] become purely a result of gambling on the stock exchange" (p.440), but it would be going too far to assume that this criticism represents the essence of Marx's critique of the joint-stock company form. Hirst makes just such an assumption in, On Law and Ideology, p.136.

51.Strangely such an approach is supported by Irving Fisher in "The Theory of Interest". As he expressed the point: "Capital, in the sense of capital **value**, is simply future income discounted or, in other words, capitalized. The value of any property, or rights to wealth, is its value **as a source of income** and is found by discounting that expected income...Income is the alpha and omega of economics...[and]...The bridge or link between income and capital is the **rate of interest**."pp.12-13.
Of course no Marxist could possibly agree with Fisher's application of a similar procedure in regard to the valuation of other commodities which "for logical convenience, include[s] as property the ownership of ourselves..." op. cit. One can only cite this as an example of the apotheosis of alienation, as an example of the insanity which passes as

normal within the capitalist mode of production. c.f. Erich Fromm, The Sane Society.

52.These problems will be considered in chapters on the share and goodwill, infra.

53.Capital, vol.3, pp.436-437.
For the moment it is not intended to pursue the question of the separation of control from ownership as posited by Berle and Means in "The Modern Corporation and Private Property" and taken up by the proponents of the managerialist school of thought. The fallacy of such views, and incidentally the primacy of Marx 's awareness of the problem has been demonstrated by, amongst others: Baran and Sweezy in "Monopoly Capital"; Nicholls in " Ownership Control and Ideology"; Aglietta in "A Theory of Capital Regulation"; and particularly by De Vroey in ""The Separation of Ownership and Control in Large Corporations".
See also chapter 7 infra.

54.Capital, vol.3, p.240. Emphasis added.
See also pp.437; 466-467.

55."The capital...is here directly endowed with the form of social capital(capital of associated individuals) as distinct from private capital...It is the abolition of capital as private property within the frame work of capitalist production itself." Capital,vol.3,p.436.
N.B. It is the abolition of capital <u>as private property</u>; clearly this does not involve the abolition of capital as such, or the exploitative social relations that constitute capitalism. Joint-stock companies thus represent an advance, and a transitional form, within the trammels of capitalism.
See ibid. p.440.
Both Renner in "The Institutions of Private Law and Their Social Functions" and Pashukanis in "General Theory of Law and Marxism", in their different ways, take up this point to suggest the transitional nature of the company form <u>to</u> socialism.

56.To the extent that their industrial-capital could function with a yield only equal to interest, so joint-stock companies could be seen as one of the countervailing tendencies to the general tendency for the rate of profit to fall.
Capital, vol.3, p.240.

57.Finance Capital, p.109.
As has been stated, the return on shares is never actually driven down to the level of bare interest. Money-capital represents the apotheosis of the fetish. Whereas the share partakes of the fetishistic appearance of money-capital, it can never slough off its dependence on the operation of

concrete industrial-capital in the same way as the pure money-capital form of transaction, the secured fixed-interest loan, can. To that extent it continues to claim a portion of profit of enterprise in the form of a risk premium.

58.What follows is based on Hilferding's own example in Finance Capital, p.111-112. The figures have been grossly simplified for ease of computation.

59.A wonderful example of this process occurred in the flotation of the T.S.B. in 1986.
Net tangible assets of some £900m. were capitalised at a fictitious share capital of £1.5 bn. In that case, however, because the government had set up the flotation procedure on the understanding that the assets were ownerless, before the House of Lords had decided that the state was the legal owner of the assets, the total amount paid for the shares went to the company, rather than being creamed off in the form of promoters' profit.
At the time the windfall that accrued to the lucky shareholders in the vastly oversubscribed issue was likened to a person buying a suit for £100 and finding £100 in one of the pockets. The following reveals how such a situation came about.

TSB's Initial Concrete Assets..................£ 900m
Initial Fictitious share capitaliisatiom.......£1,500m

As the price paid for the fictitious capital went to the company it then had:
New Concrete Assets............................£2,400m
Capitalising that new concrete capital at the same rate as the original assets were capitalised at produced:
New fictitous share value......................£4,000m

That latter figure depended of course on the new assets being operated as efficiently as the existing assets. As the progress of T.S.B. has shown, the market was wise not to apply the same rate of capitalisation to the new concrete capital!

60.Hilferding himself claimed to have gone considerably beyond Marx in his analysis of the corporation, ibid. p.114, but whilst in no way wishing to diminish his contribution, much of his work was already implicit in Marx's work, as this thesis has demonstrated.

61.The three volumes of Capital and the Theories of Surplus Value were actually written between 1863-1867.

62.Das Finanzkapital was first published in Vienna in 1910. Hilferding's own theory of the domination of finance capital, in the form of banks, over industry, and his conception of the possibility of a single super-cartel, have themselves been shown to be the products of particular historical and national factors. See Hardach G, Karras D., Fine B, History of Socialist Economic Thought; Wheelock J, Competition in the Marxist Tradition"; G.W. Edwards, The Evolution of Finance Capitalism; and G. Thompson, supra.
The most pertinent critique of Hilferding's theory is John Weekes' statement, made in response to Lenin's, Imperialism The Highest Stage of Capitalism, that: "The ascendancy of financial capital is not, a question of the role of institutions but of the nature of mature capitalism. Whatever institutional social form social capital assumes, finance capital remains dominant in that the sense that the claim on surplus value becomes detached from the level of the production unit. It is in this sense that the epoch of imperialism is the period in which financial capital dominates industrial capital. This domination is established by the nature of accumulation, not by the relationship between institutions." Capital and Exploitation, p.131.

63.See Rosdolsky, The Making of Marx's Capital, pp.48-49.

64.Capital, vol.3 p.196.

65.Finance Capital, p. 135.

66.It is recognised that some individual large scale shareholders still operate as industrial-capitalists, but even their relationship to concrete capital is mediated through the share. Their control over the enterprise is exercised through control of voting rights and not through the ownership of the concrete assets. See De Vroey, and ch.7 infra, for a consideration of this point.

Chapter Two: The Joint-Stock Company and Company Law as Money-capital Forms.

I. Introduction.

The preceding chapter has emphasised the distinction between the two fractions of total capital embodied in industrial-capital and money-capital. It is now intended to examine the emergence and development of the joint-stock company as an essentially money-capital form of business organisation, and to demonstrate generally how company law, as a discrete legal corpus, developed as the appropriate means of regulating that form.[1]

The fulfillment of the above intention requires the consideration of two preliminary points. The first of these relates to the distinction between economic and legal forms. The joint-stock company is an economic form. It represents a particular method of centralising, organising, and operating capital. As an economic form of organisation it can be distinguished from other economic forms such as the partnership or the individual proprietorship.

Differences between joint-stock companies and partnerships are usually explained in terms of quantitative distinctions between the two forms of organisation; the company being larger than the partnership, in terms both of membership, and the amount of industrial-capital controlled. This in turn is perceived as giving rise to a qualitative distinction in that

the company is a less intimate, and hence less consensual, form than the partnership.

In reality the essential distinction between the company and the partnership is, from the outset, qualitative rather than quantitative, and depends not so much on the relationship of the members inter se, as on the relationship of the members to the capital controlled by the business. The joint-stock company is a mechanism for centralising money-capital, and the relationship of the member remains external to, although certainly not disinterested in, the performance of the industrial-capital operated by his company in the process of production. The link between shareholder and industrial-capital is mediated by the share as a form of fictitious capital, the transferability of which, through the medium of the stock-exchange, permits the investment to retain potential liquidity; the essential quality of money-capital. The ideal-typical shareholder assumes the role of a rentier; a passive coupon clipper appropriating a return in the form of interest for the mere ownership of capital.[2]

The partnership, on the other hand, is an industrial-capital form in which the member's relationship to concrete industrial-capital is immediate. The provider of capital assumes the role of an active participant in the process of production, directly engaged in overseeing and controlling the movement of capital through its productive circuit. As industrial-capitalists, partners are ineluctably linked to

the performance of their capital, and the incapacity to realise its value as capital, through the sale of the business in a specialised market, precludes its transformation into fictitious capital.[3] As compensation for this dependency partners are in a position to appropriate profit of enterprise as well as interest on the basis of that capital.

For the purposes of regularising their operation and control, economic organisations assume legal forms, or have legal forms ascribed to them. It is suggested that Company Law can be seen as the legal form appropriate to the joint-stock company economic form; and correspondingly, that Partnership Law can be seen as the appropriate legal form for the partnership economic form. As an example, members of companies have no automatic right, in law, to be involved in the management of their company; and certainly have no authority, implied from their position as members, to bind the company to particular contracts. Each and every partner, however, has a legal right to be involved in the management of the partnership business, and has the implied authority to bind the firm to contracts with outsiders.[4]

It is possible, however, for there to be a disjuncture between economic and legal forms. As will be seen, prior to the middle of the nineteenth century many economic joint-stock companies were treated in law as partnerships; and today very many economic partnerships, having assumed the

form of private companies, are governed, inappropriately it may be added, by company law.[5]

The second preliminary point relates to very existence of Company Law as a discrete sphere of legal theory and practice. Shannon has suggested that the legal change that occurred in the regulation of joint-stock enterprises, during the course of the nineteenth century, represented the substitution of the law of corporations for the law of partnership.[6] This assertion is misleading to the extent that it ignores the various rules and principles which distinguish company law and make it more than simply an extension of the law of corporations: "The modern company is not the ancient corporation."[7]

The development of the specific area of law now known as Company Law occurred as a consequence of judicial and legislative perceptions that the joint-stock company as an economic form was not amenable to control within the old legal forms of the common law corporation, the partnership or the trust, but required a new legal framework.

The middle decades of the nineteenth century were marked by a lack of compatibility between legal and economic forms, and a striving for an adequate legal framework for the regulation of the increasingly important economic company form.[8] The resolution of that tension is adumbrated in the decision of James L.J. in Baird's case[9], which concerned an unincorporated company established by deed of settlement.

James L.J. was clearly aware of the qualitative distinction between the partnership and joint-stock company. The essential differences being:

(1) the transferability of the share in the joint stock company "as a separate and distinct piece of property"[10], and

(2) the shareholder's lack of immediate power in the day to day operation of the company which precluded him from binding the company in the same way as a partner could bind his firm.[11]

It was to avoid the consequences of ordinary partnership law that, according to James, joint-stock companies were "invented"; and their constitutional documents had been drawn up specifically to exclude the usual attributes of partnerships. This was the case whether the company was fully incorporated, or merely an unincorporated Deed of Settlement company.

James L.J.'s distinction, on the basis economic form, reflected an awareness of the "inconvenience, complication and confusion" that resulted from the application of partnership law to the joint stock-economic form.[12] The clarity of his perception and exposition of the underlying economic reality cannot be impugned. Also his refusal to be confined by sterile legal formalism may be seen as commendable, but it led him to either willfully misstate, or

at best to misinterpret, the generally accepted view of the law as it applied to unincorporated joint-stock companies. According to James the underlying economic form of a business association determined which legal rules were to be applied to it. From this perspective a shareholder in a joint-stock company, whether incorporated or not, was, "in the legal sense of the word", no more a partner in his company than the owner of stock in the Bank of England was a partner in the Bank.[13] Although this assertion was to become the accepted view in respect of incorporated joint-stock companies[14], it was, when it was made in 1870, not without opposition and it certainly did not apply to unincorporated companies.[15] Whereas James L.J. attempted to ensure that legal rules fitted the underlying economic form, others saw the legal form as determining how the business organisation was to be treated. From this legal formalistic perspective the key question was whether the business enterprise was incorporated or not. To understand this latter, and predominant, approach it is necessary to briefly examine the emergence and development of the joint-stock company, together with its legal regulation.

II. The Early Joint-Stock Company.

According to W.R. Scott the first joint stock companies of importance were both formed in 1553. These were the Russia company and the African Adventurers.[16] Although Scott wrote

of joint-stock companies having "some corporate character",[17] it cannot be taken that legal incorporation was a prerequisite of being a joint-stock company, for as he pointed out the Russia Company did not receive its charter until 1555, after it had successfully established its trade. The charter was in fact simply the means of reserving the monopoly of trade with Russia to the existing company.[18] Also the trade of the African Adventurers was conducted for a number of years with neither charter, nor monopoly privilege.[19]

The distinctive attributes of the joint-stock company, as stated by James L.J., in Baird's case, are highlighted by a comparison with the two forms of business enterprise which preceded it, and from which it evolved.

The regulated company had been the mechanism for effectively managing monopoly trade rights, and had in turn developed from the older gild merchant.[20] From the regulated company the joint-stock company derived its constitution. Its business was conducted by a permanent body of officials subject to the control of a ruling court presided over by a governor. The essential difference between the regulated company and the joint-stock company was that whereas in the former the members were permitted to trade on their own account using their individual capital, in the latter trade was carried out on the basis of a common stock and the members were precluded from trading in their own right. The

members did not even take part personally in the management of the joint-stock company's business.[21]

The partnership had long been used as means of uniting capital, and to that extent the joint-stock company is usually seen as a development of the partnership. Although companies tended to be larger concerns that partnerships in terms of both membership and capital, size was not the essential distinguishing characteristic between the two forms. What set the two business forms apart was the ability of the company member to realise his investment through transferring his shares without the approval of the other members.[22]

It was the combination of these two elements, the existence of a common stock of the company, maintained on a permanent basis and managed by officials, together with the ability of the investor to realise his investment through the sale of shares which generated the corporate characteristic previously mentioned by Scott.

With regard to the transferability of shares there was from an early period in England an approximation to a free market in shares, and shares were bought and sold with at least a measure of freedom. Although there is no doubt as to there being a market for shares at the end of the seventeenth century, there is less certainty as to the extent and efficiency if its operation. Whereas Scott maintained that, by the end of the century, there was an "open and highly

organized" market for stocks and shares in companies, at least in London[23]; Davies more cautiously pointed out that, at least before 1690, share transactions were more restricted; that, facilities for share transactions were "primitive", and that while dealings may have been large they tended to be confined to individuals who were "in touch with commercial intelligence and personalities."[24]

Although there was a surfeit of money-capital seeking opportunities for investment it cannot be assumed that shares in seventeenth century joint-stock companies were the appropriate source for such funds. Davies suggested that, in the seventeenth century, the purchase of shares was seen as a gamble rather than as an investment, due to the large and unforeseen fluctuations that occurred in their value.[25]

The majority of the earliest companies simply could not provide the certainty of income required as the foundation of secure investment. The relative stability of the East India Company,however, did provide such a basis; and although Davies suggested that the continuity of shareholding in that company represented the emergence of the gilt-edge share, in fact it represented no more than the emergence of the share as a form of investment, rather than as a form of speculation.

In the absence of stability of return and a fully developed stock-market, the relationship of true money-capital to the

joint-stock company at this time was mediated, not through the share, but through loan bonds:

> "As non-speculative, fixed-yield, redeemable securities, unlikely to depreciate, they commended themselves to persons not familiar with the wayward habits of the embryo stock-market...In this way the joint-stock company may be said to have provided some outlet for capital which would otherwise have been forced into traditional channels of investment."[26]

III. <u>The Development of Company Law.</u>

With the existence of a market in shares comes the possibility of speculation and fraud, and with that possibility, the likelihood of financial crises. The last quarter of the seventeenth century saw an increase in the number of companies and a corresponding increase in share transactions.[27] This boom in the promotion of, and speculation in, companies resulted in the famous South Sea Bubble in the early decades of the eighteenth century. The Bubble Act[28] was passed in 1720 in an attempt to deal with the often calamitous consequences of the speculative fever that had attacked Britain, and which, at least to an extent, had been encouraged by the State.[29] In passing the Act Parliament rejected the possibility of effective

regulation of joint-stock companies in favour of ineffectual prohibition.[30]

The Bubble Act declared illegal the raising of a transferable stock, or the transfer of such stock without the legal authority of either a charter or an Act of Parliament.[31] After the Bubble Act the position at law was that only corporations, i.e. those organisations which had received the benefit of either a royal charter or a special Act of Parliament, could constitute legal persons in their own right, with the ability to own property, sue and be sued, and most importantly have transferable shares. The effect of the Bubble Act, therefore, was to concentrate attention on the legal form of the business enterprise rather than on its economic structure.

It is not at all clear whether the act of creating a freely transferable stock of shares without the benefit of incorporation was an offence at common law[32], but even the fact that it was certainly an offence under the Bubble Act did not prevent the practice.

It has been suggested that the Bubble Act, together with the difficulty and expense business enterprises faced in achieving incorporation, brought an end to the development of the joint-stock system.[33] Such assertions are misguided, however, for they fail to take account of the development of that "ingenious evasion of the law" the Deed of Settlement joint-stock company.[34] In this latter form the company's

property was held on trust for its members by trustees who undertook in the deed of settlement to apply it, for the benefit of the members, in pursuit of the company's purposes as set out in that document. Thus was one of the attributes of the joint-stock company present, in that the shareholders were removed from direct involvement in the day to day management of the business, which was conducted on their behalf by a Board of Directors.[35]

The members also mutually covenanted to be bound by all of the terms of the deed, one of which provided for the transferability of shares. And thus the second distinguishing feature of the joint-stock company was also apparent, in that the investors in the Deed of Settlement company were able to realise their investment by selling their shares when, and to whom, they pleased. It has to be noted that for the first thirty years or so after the passing of the Bubble Act it was the practice for the articles of agreement of such unincorporated companies to contain limitations on the freedom to transfer shares, but that such limitations became less usual by the middle of the eighteenth century.[36]

In this way, through the device of the Deed of Settlement Company, were unincorporated joint-stock companies formed within the shadow of the Bubble Act. Even with the repeal of the Bubble Act in 1825 the Deed of Settlement company continued to flourish in the face of State reluctance to

provide a simple and inexpensive mechanism for incorporation.[37]

Deed of Settlement Companies "developed within the bounds of equitable jurisdiction and did not trouble the common law courts with the problems of their existence".[38] But problems they certainly did have, and these eventually forced the legislature to act in order to bring them within the ambit of legal control.

An important assessment of those problems, together with a consideration of the nature of joint-stock companies, was published in 1847, entitled "A Practical Treatise on the Act for the Registration, Regulation, and Incorporation of Joint Stock Companies". The book was written by the then Assistant Registrar of Joint Stock Companies, George Taylor, and his position lends it more than mere academic authority.

It is apparent from the outset that Taylor appreciated the two fundamental differences between the company and the partnership at the economic level; the fact that the capital of the former "was divided into small fractions separately transferable", and that "the actual management of such companies of necessity fell into the hands of a limited number of persons." In so doing he emphasised the appropriateness of the joint-stock company as a mechanism essentially for the investment of money-capital. For the aforementioned characteristics:

> "...rendered the acquisition of shares in [companies] an obvious, and, where they were properly conducted, a very legitimate investment for small savings of persons whose previous habits and training had not fitted them for directing intricate commercial transactions, and whose reliance, therefore, for the security of their investments, must have rested entirely on the prudence and integrity of others."[39]

Taylor's explanation of the legislation of 1844 was that it stemmed from the fact that, although the law had viewed such organisations as merely extended partnerships, Partnership Law was not adequate to regulate their operation.

The problems inherent in attempting to control joint stock companies by means of partnership law had been enumerated in the Report on the Law of Partnership drawn up by H. Bellenden Ker in 1837.[40] These problems mainly related to the difficulty of companies suing and being sued, due to their large and fluctuating membership. Ker had concluded that Partnership Law was absolutely inapplicable to large partnerships or joint stock companies, but that in cases where it was applied it amounted to an absolute denial of justice.[41]

As the solution to the defects disclosed, Ker recommended a system of compulsory registration for all partnerships of more than fifteen members. In order to make them susceptible

to legal control it was recommended that on registration these companies be granted the right to sue and be sued in the name of an appointed officer. In addition it was recommended that the sale of shares in any unregistered company be made illegal.[42]

The legislative response to the report, the Chartered Companies Act of 1837[43], rejected Ker's compulsory solution in favour of a permissive one. It empowered the Crown to grant Letters Patent to Deed of Settlement companies, on application, permitting them to sue and be sued in the name of a designated officer. It also provided for the possibility of shareholders' liability being limited; but it pointedly did not provide for the incorporation of such companies by mere registration.[44]

It has been suggested that Ker's proposal for the recognition of the equitable joint-stock company conflicted with the Government's inherently formalistic common-law approach.[45] The Government advisors, in contrast to Taylor and the "uninstructed public"[46], refused to recognise that the economic form of the joint-stock company tended to generate Scott's "corporate characteristic", quite independent of its actual legal form. The State would not permit a group of people to arrogate to themselves the power to create a corporate body. From the perspective of the common law the formal process of incorporation was the prerequisite of

acting as a corporate body, and incorporation was a privilege in the gift only of the Crown or Parliament.

Between 1837 and June 1854, there were 164 applications for charters under the Chartered Companies Act, of which 93 were approved[47]. The procedure for acquiring letters patent remained relatively expensive[48], and consent was not readily given; but the main reason why more applications were not made was that the Act provided no advantage that could not be achieved through the Deed of Settlement company.[49]

By failing to require registration, and by treating as a privilege that which ought to have been made an obligation, the Act of 1837 left the Deed of Settlement company outside the effective control of the law, and in a position that made it a suitable vehicle for fraud. It was in fact the fraudulent use of the company form which initially gave rise to a Select Committee investigation[50] whose recommendations formed the basis for the first Companies Act in 1844: an Act for the Registration, Incorporation, and Regulation of Joint Stock Companies.[51]

This Act compelled the registration of new joint-stock companies, and specifically applied to "every partnership with shares transferable without the consent of the co-partners". It also applied to large partnerships of more twenty-five members.[52] Completion of a two-part registration process constituted the company a corporation and gave it all the attributes of a body corporate save for limited

liability. The Act, which contained 80 sections and 10 schedules, set out detailed provisions for the internal operation of the company, and the protection of the members.[53]

IV. The Coming of General Limited Liability.[54]

It is one of the paradoxes of economic history that the Companies legislation, including the Act of 1855 which granted the possibility of limited liability to registered companies, emerged some considerable time before the joint-stock company economic form was adopted by industrial concerns.

B.C. Hunt was simply wrong in his contention that

> "...the history of the business corporation or joint-stock company in England during the 150 years following the statute of 1720 (i.e. the Bubble Act) is the story of an economic necessity forcing its way slowly and painfully to legal recognition..."[55]

In truth, and in the words of D. S. Landes:

> "The simple fact is that Britain did not need joint-stock companies to finance her industrial revolution."[56]

In spite of the suggestions to the contrary implied in its title, the Industrial Revolution, at its outset during the eighteenth century, involved no dramatic technological

innovations; and entry into production was relatively easy in terms of the amount of fixed-capital investment required. The major requirement of the early industrial-capitalist was working or circulating-capital and this was made available to them in the form of trade credit, or loans and overdrafts from the newly emergent country banks. These latter appeared in the course of the second half of the eighteenth century and provided a conduit through which available un-invested money-capital could be channelled to those industrial-capitalists who required it.[57]

Once established, growth was achieved through the ploughing back of the high profit levels enjoyed.[58]

The early industrialist, therefore, did not require a large-scale centralised capital, and as a consequence was under no financial pressure to resort to the joint-stock company form of organisation.[59] The individual proprietorship or the small partnership were adequate to his needs. As regards the latter form, it

> "could be used as the basis for very flexible forms of organization, with new partners being recruited either to increase a firm's financial resources or provide management and technical skills. Extremely complex and capital intensive concerns involving multi-site operations and combining manufacturing, merchanting and even banking could and did operate as partnerships..."[60]

According to E.T. Penrose, by 1862 the joint-stock and limited-liability legislation had removed an "important limitation on the growth and ultimate size of the business firm when it destroyed the connection between the extent and nature of a firm's operations and the personal financial position of its owners."[61]

Industry, however, declined to take advantage of the opportunity presented to it and throughout most of the nineteenth century, the fundamental business unit remained the individual proprietorship or partnership.

J.B. Jeffreys concluded that even as late as 1885 limited companies accounted for at the most between 5% and 10% of the total number of the leading business enterprises and only in the highly capital-intensive industries such as shipping, iron and steel could their influence be said to have been considerable.[62] In this calculation Jeffreys correctly ignored the one-man business/quasi-partnership as, in the terminology of this thesis, they are not economic joint-stocks although they appear in the guise of the company legal form.[63]

Interestingly Jeffreys concluded that the delayed introduction of the joint-stock system in Great Britain was mainly due to the accumulated capital at the disposal of industrial-capitalists and the ability of the process of capital concentration, the old ploughing back of profit, to keep pace with the demand for fixed capital investment,

without recourse to the centralisation of external money-capital.[64]

Thus:

> "The significant fact about the rise of the company system in Great Britain is that it was necessary, not to carry through the "industrial Revolution" as was the case in most European countries and in America, but to carry through the "widening and deepening" of the capitalist system, once the capitalist method had been accepted, and a major part of the "revolution" achieved."[65]

The words "widening and deepening" are used to connote the process whereby industrial-capital, in order to transcend its own limitations, was eventually required to assume the form of money-capital. It remains, however, to explain why the privilege of general limited liability was made available before it was actually adopted by the majority of manufacturing enterprises.

The years 1855 and 1856 marked a watershed in the development of Company Law. Not only was limited liability made available as a right to shareholders in registered companies, but the previous bureaucratic restrictions on the formation of companies were removed, and a quasi-administrative law regime was replaced by a laissez-faire approach characterised by extreme permissiveness.[66] Given the gradual evolution of the law prior to the Act of 1844, the changes that occurred

during this short period appear revolutionary not only in the nature of the changes they brought about but also in the suddenness with which such changes were accomplished.
The alterations were, however, preceded by considerable debate which took place in a variety of forums; from parliamentary commissions[67], through journals and pamphlets to the newspapers of the early to middle 1850s.[68]
The task of determining whether any recognisable pressure groups can be revealed as being behind this activity, the extent to which they were responsible for pushing for the provision of general limited liability, and their reasons for so doing has been addressed by a number of writers. Their conclusions, however, have differed.
Jeffreys suggested that the motive force behind the changes in the law was the desire of money-capitalists in the Home Counties to obtain secure, yet remunerative, investment in British manufacturing industry in the face of a restriction in other, more usual, investment opportunities for money-capital.[69]
Cottrell, whilst acknowledging the importance and plausibility of Jeffreys' interpretation, expressed the opinion that it was open to a number of objections which tended to call it into question, at least as regards its categorical nature.[70]
More forthrightly, Saville stated that it would be wrong to accept the conclusion that limited liability was in the

interests of money-capitalists rather than industrial-capitalists.[71]

It is the contention of this thesis that, in spite of the later criticisms, Jeffreys conclusion is essentially correct, and that the legislation of the mid 1850s was the product of the perceived needs of money-capital. The arguments of Cottrell and Saville actually serve to confirm, rather than to refute, the contention that it was that particular fraction of capital which stood to benefit from, and was responsible for, the introduction of limited liability. Saville located the initial impetus for limited liability in the desire of the Christian Socialists to provide the means of permitting the working class to preserve their savings, and of permitting them to enter into co-operative endeavors.[72] It is certainly true that the parliamentary representative of this group, Robert Slaney, was instrumental in the setting up of the 1850 Select Committee on the Savings of the Middle and Working Classes, and the 1851 Select Committee on the Law of Partnership, both of which he chaired. The force of the argument for seeing this particular pressure group as the instigators of limited liability is dissipated, however, by the very success of the movement in having enacted the Industrial and Provident Societies Act. This Act permitted the formation of co-operatives within the ambit of trust law, although without limited liability, and was passed in 1852; three years before the provision of

general limited liability.[73] It may be noted that if the working-class could find no place for its meager savings, then the same applied to true money-capitalists, only more so! To adapt Hunt's phrase, it may be that the Christian Socialists provided no more than a "tinge of social amelioration" to a movement that was fundamentally instrumental in the pursuit of particular capitalist interests.[74]

It is apparent that, during the middle decades of the nineteenth century, there was a pronounced narrowing of investment opportunities for the accumulated, and accumulating, money-capital available; on this point all authorities, including Cottrell and Saville, are in agreement. Capital was variously estimated to be increasing at a rate of £40 million per year[75]; £60 million per year[76]; or as much as £75 million per year.[77]

Thus in 1844 newspapers were concerned that with:

> "...the coffers of the Bank of England choked with bullion...profitable investment there seems to be none. The rate of interest continues to decline. The Funds maintain an unnatural buoyancy. Deposits in savings banks are rapidly accumulating."[78]

By 1854 it was reported that:

> "The deficiency...[was] not that of capital, but of investment for capital leading to difficulties in disposing of money."[79]

and by 1860:

> "The immense aggregate of accumulated money capital for which no eligible channel of investment, combining the qualities of security and lucrativeness, can be found, is a perplexing feature in the social condition of England..."[80]

As the National Debt was amortised, government stock in the form of 3% Consols, the traditional home for money-capital, actually rose above par for a time in the years 1844, 1845; and 1852, 1853.[81]

Foreign loans were an alternative, and one that was accepted on a wide scale, but these lacked the security of British loan-stock. It has been estimated that in the early eighteen forties, fifty million pounds in foreign government stocks were in default, with dividends overdue by anything from five to twenty years.[82] Cottrell is correct to point out the availability of foreign investment, and the use made of it by British capital. His conclusion, however, is less sound. In his view, as a consequence of the availability of foreign investment opportunities:

> "It seems unlikely...that the mid-victorian economy was running out of investment placements for its savings by the 1850s, but the volume of savings was such that the investor was confronted with the problem of a declining rate of return on low-risk securities."[83]

It is suggested that the two halves of the above sentence are incompatible. Money-capital, by its very nature, seeks low-risk investment opportunities. The fact that, in the middle decades of the eighteenth century, it was forced to accept a declining return, or alternatively was forced into high-risk investment, was symptomatic of the shortage of such secure investment opportunities in relation to the money-capital seeking investment. It reveals that the mid-victorian economy was running out of "normal" investment opportunities for its savings.

In regard to shareholding in joint-stock companies there was the possibility of investing in the construction of the transport infrastructure. Investment in canal promotion had enjoyed a boom during the 1790s as investors became aware of the large profits that had been achieved by some of the earlier canal companies; but by the middle decades of the nineteenth century the system was essentially complete. Canal shares had, in any case, not necessarily proved themselves capable of sustaining large dividends.[84]

The railway boom of 1845-1847 accommodated a great deal of capital but it did not solve the problem of oversupply. Indeed it may even have exacerbated the situation by creating an increased number of potential investors seeking profitable application of their money-capital. Prior to 1846 the average dividends of the leading railway companies were above 6%. The depression which followed the 1845-47 period of "mania"

brought with it a dramatic reduction in returns on railway shares. In the years 1849 and 1850 dividends actually fell below the yield on Consols; and the low of 2.88% in 1850 represented a 50% fall from the average return that had been enjoyed in the 1840s.[85] From 1850, dividends showed a slow but steady increase, but on the whole they remained modest.[86] Cottrell, once again correctly, points out that the railway companies still sought funds during the 1850s but could not issue shares successfully because of the low earning power of the existing shares.[87] However, although Jeffreys' suggestion that the period saw a decline in the **opportunity** to invest in domestic railway companies may not be accurate[88], it must again be emphasised that, as with foreign stocks, mere opportunity for the investment of money-capital is not sufficient, unless it provides security, both in terms of dividend and capital returns. The failure of the railways to pay a return above the return on Consols precluded them from acting as a focus for new money-capital investment.

Cottrell has also taken Jeffreys to task in relation to his contention that it was essentially people from the Home Counties who embodied the investing class in mid-Victorian society, and who, therefore, stood to gain most by the provision of limited liability. He suggested that a study of the flow of funds within the railway capital market of the second quarter of the nineteenth century fails to reveal the predominance of south-eastern investment. On the contrary

investors resident in Lancashire and Yorkshire played an equal, if not a greater, part in the provision of funds for railways promoted during that time.[89] The important point, however, is not the geographic location of the investors but the manner in which they invested their capital. The source of the money invested by North-Country railway shareholders may well have been industry, where they operated as industrial-capitalists, actively participating in the process of production. But it was not re-invested as industrial-capital, but as money-capital; its suppliers playing no active part in putting it through its cycle of production. Cottrell's findings support rather than refute this conclusion.

If the interests of money-capital pressed for alterations in Company Law, the attitude of industrial-capital to the question of limited liability can most cogently be implied from its subsequent rejection of the limited lability company form, but it is also apparent in its usual silence, and disinclination to become involved in the debate leading up to general limited liability. When the contemporary representatives of industry did express any opinion on the matter, they tended to be opposed to it.[90]

V. The Need for Limited Liability.

The general economic conditions prevailing during the middle decades of the nineteenth century suggest, therefore, that

there was a need for money-capital to insinuate itself into the industrial sector in order to maintain, and improve, its position as capital by gaining access to the profit generated by industrial-capital. The external relationship of money-capitalists to the process of production, however, required the availability of general limited liability[91] before that wish could be fulfilled.

For money-capital to assume the form of shareholding required a shift in emphasis from the rights of creditors, protected by unlimited liability; to the protection of shareholders' interests by the provision for limited liability.

Creditors of a partnership are safeguarded by the knowledge that all partners are jointly and severally responsible for their firm's debts to the full extent of their personal estate. This apparently harsh provision is balanced by the control that the partners exercise over the running of their joint business: the partner does not enter into any transaction, nor accepts any risk, other than willingly, with full knowledge of the consequences should it prove unsuccessful.

In the joint-stock company, however, the externality of the shareholder to the actual operation of his company's capital required that a limitation be placed on the extent of his risk. Limited control had to be recognised and balanced by limited liability. The typical shareholder was not involved in taking decisions in regard to the day to day operation of

the business of his company, and therefore could not risk, and should not legitimately be held responsible to the extent of, his personal wealth.[92] Creditors should look to the capital fund supplied by the shareholders for their protection rather than to the personal wealth of any partners.[93] This had been recognised in the statutory companies that had been formed to construct the canals and railways; in regard to those concerns there was no question as to the appropriateness of shareholders having limited liability. It remained for the same facility to be extended to money-capital in whichever type of enterprise it was engaged.[94]

VI. The Legislation of 1855 & 1856.

It has been suggested that the emergence of limited liability presents a particular problem for Marxist analysis in that it

> "[has] tended to treat the development of limited liability simply as a function of the development of the forces of production and the forms of concentration of capital required by them."[95]

The fact that limited liability was available to industry well before it actually made use of the privilege is taken as demonstrating the invalidity, and the "naively apolitical" nature of the Marxist proposition that the emergence of legal form can be reduced to the "necessary expression of the objective developments in capitalist production."[96]

The foregoing has demonstrated that limited liability can be understood as a product of the specific objective conditions of capitalism in the middle of the nineteenth century without reducing the analysis of the legal sphere to any simplistic relationship with the material forces of production.

The achievement of limited liability was not an automatic process, simply the reflex of the prevailing economic conditions. It was the outcome of an intense political engagement, reflecting the chafing of capital against inappropriate pre-capitalist forms of legal regulation, and the intra-class antagonism that existed within the capitalist class as a whole. The companies legislation of the mid-nineteenth century represented the victory of money-capital in this struggle, but it cannot be claimed that the instrumental requirements of that particular fraction of capital dictated the specific form in which limited liability was extended to it.

The Limited Liability Act 1855[97] essentially was no more than an amendment to the Joint Stock Companies Act of 1844. The basic procedure for registration under the latter Act had to be followed, but on compliance with addition conditions the members of such companies were granted limited liability.[98] Within the year both of these Acts were repealed and replaced by the Joint Stock Companies Act 1856[99]; and the procedure whereby companies were formed and regulated was changed dramatically. The 1856 legislation marked a repudiation of

the previously regulatory structure of company law. No longer was the state to obstruct the formation of companies, its function was merely to provide a facilitative framework within which individuals were to have the utmost freedom to conduct their own economic activity.

The 1856 Act reflected the extreme of economic liberalism as embodied in its progenitor Robert Lowe. As Vice- President of the Board of Trade, Lowe introduced the Bill in the Commons in a tour de force speech in which he not only set out the shortcomings, as he saw it, of the existing law, but expressed his own political philosophy:

> "I am arguing in favour of human liberty - that people be may be permitted to deal how and with whom they choose without the officious interference of the State...We do not believe it is in the power of the Government to supersede the vigilance of individuals who are actuated by the strongest personal interests...We propose to take now our stand upon the only firm foundation on which the law can be placed - the right of individuals to use their own property, and make such contracts as they please, to associate in whatever form they think best, and to deal with their neighbours upon such terms as may be satisfactory to both parties."[100]

Under the 1856 Act the two-fold registration procedure was discarded and the minimum number of shareholders was reduced

to seven. In regard to capital there was no longer any requirement relating to minimum subscribed capital; no requirement relating to the proportion of shares that had to be paid up; and no requirement relating to the minimum value of shares. The previous compulsion on a company to be wound up on the loss of 3/4 of its capital was reduced to a permissive provision. As the justification of the Act was expressly founded on the moral and economic superiority of individuals making their own rational decisions on the basis of freely available information[101], it is more than somewhat ironic to note that it actually reduced the flow of information required to be supplied to shareholders. Whereas previously the Minute Book and the Accounts Books of a company were required to be open to inspection by members; under the 1856 Act the power to inspect either of these documents had to be expressly granted by the company's articles of association. Perhaps even more significant, given the passive nature of the typical shareholder, was the fact that the appointment of an auditor was no longer compulsory; nor was the registration of a balance sheet and auditors report.

It is impossible to explain such extreme permissiveness and lack of restraining control on the immediate needs of money-capital, which could have been accommodated within a more regulated form of company law. Indeed the very lack of control operated against the interests of many money-

capitalist investors as well as ordinary creditors, as unscrupulous company promoters made full use of the latitude allowed them by the legislation to perpetrate frauds. The form which the legislation took may better be explained by the attitudes of the members of what was in essence a free-trade parliament. To the majority of these, <u>un</u>limited liability operated as a form of protection, either through the wealth and active management needed to minimise its possible effect, or through the high cost of avoiding it completely through incorporation. As Palmerston expressed it, limited liability was "a question of free trade against monopoly."[102] It may be well be said that the passage of the Joint Stock Companies Act in 1856 signally represented:

> "the triumph of liberal economic sentiment within and without the business community, a triumph that washed away corn laws, navigation acts, tariffs,and usury laws as well as restraints on company formation."[103]

That the passing of the legislation was a manifestation of the hegemony of laissez-faire capitalism is not to be doubted; but such recognition must not detract from the essential assertion of this thesis that the underlying factor that generated this display of political and ideological power was the objective economic condition and instrumental needs of money-capital. As the Economist fully recognised at

the time, the companies legislation of the middle period of the nineteenth century signalled the fact that:

> "Capital is a commodity to be sold or bought, lent, borrowed, and in every way to be dealt in, as much as corn or cotton ."[104]

It was intended that the limited liability company should provide the institutional framework whereby money-capital could more readily assume this commodity form, and, perhaps more importantly, claim its appropriate price.

The typical shareholder could no longer be thought of as an "adventurer" as the shareholders in the old joint-stock companies had been. He was not so much an entrepreneur, more a purchaser of income.[105]

The railway mania of the eighteen forties had created a new and numerous investing public; "a brood greedy for security at ten per cent and embracing well-nigh the whole electorate."[106] By 1875 it could be claimed that "England was a stock-and-bond-holding aristocracy, measuring income in dividends and wealth in the quotations of the Stock Exchange."[107]

Given the passive and external nature of money-capital investment it is evident that it required greater regulation and protection than the Act of 1856 afforded it; and to a large extent the later history of Company Law may be seen as an endeavour, by both the legislature and the judiciary, to remedy the failings of the 1856 Joint Stock Companies Act[108],

and provide an adequate legal framework within which joint-stock companies could operate not only legitimately, but effectively.[109]

VII. The Private Company: the Quasi-partnership and the One-man Business.[110]

In spite of the deliberate permissiveness introduced by the Act of 1856, the Companies Acts[111] were never intended, even by the leading parliamentary proponents of economic liberalism such as Lowe, to be used by partnerships or individual proprietorships. The company legal form, involving incorporation and limited liability, was intended to be restricted to economic joint-stock companies.[112]

In introducing the second reading of the 1855 legislation, Lowe's immediate predecessor as vice-president of the Board of Trade, E.V. Bouverie stated that two pieces of legislation were necessary to deal with the two distinct forms of organisation: the private partnerships and the joint-stock company. Bouverie distinguished the two economic forms on the basis of the transferability of the share in the joint-stock company and the fact that its members were not actively involved in the management of the company.[113]

It was evidently the fact of externality coupled with transferability that required full limited liability in regard to the joint-stock company. The reason being that in the joint-stock company even the active participants, the

directors, could transfer their shares, and in the absence of limited liability, new shareholders would be fully responsible for company debts.[114]

In relation to the individual industrialist or the partnership, money-capital appeared in its archetypal form of the loan, and received a return equivalent to interest, in both form and content. Attempts to improve the situation of money-capital in this simple debtor/creditor relationship confronted two particular problems.

Firstly, the Usury laws which had limited interest payments on loans to 5%. These were repealed in 1854[115].

The second impediment was the decision in Waugh v Carver. This had held that a lender who received interest which fluctuated according to the profits of the business to which he had loaned money, was himself a partner in the concern, and thus fully liable for any debts of the partnership.[116]

The effect of Waugh v Carver was that money-capital could not appropriate any portion of profit of enterprise, without assuming the risks of industrial-capital; while its externality to the process of production made it incapable of monitoring or assessing those risks.

The first attempt to repeal Waugh v Carver, lapsed in 1855; and a second attempt also failed in the following year. The rule was eventually repealed in 1865.[117]

It was assumed that, within the partnership, the active industrial-capitalists would be in a position to protect

themselves from the consequences of unlimited liability, and as they could not transfer their interests, they could not dispose of their responsibilities to third parties. The aim of the partnership law amendments, therefore, were not to give limited liability to the active partners, but merely to offer that facility to the money-capitalist "sleeping partners".[118]

It was immediately evident, however, that in spite of the intentions of the framers of the legislation[119], the Joint Stock Companies Act of 1856 provided the means whereby partnerships, and indeed individual traders, could obtain the benefit of limited liability. Edward Cox, a severe critic of the 1856 Act and opponent of limited liability on moral grounds, nonetheless, as early as 1857, extended the following advice to the individual proprietor:

> "Let him convert his business into a limited liability Company, with so much capital as he is willing to stake, say £1,000, in shares of £1 each. As the Company must consist of seven persons at least, he has but to give one £1 share to each of his children (if of age), brothers or sisters, parents or servants, and keep the remaining 994 shares himself, and so he will obtain the advantages of incorporation..."[120]

P. W. Ireland[121] has traced the emergence, and legal recognition of the private, and one-man, company form, from

the mere suggestion of its possibility as outlined above, through to its full development and recognition by the Courts[122], and the legislature.[123] His conclusion is that the by 1925:

> "The triumph of the limited liability company was complete, as was the perversion of the Acts of 1856-1862."[124]

The perversion referred to relates to the manner in which partnerships and sole traders utilised Companies legislation which was not intended for their use, in order to obtain the benefit of limited lability[125] Such businesses usurped the legal form of the joint-stock company without assuming its economic form; the attributes which distinguish the contemporary joint-stock company, and characterise it as a specifically money-capitalist economic form, not being present in the case of the private company.[126]
Reflecting the industrial-capitalist nature of the private company the member's relationship to concrete capital operated by his company is more direct than that of the shareholder in the true joint-stock company, whose relationship to the productivity of concrete capital is mediated through the share and the stock exchange. As a consequence the separation of ownership and control which typifies the public company is not apparent in the private company.[127]

There are in addition a number of differences in relation to the share capital of the two forms. In the first place not only are the shares in the private company not dealt with in the stock exchange, but their very transferability is severely restricted.

Secondly as there is no market in the shares the level of share capitalisation is a matter of choice. It does not assume the form of fictitious money-capital, the value of which is determined by the external valuation process of the capital-market.[128]

Thirdly as the share capitalisation is not translated into fictitious money-capital, dividends in private companies may actually include profit of enterprise, although they appear in the form of interest.

Although the registration, and incorporation, of economic partnerships was recognised by the law, the inevitable consequence was a disjuncture between economic form and legal regulation. As a consequence of assuming a legal form designed specifically for the regulation of economic joint-stock companies, private companies became subject to inappropriate controls. The inappropriateness of such regulation has been recognised by the judiciary and the Companies Acts, which have provided numerous exceptions to the general rules of Company Law in relation to private companies. Contemporary Company Law thus distinguishes between private and public companies on the basis of economic

form, and formulates and applies law appropriately.

Chapter Two: Endnotes.

1.Much of what follows draws on secondary sources, and is by necessity cursory. The purpose is to place what may well already be known within the framework set out in the first chapter of this thesis, in such a way as to explain, rather than merely describe, the emergence and development of the general notion of Company Law as a discrete area within the legal universe.
The chapters following will deal with specific areas of Company law: the nature, transfer, and valuation of shares; Goodwill; Dividend Law; Ultra Vires; and Separate Personality.

2.This ideal-type does not consider the private company/quasi partnership, but see infra.
Nor does it consider the active industrial-capitalists, who use their control of companies in order to increase the amount of capital under their control. See De Vroey; and Aglietta in chapter 1 supra. But even here the relationship to industrial-capital is still mediated through the control and manipulation of company law mechanisms that large shareholding permits.

3.Unless the partnership articles provide otherwise, partners may be entitled to assign their interest in the firm, but the assignee only becomes entitled to receive financial returns due and does not become a partner. This in no way approximates to the free transferability that is one of the fundamental attributes of the share.

4.Partnership Act 1890, Ss.24(5); 5.

5.For further consideration of this point see P. Ireland, "The Rise of the Limited Liability Company" (1984) 12 International Journal of Sociology of Law, p.236.
This thesis will concentrate on the true joint-stock company, essentially the public limited company; but the emergence of private companies, and their usurpation of the company legal form, will be considered infra.

6.H.A. Shannon, "The Coming of General Limited Liability",(1931) VI Economic History, pp.267-291; reprinted in Essays in Economic History, ed. Carus-Wilson; pp.358-379 at p.358.

7.T.B. Napier, The History of Joint Stock and Limited Liability Companies, in A Century of Law Reform, pp.379-81, at p.396.
Shannon himself makes the same point, ibid. at p.366 when, in considering the effect of the Act repealing the Bubble Act, 6 Geo.IV,c.91, he stated that "for the first time in a general Act the bundle of common law rights possessed by a

corporation, unbreakable if kept whole, was loosened; and with one right broken separately the others were to follow, until a new statutory bundle was made up." Emphasis added.

8.It is ironic that the company form achieved predominance in the legal sphere before its predominance at the economic level. See Ireland, ibid., and infra.

9.re Agriculturist Cattle Insurance Company, (1870) 5 Ch. App.725.

10.ibid. p.734.
How the share came to be seen in this way will be considered in Ch.3 infra.

11. ibid pp. 733 & 744

12. ibid. p.732

13. Ibid. p. 734.

14.It did not apply to the later quasi-partnership/private companies.

15. A more conventional statement of the law, equating unincorporated companies with ordinary partnerships, can be seen in Lord Romilly M.R.'s decision in Baird's case. It is somewhat ironic that the report of Romilly's decision is given in the same report as James's directly contrary decision (1870). 5 Ch. App 725 at p.727.
In considering Baird's case R.R. Formoy, The Historical Foundations of Modern Company Law, at p.38, convincingly suggested that as a consequence of the various Acts which had been passed to facilitate the incorporation of companies, even companies which had not taken advantage of those Acts, and so remained unincorporated, received more favorable treatment than their predecessors.

16.W.R. Scott, The Constitution and Finance of English, Scottish, and Irish Joint Stock Companies to 1720 vol.i pp. 17 & 21.

17. Ibid. p. 17

18.Under the Statute of Monopolies individual monopolists were prohibited, but s.9 retained the privilege for corporations.
See C.A. Cooke, Corporation Trust and Company, chapter 4.

19.Scott, ibid., p.21.
See also K.G. Davies, The Royal African Company.

20. The most detailed study of the gild system is to be found in C. Gross, The Gild Merchant.

21. Scott ibid. vol. i p.18 & p.45.
The earliest trading companies were financed on the basis of a temporary joint-stock the proceeds from which were realised and divided at the end of each particular trading adventure. The East India Company, incorporated in 1600, initially operated on the basis of private trade or temporary joint-stocks. It was only in 1657 that a permanent joint-stock was established, and only in 1693 that private trade was prohibited. Scott ibid. vol 2, and Cooke, op.cit.
The emergence of a fixed common stock is the essential precursor to the emergence of the share as fictitious capital, as sale of the share becomes the only means of realising investment.

22.Scott, ibid. vol.1, p.442 states that: "No fixed line can be drawn between a large partnership and a small company, except in this single characteristic, that the member in the latter could dispose of a part or the whole of his share in the undertaking without receiving the consent of others concerned."
and Dubois, The English Business Company after the Bubble Act,1720-1800, p. 349 states that: "...the division of the capital into transferable shares owned by individuals, was...regarded as the essence of the business company..."

23.Scott, ibid. vol.1 p.433. See also pp.45 & 493 et seq.

24.K.G.Davies, Joint Stock Investment in the Later Seventeenth Century, in Essays in Economic History vol ii pp. 273-290, at pp. 283-84.

25.Davies' choice of language emphasises this point, for as he stated at p.286:

> "The inference suggested is that the smaller investor normally concentrated on his fancy, while the large investor, instead of dividing his stake-money equally, backed the favorite heavily with a small or medium-sized saving bet on the outsider."

26.Ibid. p.289.

27.In the period between 1689 and 1695 the number of joint-stock companies in England increased from eleven to approximately one hundred. See Davies, ibid., p. 281; Scott ibid.,vol.1 p.327.

28. (6 Geo.1, c. 18) For consideration of the genesis of the Act see Scott, ibid, vols. i & iii.

29. Scott ibid. vol.iii pp.351-352.; and Holdsworth, History of English Law, vol. viii, pp.218-219.

30. Holdsworth ibid. pp. 219-220

31. 6 Geo 1 c. 18 S.18. See Ch. 3 infra.

32. Authority exists for both sides of the argument. Cases which suggest that the transfer of shares outwith incorporation was illegal at common law are: Kinder v Taylor (1825) 3 L.J.Ch. 68; Duvergier v Fellows (1830) 10 B.& C. 826; ; Blundell v Windsor (1837) 8 Sim 601; Sheppard v Oxenford (1855) 1 K.& J. 491.
On the other side suggesting the legality of such a practice at common law are: Walburn v Ingleby (1832) 1 M.& K. 61; Garrard v Hardey (1843) 5 Man. & Gr. 471; Harrison v Heathorn 6 Man. & Gr. 81.
These cases will be considered in chapter 3 infra.

33.See for example T.B. Napier, The History of Joint Stock And Limited Liability Companies, from A Century of Law Reform p.383; Holdsworth ibid. p.221; and Scott ibid. vol.i p.438

34.D.S. Landes, The Rise of Capitalism, p.100.

35.The collective powers of the shareholders in general meeting will be considered in ch.6 infra.

36. Du Bois ibid. p.40.

37. At common law the members of a corporation could not be held liable for its debts but with the repeal of the Bubble Act, by Geo IV c. 91, the Crown was given the power to create corporations which retained the members' several liability for the corporation's debts. This privilege, however, was not readily available. Nor was the later Crown power, given under 4 and 5 Wm. IV c 94, to permit companies, by grant of letters patent, to sue and be sued in the name of an officer widely used.

38. C.A. Cooke, Corporation, Trust and Company p.85. The classic examination of this form of business organisation is A.B. Du Bois, The English Business Company after the Bubble Act which shows the extent to which these companies endeavoured to avoid having anything to do with the courts through the use of arbitration based on the opinions of eminent lawyers such as Sergeant Pengelley.

39. G.Taylor, A Practical Treatise on the Act for the Registration, Regulation and Incorporation of Joint Stock Companies, p.2.

40. Parliamentary Papers XLIV 503. The report was also published as an appendix to the Report on Joint Stock Companies 1844 VII (119) p. 245. For summary of the report see: Times ,October 9 1838; Taylor ibid. pp.5-9; and H.A. Shannon, "The Coming of General Limited Liability", V1 Economic History pp.267-291, and in Essays in Economic History, pp.358-379 at p.361-364.

41.Report on the Law of Partnership supra, concluded: "It has been shown clearly that the present law is not suited to partnerships, unless they have obtained the power of suing or being sued by some means. The consequence it may be assumed is either, that all such partnerships as, in the words of Lord Eldon "prevent the jurisdiction of the court from being usefully administered between them" should be declared illegal, unless an act or charter is obtained, or that the law should be so altered as to enable the jurisdiction of the courts to be administered. Assuming that it is not expedient to suppress each partnership, then the only way to remedy the evil will be to allow all large partnerships to possess the power of suing and being sued by an officer to be appointed." Taken from The Times, October 9th, 1838.
The classic example of the injustices that were consequent on the failure of the law to adequately deal with joint-stock companies is Van Sandau v Moore and Others 1 Russell 441, which gave rise to the expression of Lord Chancellor Eldon's antipathy towards the company form.

42.It is apparent that Ker did not distinguish partnership and joint-stock companies on any qualitative basis, but continued to see the company as essentially a large partnership. Although the proposal in regard to preventing the transfer of shares did address the key issue.

43.7 Wm.4 & 1 Vict. c.73.

44. It had always been possible, even during the period when the Bubble Act was in force, for companies to acquire a special Act of Parliament in order to sue and be sued in the name of a designated officer. That possibility had been extended by the passing of the Trading Companies Act 1834 4&5 Wm.c. 94.

45. C.A. Cooke, ibid. pp.127-135.

46. Taylor, ibid. p.3

47. B.P.P. 1854, LXV, Returns of all Applications referred by Her Majesty to the Board of Trade,praying for Grants of Charters with Limited Liability under the Act 1 Vict. c. 73. cited in P.L.Cottrell, Industrial Finance 1830-1914, p.43.

48. E.W. Field Observations of a Solicitor on the right of the Public to form Limited Liability Partnerships and on the Theory, Practice and Cost of Commercial Charters 1854, pp.51-73. Cited in Cottrell ibid.

49. Companies even contracted on the basis of limited liability. See infra.
As Rubin and Sugarman point out, Law Economy and Society, p.5: "Traders and entrepreneurs might, on occassions, actually have a stronger interest in a legal system characterised by confusion and complexity, which they could exploit, rather than the supposed certainty and calculability which lawyers often argued, enterprise required of the legal order."

50. Select Committee Report on Joint Stock Companies, 1844, B.P.P. VII (119).

51. 7 & 8 Vict. c.110.

52.Ibid. s.2. Insurance companies were specifically covered by the Act whether they were joint stock companies or not, and section 2 also set out a number of exceptions in regard to registration.

53.The Act provided for the control of directors, the holding of meetings, the production of balance sheets, and the holding of an audit. Also a model Deed of Settlement was appended, and the Registrar was placed under a duty to ensure that companies conformed with the Act and the general law. In the words of H.A. Shannon, ibid p.370, this was "not laissez-faire but administrative or quasi-administrative law". The reason for the amount of regulation lay in the need to protect money-capitalist shareholders from the depredations of company promoters and directors.

54.The title of this section is taken from Shannon's article mentioned supra.
Again it must be emphasised that it is not the intention of this thesis to retread the ground already covered in such works as Shannon's; B.C. Hunt's Development of the Business Corporation in England; Cooke's Corporation Trust and Company; J. Saville's "Sleeping Partnership and Limited Liability 1850-1856", 1956, VII Economic History Review,"(2nd series); or P.L. Cottrell's, Industrial Finance 1830-1914; in which the actual historical process which brought about the emergence of limited liability is considered in detail. Reference will be made to that historical process in order to place it within, and explain it in terms of, the theoretical context established in the first chapter of this work.

55.B.C. Hunt, ibid, p.13.

56.D.S. Landes, ibid, p.101.
Those in accord with this view are; A.E. Musson, "The Growth of British Industry", pp.66-67; P. Deane, "The First Industrial Revolution" p. 205; P.L. Payne, "British Entrepreneurship", p.17; Cottrell, ibid. pp.10-11; and J. B. Jeffreys, "Trends in Business Organisation in Great Britain since 1856", Ph.D., University of London, 1938, p.441.

57.See generally L.S. Pressnell, Country Banking in the Industrial Revolution; and specifically Landes, ibid. p.103; Musson, ibid. pp.65-66; Deane, ibid. p.163; and Cottrell, ibid. pp.11-16.
Pressnell's study provides evidence for the conclusion that the banks were willing even to provide long term capital to industry, or alternatively, in Landes phrase, overdrafts "that in fact constituted indefinite revolving capital." Ibid. p.102. See also P. Mathias, "Capital Credit and Enterprise in the Industrial Revolution".

58.T.S. Ashton, The Industrial Revolution 1760-1830 p.97; P. Deane, ibid. pp.163-164; S. Pollard, The Genesis of Modern Management pp. 284-287; F. Crouzet, Capital Formation in Great Britain during the Industrial Revolution, passim. Although P.L. Cottrell agrees with the general conclusion, ibid. p. 257, he does caution against the possible lack of typicality of the concerns which have provided the evidence to substantiate it. Most of the evidence has been drawn from studies of relatively successful businesses and thus there may have been a tendency to disguise the high rate of mortality in certain industries, which may be indicative of, at least initial, poor profitability. See ibid. pp.254-255.

59.Where large capital funds were required, as in the case of canal and railway construction, incorporation under a special Act of Parliament was not problematic.

60.Cottrell, ibid. p.10.
P.L. Payne, "British Entrepreneurship", p.17-18 also emphasises the "kaleidoscopic" nature of the partnership.

61.E.T. Penrose, The Theory of the Growth of the Firm, p.6; cited with approval by P.L. Payne in "The Emergence of the Large-scale Company in Great Britain, 1870-1914."

62.The Royal Commission on the Depression of Trade and Industry, B.P.P., XXII, 1886 provides some evidence for the spread of the limited company form within the manufacturing sector of the economy, especially in relation to the textile industry.
The cotton industry was anomalous in that although its fixed-capital requirement was not particularly high the joint-stock

company, in the shape of the "Oldham limiteds", was an important organisational form in regard to coarse spinning from the first half of the 1870s. For a consideration of this special case see Cottrell, ibid. pp.109-112.

63.J. B. Jeffreys, ibid. p.105. The one-man business/quasi partnership type of business form is considered infra.

64.Ibid. p.441.
See also Payne, British Entrepreneurship, p.18; and Cottrell, ibid. p. 270.

65.Jeffreys, op. cit.

66.Limited liability was not granted to joint-stock banks until 1858, 21 & 22 Vict. c.91; and insurance companies were not extended the same privilege until the 1862 Companies Act, 25 & 26 Vict. c. 89. Given the acceptance of the principle of general limited liability under the Acts of 1855 and 1856 these were anomalies to be rectified in time.

67.The following reports demonstrate parliamentary interest:
Select Committee on Investments for the Savings of the Middle and Working Classes, 1850, B.P.P. XIX (508).
Select Committee on the Law of Partnership, 1851, B.P.P. XVIII (509).
Royal Commission on Mercantile Law, 1854, B.P.P. XXVII (1791).

68.According to Hunt, ibid. pp.116-17:"Limitation of responsibility became the subject of repeated and voluminous legislative enquiry and heated debate, a topic of widespread discussion in commercial circles, an object of professional investigation, and the solicitous concern of the social reformer."
Hunt provides a detailed consideration of this debate, and the emergence of limited liability, as does J. Saville, and Shannon. See supra. See also W. Horrwitz, The Historical Development of Company Law, 1946, 62 L.Q.R. 375.

69.Jeffreys, passim, but especially pp. 48-52.

70.Cottrell, ibid. pp.45-47.

71.Saville, ibid. p.432.

72.Ibid. p. 419.

73.15 & 16 Vict. c. 31.
Saville himself remarks on this fact at p. 422.

74.B.C. Hunt, ibid. p.120.
Jeffreys, ibid. p.52. considered this point thus:

> "The industrialists had capital and they invested it in their partnerships. The commercial, trading and professional classes similarly possessed capital but their outlets were narrow and limited...There was no common ground between these rival forces. The introduction of moral and other issues tended to confuse rather than clarify the issue."

75.This was the estimate of G.R. Rickards of Oxford University professor of Political Economy, expressed to the Royal Commission Report of 1854, cited in Hunt, ibid. p. 117, footnote 9.
Saville, ibid. p. 424, cites a pamphlet by Lord Hobart in support of this figure.

76.This estimate was provided in response to Q.386 in the 1850 Select Committee report supra.
Saville also cited this figure, op. cit. f.n.9.

77.This highest figure was suggested by Robert Slaney in the House of Commons; Hansard, CXIX, 670.
Again Saville cited this estimate, op. cit.

78.Morning Chronicle, January 22, 1844. Cited in Hunt, ibid. p.103.

79.G.R. Rickards, ibid, p.231. Cited in Hunt p.120.

80.American Securities, 2nd edn. 1860,p.13. Cited in Cottrell, ibid, p.46.

81.In 1844 the annual high price was 101 3/8, representing a yield of 2.96%: the annual low was 96 1/2 representing a yield of 3.11%: the annual averages were 99 and 3.03 respectively.
In 1845 the annual high was 100 5/8; the annual low 91 7/8; and the average 96 1/8.
In 1852 the annual high price was 102, representing a yield of only 2.94: the annual low 95 7/8; and the annual average was 99 3/8.
In 1853 the high was 101; the low 90 3/4; and the average 97 3/4.
The 10 year average yield for the 1840s was 3.26%
The 10 year average yield for the 1850s was 3.16%
The 10 year average yield for the 1860s was 3.27%
All figures derived from S. Homer, A History of Interest Rates.

82.L.H. Jenks, The Migration of British Capital to 1875, p.115.

83.Ibid. p. 46.

84.G. Hawke and J. Higgins, Chapter 6, Railways and Economic Development, pp.172-1181.

85.T.R. Gourvish, Railway Enterprise, in The Dynamics of Victorian Business, p.129.

86.According to Gourvish, op. cit.:"An unweighted average dividend for the leading 15 companies, 1850-75, amounts to only 3.65%. Only 5 companies...paid dividends of 5 to 6%, while 4...were unable to pay 1 1/2%."

87.Ibid. p.46.

88.op. cit.

89.Cottrell, ibid. p45-46.

90."...it is an important point that the voice of the industrialist was seldom heard in all these discussions. When he was vocal, as with certain of the cotton and woolen interests, the balance of the argument was rather against change." Saville, ibid. p.432.

91.Attempts had been made previously to obtain limited liability through contract law. The first method was by a mutual agreement between the members in the deed of settlement that they would only be liable up to a certain amount in respect of company debts. Although this might be effective within the company it could not bind outsiders, even if they were aware of the limitation: re Sun Fire and Life Assurance Company (Greenwood's case) (1854)3 De G.M.& G. 459.
The second method was for restricted liability to be expressly provided for in each contract which the company entered into. This device was more successful: Hallett v Dowdall (1852) 18 Q.B.2; re Athenaeum Life Assurance Society (Durham's case) 4 K.& J. 517. It was suitable for insurance companies but the need for particularised contracts rendered it less useful for other concerns.

92.As to the competence of this typical shareholder to take such decisions; see the evidence of the Royal Commission of 1854, App. p.145.
It was the separation of ownership and control, that he had seen as inherent in the joint-stock company, that led Adam Smith to reach his famous conclusion, in the Wealth of Nations, that companies would be unable to compete

effectively with partnerships within the industrial sector. The fact that directors were the managers of other people's money rather than their own led him to characterise such companies as tending towards negligence, profusion, and waste.

93.A witness to the 1854 Royal Commission, T.N. Weguelin, at App. pp.123-124, expressed the view that this could in fact increase the security of creditors by substituting certain capital in place of uncertain credit. In relation to the partnership, credit ultimately rests on the creditworthiness of the partners, which is necessarily uncertain. In the case of the joint-stock company the capital fund was assumed to be fixed and certain. However as long as shares retained a large portion of their value unpaid this benefit was to a great extent illusory; as the creditor could not be certain that the shareholder could afford to pay calls. Weguelin's opinion also fails to consider the fact that the nominal capital may not actually be equalled by the value of a comany's assets. See ch.s 4 & 5 infra.

94.Lord Hobart in his 1853 pamphlet on partnership liability, supra, accurately distinguished between the active entrepreneur and the passive shareholder. He suggested that whereas it was "natural justice" that the former be held liable for his firms engagements; it would be "unjust" for the latter to be held fully liable.
A submission to the 1854 Royal Commission, App. p.95. also recognised this distinction and suggested that it was "only fair" to restrict shareholders' liability to the extent of their investment.

95.P.Hirst, On Law and Ideology, p.137.

96.Op. cit.

97.18 & 19 Vict. c.133.

98.The additional conditions were designed to prevent the use of the limited company form by merely speculative bubble companies and provided that the company must have at least 25 members who had subscribed for at least 3/4 of its nominal capital. Each shareholder must have paid up their shares to at least 1/5 of their nominal value. In addition the company had to adopt the word limited as the last word of its name. The Bill had originally contained provisions for a minimum capital of £20,000, and a minimum share value of £25. In the face of hostility the former proposal was dropped and the latter reduced to £10.

99.19 & 20 Vict. c. 47.

100.Hansard CXL(1856)pp.110-138. passim.

101.Hansard,op.cit.

102.Speech in support of the 1855 Limited Liability Act. Hansard CXXXIX 1378.

103.Landes, ibid. p. 103.

104.The Economist, 16 August, 1856. Cited in Saville ibid. p.433.

105.Hunt,ibid. p.130.

106.Jenks,ibid. pp.132 & 236.
According to Jenks the transformation of the money market into unified national system was accompanied by democratisation, as the Stock Exchange embraced the bulk of the middle classes amongst its clientele., ibid. p.131.

107.Jenks, ibid, p.327.
See also Jeffreys, ibid, pp. 337-339; 408-413.

108.A propos the 1856 Act M. Rix believed that " the history of company law, actual and proposed, is a record of attempts, unsuccessful in the main, to retract some of this sweeping declaration of liberty". See "An Economic Analysis of English Legislation Concerning the Limited Liability Company", M.Sc. University of London, 1936.

109.The remaining chapters of this thesis will consider some of the major elements of that emergent legal framework.

110.Although this thesis is essentially concerned with the joint-stock company and explaining the development of Company Law as the appropriate means of regulating such a money-capital form; the private company has to be considered in order that it might be shown to be of a different nature, and for that reason to require a different mode of regulation.

111.The Companies Act of 1862, 25 & 26 Vict. c. 89, was essentially a consolidating Act combining the 1856 Act; the legislation which had extended the availability of limited liability to joint-stock banking; and permitting insurance businesses to operate on the basis of limited liability. The major new provision of the 1862 Act was the absolute prohibition, by s.12, of any alteration of the objects clause in the memorandum of association once registered. Thus it introduced the doctrine of ultra vires. This will be considered in detail in ch.6 infra.

112.P.W.. Ireland, The Rise of the Limited Liability Company, pp.241-244.

113.Hansard CXXXIX 310 et seq. passim.

114.See ch.3 infra for a consideration of how such liability would arise.

115.They had been repeatedly amended between 1834, and 1850 before being finally repealed completely in 1854, 17 & 18 Vict. c.90. According to Gladstone, their repeal permitted the: "unrestricted freedom of trade in all that related to the borrowing and lending of money." Hansard, CXXXIV,931.

116.(1793) 2 Wm. Blackstone 23. The justification of the case is apparently based on the following spurious chain of reasoning. The relationship of money-capital to functioning industrial-capital is the loan. The loan receives fixed interest. Thus any return that is not fixed cannot be the product of money-capital, but has to be the product of industrial-capital. Therefore the recipients of fluctuating interest must as industrial-capitalists be liable as such to the full extent of their wealth. See Grace v Smith (1775) 2 Wm. Blackstone, 1000.

117.Although most of the debate concerning limited liability had related to the **societe en commandite**, with its mixture of limited and unlimited partners, neither the successful joint-stock company Bills nor the unsuccessful Bills for altering Partnership Law actually provided for this possibility. Even when the rule in Waugh v Carver was overruled in 1865, Partnership Amendment Act, 28 & 29 Vict. c.86, the repealing statute did not legalise the en commandite form. It made the lender a deferred personal creditor of the partners, and involved no partnership rights whatsoever. In fact the Act merely gave statutory form to what had already been decided by the House of Lords in Cox v Hickman, (1860) 8 H.L.C. 268. The possibility of en commandite partnerships was introduced in 1867, 30 & 31 Vict. c. 131; but it was hedged round by so many restrictions as to make it unattractive. Only 6 partnerships were formed under it and two of them retained unlimited directors for only a short time.(Select Committee of the House of Lords on the Companies Bill, B.P.P. 1896, IX, 342, QQ 56-61; 1454-1462.)
The true en commandite partnership form was not introduced until 1907 by the Limited Partnership Act, 7 Edw. VII c. 24, by which time the growth of the private limited company had rendered it otiose.

118.Lowe was fully aware that the interest of the sleeping partner could be protected by the extension of full incorporation with limited liability to the partnership. He

rejected this course of action, however, on the grounds that:

"there was no particular demand for such an extension of the law"

and the incorporation of partnerships of less than 7, especially in the case of the single tradesman, would lead to "constant ambiguity" in regard to whether they were acting as agents of their business or on their own account. In the former case they would have limited liability in the latter they would not. Hansard (1856) CXL, 112-114.

119.The actual draftsman of the Act was Henry Thring, and the fact that he was apparently unaware of the possibility of partnerships and sole traders using the legislation he produced is evident from his book, The Joint Stock Companies Act 1856, pp.25-27.

120.E. Cox, The New Law and Practice of Joint Stock Companies, London, 1857. pp. xviii-xix.
Ireland, ibid. p.243, cites similar, and even earlier, awareness on the part of the M.P. Alexander Hastie, in Hansard, CLX, 642-645.

121.P. W. Ireland, The Rise of the Limited Liability Company, International Journal of the Sociology of Law, 1984. That work is a condensed version of an earlier unpublished work, The Triumph of the Company Legal Form 1856-1914. See also F. Wooldridge, The Private Company: Its Concept and Legal Characteristics, C.N.A.A. 1971, Ph.D. thesis.

122.The private company was recognised by the courts in re British Seamless Paper Box Co. Ltd. (1881) 17 Ch. Div. 467. The registration of the one-man business under the companies legislation was recognised as legitimate by the House of Lords in Salomon v Salomon & Co. Ltd. [1897] A.C. 22; reversing the decision of two lower courts in Broderip v Salomon [1895] 2 Ch. D. 323.

123.Companies Act 1907. S.37 provided that only two members were required to form such a company.

124.Ibid. p. 258. In 1925 of the 95,055 companies still believed to be trading 86,065 were private limited companies, op.cit.

125.Jeffreys, ibid., passim; Ireland, ibid. pp.247-249. Incorporation to avoid unlimited liability was only one way in which the joint-stock company form was subverted in order to avoid the consequences of the Great Depression of 1873-96. It was also used as a mechanism for the elimination of competition.
Engels' contemporary comment on this particular use of the company form in a footnote to vol.3 of Capital pp.437- 438,

which he prepared for publication in 1894, is confirmed by Leslie Hannah:

> "none the less not until the latter decades of the century that a systematic tendency to large-scale enterprises, created by sustained merger activity as opposed to occasional acquisitions and extended partnerships, appeared in manufacturing industry...a necessary condition for the development of merger activity in its new form was the extension to manufacturing industries of the facilities of limited liability and stock-market quotation.. what was new in the situation was that, with the availability of limited liability and stock exchange quotation, an alternative to restrictive practices or to internal growth and the elimination of rivals was opened up for entrepreneurs..The joint stock company merger creating a monopolistic or oligopolistic structure was now a possible option.",

Mergers in British Manufacturing Industry, 1880-1918, 1974, Oxford Economic Papers, vol.26.
See also Hannah, The Rise of the Corporate Economy, Ch.2; M.A. Utton, Some Features of the Early Merger Movements in British Manufacturing Industry, 1972, 14 Business History, pp. 51-60; P.W. Ireland, The Rise of the Limited Liability Company.

126.The opaque definition of the private company in the Companies Act 1985 as a company which is not public, does not reveal its true nature. The Companies Act 1848 was more revealing. It set out three requirements that had to be contained in the articles of any private company:

(1) a restriction on the right of the members to transfer their shares;
(2) a limitation of the number of members to fifty;
(3) a prohibition of any invitation to the public to subscribe for the shares or debentures of the company.

Only the third restriction is still a legal requirement, but restrictions on membership and share transfer are still generally included in the articles of private companies.

127.The right to participate in management is recognised by the courts in the case of the quasi-partnership, and is one of the characteristics which distinguish this particular type of private company: re Yenidje Tobacco Co. Ltd. [1916] 2 Ch. 426.

128.The particular problems which arise in relation to the valuation of shares in private companies will be considered in ch.4 infra.

Chapter Three: The Legal Nature of the Share.

I. Introduction.

The purpose of this chapter is to consider the change in legal understanding and regulation of shares in joint-stock companies which took place in the course of the nineteenth century as a consequence of the development of the share as a true money-capital form.

Some of the basic research on this topic has already been undertaken.[1] It is not the intention of this work to duplicate such work; for the main part the historical process is not contentious. It is necessary, however, to explain the change in the legal concept of the share, and this perforce requires that the same ground be covered in order to place it in the theoretical context of this thesis.

II. The Legal Reconceptualisation of the Share in the Nineteenth Century.

Shares in the earliest joint-stock companies were understood differently from the way they are understood today. In the sixteenth century the terms; share, portion, or part, were used in their most immediate sense, to designate a part of the company's business undertaking. They referred to a proprietary interest in the company's concrete capital; not to units of abstract fictitious capital. Thus:

> " The person, who owned one share in the Mines Royal considered himself as an owner of one twenty-fourth part of the whole, and similarly, if he had two shares, he thought of his property as a twelfth."[2]

That the judiciary continued to share this perception, is evident in the manner in which the legal concept of the share was developed in the course of the eighteenth, and early nineteenth century.

It has been suggested that:

> "The numerous old cases bearing on the nature of the share establish beyond reasonable doubt two propositions...(i) that a share was a right to an undivided part of the company's assets and (ii) that in the hands of a member it was an equitable, and not a legal, interest."[3]

In support of the contention that shares were originally considered as a fractional portion of the company's assets is the fact that the nature of the interest held by the shareholder depended on the nature of the assets owned by the company. Thus if the company owned realty the share was itself treated as realty[4], whereas if its assets were personalty the shares assumed the form of personalty.[5] This was the case whether the company was incorporated or not.[6] Also the fact that it was usual for acts of incorporation to make express provision for shares to be treated as personalty

suggests that they might otherwise have been treated as realty.[7]

Shareholders, however, were only the co-owners of the company's assets in Equity. Although the individual shareholder might hold an interest in realty, his interest was not a legal one; but was merely equitable. The company held the legal interest in the assets, as trustee for the shareholders as cestuis que trust. Authoritative support for this contention is both explicit[8], and implicit in the cases dealing with the fraudulent transfer of shares.

If shareholders had held a legal interest in the property represented by their share then in the case of a fraudulent transfer there could have been no question of those rights being lost to another party without the interference of the doctrine of estoppel. If, however, the share merely represented an equitable interest then innocent third parties might have acquired a good title to the property represented by the shares they acquired. In all the early cases in which this question arose the courts adopted the latter approach.[9]

The conception of the share as an equitable right to an undivided portion of the company's assets designated the shareholder as essentially an industrial-capitalist. The fact that he had a claim against the assets, be they realty or personalty, controlled by his company merely reflected the change undergone by his capital, from its money-capital form to its commodity-capital form, in the course of its cycle of

production. The movement represented diagrammatically in the form[10]:

M---C---P---C'---M'

This conceptualisation persisted throughout the eighteenth century[11], and for a considerable time into the nineteenth century. Thus in 1832 Lord Lynhurst could state that:

> " the persons who are shareholders are absolute holders of the entire interest in the property, whatever that is."[12]

In the course of the middle period of the nineteenth century[13], however, the legal nature of the share underwent a change. It began to be understood in its contemporary meaning, as a form of personal property, quite distinct, and independent, from the property of the company, whatever form the latter might take. That an appreciation of the increasing importance of the joint-stock company as an outlet for money-capital investment led to the legal reconceptualisation of the share is evident from the cases through which this process of change can be traced.

It is generally recognised that the first statement compatible with the contemporary perception of the share was expressed in Bligh v Brent.[14], and as such it merits close attention. The question before the court was whether shares in the Chelsea Waterworks Company could be bequeathed by a will not executed as required by the Statute of Frauds. The company's Act of incorporation, unusually, did not provide

for the shares to be treated as personalty, so the outcome depended on the general nature of shares.

Counsel for the plaintiff heir-at-law cited the previous authorities in support of his contention that as the company was trustee of its property for the shareholders, those shareholders' interests must be co-extensive with the legal interest of the trustee. And as the property of the company in question involved land its shares must be real property.[15] Surprisingly, the court evinced clear dissatisfaction with this, well substantiated, line of argument during its submission, and categorically rejected it in the course of its collective judgement. The shares in the Chelsea Waterworks Company were personalty irrespective of the nature of the property owned by the company.

The unanimous opinion of the court was expressed by Baron Alderson, whose judgement contains the following, extremely illuminating, passage:

> " It is of the greatest importance to look carefully at the nature of the property originally entrusted, and that of the body to whose management it is entrusted: the powers that body has over it, and the purposes for which these powers are given. The property is money - the subscriptions of individual corporators. In order to make that profitable, it is entrusted to a corporation who have an unlimited power of converting part of it

into land, part into goods; and of disposing of each from time to time; and the purpose of all this is the obtaining a clear surplus from the use and disposal of this capital for the individual contributors.

<u>It is this surplus profit alone which is divisible among the individual corporators.</u> The land or the chattels are only the instruments (and those varying and temporary instruments), whereby the joint stock of money is made to produce profit."[16]

and later:

" the property entrusted is money; the corporation may do what they like with it, and may obtain their profits in any way they please from the employment of their capital stock."[17]

In these passages it is possible to see the emergence of an understanding of the economic nature of the joint-stock company as a form of money-capital investment. And it is clearly that understanding which generated the change in the legal nature of the share. Alderson distinguished between a claim against the product of assets, and a claim against the assets themselves; and recognised that the typical investor was interested in the end product of the production process, rather than in the actual process itself. In other words the main concern of the shareholder was profit, and the share represented a claim over profit rather than an interest in

the assets which generated it. It was on such an understanding that the share appeared as personalty, irrespective of the legal form of the company or the assets owned by it.

The passages also show, however, that the process whereby concrete capital is transformed into abstract money-capital, and the shareholder rendered a pure money-capitalist, was not as yet complete, either in practice or legal theory.

Two essential attributes which characterise the joint-stock company as a money-capital form were evident. The individual shareholders gave up the right to recover their invested capital directly, and could only realise it through the transfer of their shares; and the actual day to day operation of the capital fund was left under the control of a limited number of people, the directors and the managers. The members, however, as a collectivity, i.e. as a corporation, still retained the power, at least in theory, to supervise and exercise control over the operation of the capital fund.[18] The shareholders were seen as providing a capital fund, which was to be operated collectively as so much industrial-capital by the corporation, which was the "metaphysical body" constituting the corporators as a body.[19] Hence they retained the potential power, as a body, to function as industrial-capitalists.[20]

On the basis of his examination of Bligh v Brent, D.G. Rice concluded that:

"As a direct corollary to shares becoming invariably regarded as personalty irrespective of the nature of the company's assets, it was no longer possible to look upon a share as a right to an undivided part of the company's property."[21]

Although the facts of that claim are undeniable, the foregoing analysis has demonstrated that Rice has reversed the causal relationship. Shares became personalty because they no longer represented a claim against the assets, and not vice versa as he suggested.[22]

In 1838 the Court of Exchequer confirmed its judgement in Bligh v Brent in Bradley v Holdsworth.[23]

The court in Bligh v Brent had distinguished the authorities upon which counsel for the plaintiff relied. The New River cases[24] being distinguished on the grounds that the shareholders there had retained title to the real estate concerned, whilst the company had only been granted management power over it.[25] Buckeridge v Ingram[26] had been distinguished on the fact that the Avon Navigation company had not been incorporated.[27]

In relation to this second line of distinction, although emphasis was placed on the fact that the Chelsea Waterworks was incorporated, a reading of the judgement suggests its justificatory rather than explanatory role in the actual decision. It was, however, to prove the basis for the troublesome case of Baxter v Brown[28] in which it was held

that the legal, rather than the economic, form of the business association concerned was paramount in determining the nature of its shares. In the case of an unincorporated association, in which the legal title to business assets was held on trust, the shareholders retained an equitable interest in those assets. As a consequence, in the case in point, thirty seven individuals were held to satisfy the property qualification for voting on the basis of their shareholdings in an unincorporated undertaking, which had been formed to oversee the operation of a fulling mill.[29] A view contrary to that stated in Baxter v Brown, and the first categorical statement that the nature of the share depended on underlying economic form rather than the legal form assumed by it, was provided in 1846 by Lord Langdale M. R. in Sparling v Parker.[30] In considering whether shares in various joint-stock companies, some only of which were incorporated, were realty within the provisions of the Mortmain Act, he expressed the view that:

> " A shareholder in one of these companies, whether incorporated or not, has a right to receive the dividends payable on his share; i.e., a right to his just proportion of the profits arising from the employment of the joint-stock, consisting partly of land; and he also has a right to assign his share for value; but whilst he continues to hold his share he has no interest or separate right to the

> land, or any part of it.....a shareholder in such joint stock companies as those which are now under my consideration is not in that character or right entitled to any such estate or interest in land , as falls within...the Mortmain Act.. If the company continues, the share is transferable only for money. If the company be dissolved, the whole property is sold, the concern is wound up, and the shareholder obtains only his share of any surplus, which there may be after satisfying all demands on the joint concern."[31]

Lord Langdale not only refused to distinguish between joint-stock companies on the basis of their legal form, but also recognised that the legal nature a share in such companies stood to be determined, on the basis of the particular economic function it performed, as a distinct form of property.

The above passage exhibits a clearer analysis of the shareholder as money-capitalist, than was found in Alderson B's Judgement in Bligh v Brent. Attention is still focussed on the shareholders interest in profit rather than the assets which generate that profit. There is, however, an increased awareness of the externality of the individual shareholder to the actual process whereby the profit is produced, apparent in the emphasis placed on the transferability of the share. The property rights embodied in the share are: firstly, the

right to participate in profits; and secondly, the right to transfer one's interest. Of these rights it is the latter, together with the existence of a ready market for such titles to revenue which permits the shareholder to assume the role of a money-capitalist; or more accurately permits money-capitalists to assume the role of shareholders.

Lord Langdale continued his analysis of the nature of the share in Walker v Milne[32], in which, in spite of being made aware of a previous decision of Sir John Leach's to the contrary[33], he adhered to the opinion he had already expressed in Sparling v Parker. In the course of his judgement he referred to the difficulty of applying the Statute of Mortmain to shares. In his view:

> "The species of property now under the consideration of the Court was never contemplated when the Mortmain Act was passed....
> We are now applying this Act to a new state of things, which has since arisen, to joint stock companies, which have created a new species of division of property among numerous parties, and to new rights, which, within a very few years, have been brought into existence."[34]

According to Lord Langdale, therefore, the development of joint-stock companies had given rise to a new species of property which the law had to accommodate.

Another judge who was endeavouring to facilitate this articulation of legal with economic form at this time was Sir J. Knight-Bruce V.C. In Ashton v Lord Langdale[35] he expressly approved Sparling v Parker and Walker v Milne in holding that shares in various companies, some of which were not incorporated, were not realty within the control of Mortmain.[36] In the course of so doing Knight-Bruce felt compelled to express his strong dissent[37] from the previous judgement of Sir Lancelot Shadwell V.C. in Myres v Perigal[38], that shares in an unincorporated company were in the nature of realty. Shadwell V.C.'s judgment, however, was only the first of many, as Myres v Perigal, made its way through various courts in the period between 1849 and 1852.
The appeal from Shadwell's original decision came before Lord Chancellor Truro in November 1851[39] and, as he recognised, by that time the increased importance of the company form made it imperative to settle precisely what rights appertained to shares in such associations. In pursuit of an authoritative decision Lord Truro proposed submitting the question to a court of law for its opinion before a final judgement was delivered. This proposal, however, did not prevent him from considering the nature of the problem before him, and his observations reveal a failure to appreciate the essential nature of the joint-stock company. It is apparent from his language throughout that, although he left the question open, as far as he was concerned, the legal form under which the

business association operated should determine the nature of the interest represented by the share; and that unincorporated companies should be treated as ordinary partnerships.

The Court of Common Pleas declined to recognise any distinction between incorporated and unincorporated companies in respect of the nature of their shares, and stated, without expressing any reason, that the shares in question were not within the restrictions of Mortmain.[40]

The case then returned for the hearing of the original appeal; by then, however, Lord Truro had been replaced, as Lord Chancellor, by Lord St. Leonards. In December 1852 the latter delivered his judgement that the shares were not realty subject to the Statute of Mortmain.[41]

According to St. Leonards:

> " If we look at the intention of the purchaser of these shares, it is obvious that he no more intended to buy an interest in real estate, which might form part of the partnership property, than to buy a portion of the real estate for his own use....[his] whole interest in the property of the company is with reference to the shares bought which represent their proportions of the profits."[42]

The company was not incorporated and its legal form, therefore, was that of a partnership; but the shareholder

still acquired no interest in the partnership property, other than the right to receive the profits generated by its productive use.

In Watson v Spratley[43] the question to be decided was whether the sale of shares in an unincorporated joint-stock company operating a mine on the cost-book principle, was to be treated as a sale of realty for the purposes of section 4 of the Mortmain Act. The court was divided on its approach. Martin B., stated that his

> " judgement was founded on the essential nature and quality of a share in a joint-stock company"[44]

and held that the shares were not an interest in land. Platt B. concurred in this conclusion but whereas he did not deliver an extensive judgement, Martin B delivered a reasoned judgement of commendable clarity. Martin began his judgement by distinguishing between ordinary partnerships and joint-stock companies on the basis of the transferability of the share in the latter organisation;

> " the right [of the member of a joint-stock company] at his pleasure to sell his share, and insist upon the vendee being accepted as a member of the partnership in his place or stead."[45]

He then considered the nature of the claim represented by the share, and concluded that:

> " the shareholder has only the right to receive the dividends payable on the share, that is, a right to

his just proportion of the profits arising from the employment of the joint stock, consisting indeed partly of land; but whilst he holds his share, he has no interest or separate right to the land, or any part of it."[46]

On the basis of the similarity of interests represented by shares of both incorporated and unincorporated companies he concluded that they were merely different examples of a larger category: the joint-stock company. With regard to incorporated companies the law had been stated in Bligh v Brent, and was to be applied equally to unincorporated companies. To treat them differently:

> " would make a distinction between shares in one species of joint-stock companies and another, which persons not acquainted with the law would not readily appreciate or understand. I think, however, there is no such difference. In substance and reality, the interest of the shareholder in the unincorporated mining company and in the incorporated joint-stock company is exactly the same. In both it is an interest in the ultimate profits."[47]

It is apparent that as far as Martin was concerned the legal form of the company did not affect the nature of the share, but rather the reverse. In any event the point had

already been decided to that end in Sparling v Parker, and Myres v Perigal; which decisions he was content to follow. Parke B. agreed that shares in incorporated companies were not realty. He also accepted that shares were personalty in some unincorporated companies; i.e:

> " joint-stock companies, where the persons seised of the realty hold in the same way as the corporation...in trust only to use the land, make profits as part of the stock in trade, and then to divide those profits between the shareholders, whose only interest is in those profits."[48]

Where, however, Martin had sought to marginalise Baxter v Brown[49] by restricting its application within the sphere of "common partnership", Parke permitted it scope in relation to unincorporated joint-stock companies.

Instead of differentiating strictly between joint-stock companies and partnerships on the basis of their economic structure, he permitted the possibility of real property being held on direct trust for the members of an unincorporated company. As a consequence he retained an element of confusion between what were two distinct economic forms of business organisation. Whether real property was held on trust or not was a matter of fact for a jury to decide. Alderson B. agreed with this conclusion, although he did permit himself to express the opinion that the immediate case did not involve a direct trust of the mine.[50]

If Parke B reintroduced the possibility of treating joint-stock companies as partnerships, it was a slight one; and one that was soon overcome[51]. Certainly his challenge was insignificant in comparison with the direct rejection of the reconceptualisation of the share to be found in cases decided by Sir John Romilly when he was Master of the Rolls.

In Ware v Cumberledge[52] he had to deal with the incorporated Grand Junction Waterworks, whose Act of incorporation had failed to provide that its shares be treated as personalty. Romilly rejected any fine legalistic distinction between incorporated and unincorporated companies, citing Myers v Perigal, and Ashton v Lord Langdale in support; but quite astonishingly, given those authorities, he held that shares in such a company as a waterworks, where there was no express clause to the contrary, were within the various restrictions of the Mortmain Act. As he stated:

> " The view which I have always taken of this subject is that where the substance of the undertaking is a dealing with land, and that land is of the essence of the thing which creates the junction of these parties together, whether incorporated or not, the case falls within the Statute of Mortmain"[53]

This view reflected a failure to differentiate between the joint-stock company and the ordinary partnership as distinct economic forms.[54] One can ascribe such a failure of

perception to either complacent obtuseness or willful disingenuousness; with the former explanation the more likely.

Romilly reached his conclusion in Ware v Cumberledge in spite of being informed of, and considering, a recent decision to the contrary delivered by Wood. V.C. in Edwards v Hall. When that case subsequently went on appeal before Lord Chancellor Cranworth, he reasserted the authority of Myers v Perigal.[55] Sir John, however, persevered in his approach and, four years later in 1859, in Morris v Glynn he repeated his opinion.[56] The relationship to land was the determinant factor in deciding the nature of shares in a company, whether it was incorporated or not. As far as he was concerned:

> " The only question is, whether the substantial nature and object of this company is a dealing with the land for the purposes of making profits out of it. If it be, then, in my opinion, the bequest is obnoxious to the statute [of Mortmain], but if the holding of land be only ancillary to an ordinary trading purpose, then it is not."[57]

As the case involved an unincorporated mining company Romilly held that its shares were to be treated as realty and subject to the restrictions of Mortmain.

Romilly's decisions were clearly anachronistic and anomalous, and represented the residual resistance to the process of legal reconceptualisation that both the joint-stock company

and the share had undergone in the course of the period under consideration.[58] So it should not be surprising that by 1880 the Court of Appeal was able to demonstrate the extent to which the judiciary had come to comprehend the joint-stock company as a distinct economic form and had fully assimilated the change that this necessarily involved in the legal nature of the share. This definitive exegesis was delivered in Ashworth v Munn[59], in which a testator left the proceeds of the sale of his share in the property of a partnership, in which he had been a member, to various charities. Part of the property of the partnership consisted of real property and it was argued that, as a consequence of this, the share represented an interest in land subject to the restrictions of the Statute of Mortmain. Counsel for one of the charities maintained that there was no distinction in principle between shares in public companies and ordinary partnerships, and that the share in the partnership in question was not therefore controlled by the Mortmain provisions. This argument was clearly and firmly rejected by the court: shares in companies and partnerships were distinct and were not to be treated in the same way. In distinguishing the two forms, all three of the judges involved stressed the free transferability of the share in the joint-stock company. According to James L.J. companies were:

> ..." intended to have perpetual existence, and they are all intended to exist with fluctuating bodies

of members from time to time, just like a corporation. Then no partner is ever supposed to have anything to do with the land except as one of the society through the machinery provided by the Act or deed of settlement, and is never intended to have anything to do with the land in any shape or form except to get the profits from the land or the profits from the business of which the land is part, and <u>it is always intended that every share should pass in the market as a distinct thing, and in point of beneficial ownership wholly unconnected with the land or with the real assets of the partnership property of the company</u>."[60]

Such was the case whether the company was incorporated or not; but in the case of the ordinary partnership matters were different.

The importance of the manner in which the interest represented by the share was realised, in distinguishing the share in the unincorporated company from the partnership, was equally emphasised by Cotton and Brett L.J.J. According to the former, the unincorporated company in <u>Myers v Perigal</u>, stood on different ground from the association under immediate consideration:

" There is the great distinction that the shares in that case from the constitution of the company were capable of being realized without winding up the

> concern, and therefore what the charity took was a share which it could sell in the market or might hold without any objection as to its being an interest in land, whereas, in the present case, the interest of the testator in this partnership property could only be realized by requiring the assets to be realized, that is, that the particular asset should be sold and a portion of the proceeds of sale paid to him."[61]

All three judges agreed that the interest represented by a share in an ordinary partnership owning realty was itself realty for the purposes of the Statute of Mortmain.[62] The reason for this conclusion being the lack of scope for realising the interest, without the necessity of winding up the business concern; for that would involve:

> "...for the purposes of realizing that which he gives to the charity, the necessity of dealing with land, and gives him, for the purposes of so dealing as to realize his interest, an interest or charge upon land."[63]

It is clear from this decision that it was the economic, rather than legal form which distinguished the joint-stock company from the partnership. Even although the legal form of the unincorporated company and the partnership were essentially the same they were viewed, and treated, differently. The unincorporated company, the money-capital

form, shares in which merely represented a claim against profits, possessed the same economic traits as the incorporated company, and was to be regulated in a similar fashion. The partnership on the other hand constituted a discrete form of organization for the operation of industrial-capital and was subject to its own distinct regulation.

III. The Share as a Chose in Action.

As a consequence of the process of reconceptualisation considered above the share is no longer seen as representing a claim against the assets of the company, but is understood as a claim against the income generated by those assets[64], together with any particular rights set out in the company's memorandum or articles of association, or otherwise provided by the Companies Acts. It cannot be denied, however, that even the leading judicial pronouncements as to the nature of the share tend to be inadequate to the task of precise definition. For example according to Lord Wrenbury:

> " A share is, therefore a fractional part of the capital. It confers upon the holder a certain right to a proportionate part of the assets of the corporation, whether by way of dividend or distribution of the assets in winding up. It forms, however, a separate right of property. The capital is the property of the corporation. The share,

> although it is a fraction of the capital, is the property of the corporator. The aggregate of all the fractions if collected in two or three hands does not constitute the corporators the owners of the capital- that remains the property of the corporation. But nevertheless, the share is a property in a fraction of the capital....[65]

Such a statement is neither coherent nor particularly helpful, although it does at least emphasise that the share constitutes an object of property in its own right, apart from the assets of the company. Even the classic definition of the share provided by Farwell J. is not without shortcomings. Thus:

> " A share according to the plaintiff's argument, is a sum of money which is dealt with in a particular manner by what are called for the purposes of argument executory limitations. To my mind it is nothing of the sort. A share is the interest of a shareholder in the company measured by a sum of money, for the purposes of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se in accordance with [what is now S. 14 of the Companies Act 1985]. The contract contained in the articles of association is one of the original

incidents of the share. A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount."[66]

The above passage is generally cited as the definition of what a share is, and to that extent the sections underlined are not usually cited.[67] Those sections are important, however, in defining what the share is not; it is not industrial-capital, merely assuming the transitional form of money-capital in the course of its productive cycle. It is implicit from such a reading that the share is essentially a money-capital form, but the failure to define the actual nature of the interest represented by the share, other than on the basis of the rights contained in the memorandum and articles, leads to the lack of certainty in regard to the return commanded by it, evident towards the end of Farwell J's definition.

It is generally agreed that the nature of the claim represented by the share is most adequately encompassed within the general legal category of choses, or things, in action of a proprietary nature.[68] Originally the term "chose in action" meant a right of action and nothing more. As in the case of a debt, it represented the right to sue to recover money or property, rather than any specific object of

property in itself. But the concept was expanded through a process of analogy to cover rights of a proprietorial nature not in possession, such as rights of entry.[69] And in the case of shares the term has been extended to cover objects more immediately in the nature of property.[70] Thus the meaning of the term chose in action, according to Halsbury's Laws,

> " has varied from time to time, but is now used to describe all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession "

and is used in respect of both corporeal and incorporeal personal property which is not in possession.[71]

Opinion as to the adequacy of such categorisation of shares differs[72], but little attention has been paid to one critical feature of choses in action: the fact that they are not transferable at common law.[73] The common law rule against the assignment of choses in action was a consequence of their original nature, being designed to prevent maintenance and champerty. There were three exceptions to the rule:

1. Assignments could be made to and by the Crown. This exception is of no immediate interest.
2. Assignments of particular choses in action, such as bills of exchange and promissory notes, were permissable under the law merchant. Although of considerable interest and importance in the

development of capitalist commerce and law, this again is not the immediate concern of this work.

3. Statute law, of course, could relax the common law rule to permit the assignment of particular choses in action by means of the procedure detailed in the statute.[74]

The earliest joint-stock companies, created by charter, were granted the privilege of having transferable shares, and although the power of the Crown to grant such a privilege was questionable[75], no cases arose relating to the question of the assignability of such shares.[76] Companies incorporated by special acts of parliament which expressly provided for the transfer of shares were within the third exception above[77]; as were companies registered under the various Companies Acts.[78]

To the extent that the transferability of shares in such companies was not subject to the common law rules relating to assignment, no significant difficulty arose from their categorisation as choses in action. Problems did arise, at least in theory, with regard to shares in unincorporated deed of settlement companies, established prior to the first Joint Stock Companies Act in 1844. Such companies possessed no exemptions from the common law and therefore shares in them, as choses in action, should have been governed by the common law rule prohibiting their assignment. The effect of such a restriction, however, would have deprived the share of

liquidity and prevented it from operating as a money-capital form. As the facility to realise investment through the transfer of shares is essential for the money-capitalist shareholder, in order for him to maintain his position as such, and was one of the attributes which distinguished the joint-stock company from the partnership,[79] the Courts, were faced with a conflict of legal rule and economic requirement, in respect of shares in unincorporated deed of settlement companies. In the event the former gave way.

IV. <u>The Transferability of the Share.</u>

The process of reconceptualising the share, which the courts engaged upon during the middle period of the nineteenth century, necessarily involved a consideration of the transferability of the share as well as the nature of the claim it represented.

The Bubble Act[80] had been aimed at some specific undertakings and more generally at "undertakings and attempts tending to the common grievance, prejudice, and inconvenience of His Majesty's subjects". Amongst these latter it particularly condemned those which presumed to act as a corporate body; and declared illegal the raising of a transferable stock, or the transfer of such stock without the legal authority of either a charter or an Act of Parliament.[81] Contemporary legal opinion supports the conclusion that the creation of a large stock of freely transferable shares was the evil at

which the Act was aimed, but also suggests that the statute merely provided a more expeditious way of restraining activity that was already an offence at common law.[82]
For the first thirty years or so after the passing of the Bubble Act it was the practice for the articles of agreement of such unincorporated companies to contain limitations on the freedom to transfer shares, but such limitations became less usual by the middle of the eighteenth century.[83]
Given the hysterical and imprecise language of the Bubble Act, together with the dissipation of the speculative crisis which gave rise to it, it is not as surprising as it might at first appear to note that in the years between 1723 and 1808 there were no recorded instances of the Act being invoked against any deed of settlement company. In 1808, however, the Bubble Act was re-activated in an endeavour to deal with the proliferation of unincorporated joint-stock companies.
In R v Dodd.[84], Lord Ellenborough declined to enforce the statute. The reasons for this refusal was partly the length of time since the legislation had last been used, and partly the fact that the individual who had raised the action had not claimed to have been deluded by the project under consideration. The court did, however, recommend:

> " as a matter of prudence to the parties concerned, that they should forbear to carry into execution this mischievous project, or any other speculative

project of the like nature, founded on joint stock and transferable shares..."[85]

In Buck v Buck and R v Stratton[86] actions arising from the operation of unincorporated companies were nonsuited on the basis of the illegality of the companies under the Bubble Act. In R v Webb [87], however, it was held that an unincorporated company whose constitution permitted only a limited right of transfer of its shares was not in breach of the Act. In delivering the judgement of the court Lord Ellenborough pondered the general legality of unincorporated companies with transferable shares under the Act:

> " It may admit of doubt, whether the mere raising transferable stock is in any case, per se, an offence against the Act, unless it is has relation to some undertaking or project which has a tendency to the common grievance...But...It was not the object of the undertaking to raise stock for the purposes of transfer, nor to make such stock a subject of commercial speculation or adventure..."[88]

and for that reason the raising of the capital by subscription for shares which bore a qualified right of transfer was not covered by the Act. It is apparent that the court considered that share speculation was an abuse at which the Bubble Act was aimed, as tending to the common grievance.

Lord Chancellor Eldon's opposition to unincorporated joint-stock companies together with his opinion as to their illegality is clearly evident in his judgement in Ellison v Bignold[89]:

> "...when a number of persons undertake to insure each other, if the shares and interests in the money that is laid up, be not assignable and transferable to any persons who are not members, the society is not illegal; but if there may be assignments and transfers of the shares, I have understood that made it illegal."[90]

In Kinder v Taylor[91] Eldon L.C. cast doubts on R v Webb in expressing his view that the raising of a transferable stock was illegal as being sufficient to amount to acting as a corporation without authority.

This antagonistic approach to joint-stock companies was taken up in Josephs v Pebrer[92], in which it was held that an unincorporated company, The Equitable Loan Bank Company, was illegal in that it purported to provide unrestricted freedom in respect of the transfer of its shares. Aboott C.J. revealed the underlying reason for this view to be the speculative rather than the investment nature of shareholding in contemporary companies:

> " unless we shut our eyes altogether to what is going on in the world, we cannot help observing that in other companies and associations the sale

and transfer of shares at enormous premiums is carried on to a greater extent than was ever known, except at the period when the statute referred to was passed The necessary effect of such a practice is to introduce gaming and rash speculation to a ruinous extent."[93]

When the Bubble Act was repealed in June 1825 the Act of repeal provided that "the several undertakings attempts and practices aforesaid (i.e those previously covered by the Bubble Act) should be adjusted and dealt with according to the common law."[94] The question that was now to exercise the courts was as to precisely how the common law viewed unincorporated companies purporting to have freely transferable shares. There was no doubt that acting as a corporation without authority of a charter of act of parliament was an offence at common law. But what constituted acting as a corporation; and did merely having a freely transferable share capital suffice? Answers to those questions differed between those judges, such as Lord Eldon, who had seen companies as inherently pernicious, and those such as Lord Ellenborough who had seen them as evils only to the extent that they were used as mechanisms for fraud.

In Duvergier v Fellows[95], Best C.J. revealed himself to be an adherent of the former approach. It was apparent to him that the Patent Distillery Company was:

" one of those bubbles by which, to the disgrace of the present age, a few projectors have obtained the money of a great number of ignorant and credulous persons, to the ruin of those dupes and their families, and by which a passion for gambling has been excited, that has been most injurious to commerce and the morals of the people."[96]

No doubt this view as to the speculative nature of joint-stock companies informed his conclusion that claiming to possess a transferable stock, without the sanction of parliament, was pretending to act as a corporation, and in contempt of the Crown by usurping its prerogative.[97]

Lord Chancellor Brougham adopted an approach to unincorporated companies which mixed legal conservatism and economic pragmatism in equal measures in Walburn v Ingilby in which he stated that:

" To hold such a company illegal would be to say that every joint stock company not incorporated by Charter or Act of Parliament is unlawful, and, indeed, indictable as a nuisance, and to decide this for the first time, no authority of a decided case being produced for such a doctrine."[98]

Lord Brougham was not prepared to reach such a conclusion. Nor, however, was he was willing to accept that the plaintiff actually held shares without proof that a transfer had been made in accordance with the requirements of the company's

deed of settlement. The holding of shares was not sufficiently known in the law to make its mere allegation sufficient to found an action. Indeed he even asserted that shares, or their purchase were not known in law.[99]

The conflicting decisions in Walburn v Ingilby and Duvergier v Fellows were cited in argument before Shadwell V.C. in Blundell v Winsor[100], and he expressly approved the latter. Such companies as the unincorporated Anglo American Gold Mining Association which purported to have freely transferable shares were illegal. By inference, the deed represented that any person who should assign his shares would, at the same time, get rid of any liabilities attached to them. In effect passing such liability on to the person to whom the shares were transferred. According to Shadwell, as that procedure could not legally be undertaken, the deed amounted to a false and fraudulent inducement.[101]

By the fourth decade of the nineteenth century, however, judicial attitudes to joint-stock companies were changing in correspondence with the increasing importance of joint-stock companies as sources of investment rather than as objects of mere speculation. Crucial to this development, was the fact that the member of a joint-stock company was in a position "to retire and withdraw his capital from the concern without a dissolution of the partnership, by transferring his shares to another".[102]

In relation to the transferability of shares, the consequence of this altered perspective was apparent in Tindal C.J.'s judgement in Garrard v Harding.[103] In holding that the unincorporated Limewick Marble and Stone Company was not an illegal association at common law simply because its shares were transferable he made the following pertinent statement:

> " The raising and transferring of stock in a company cannot be held, in itself, an offence at common law: such species of property was altogether unknown to the law in ancient times: nor indeed was it in usage and practice until a short period antecedent to the passing of the [Bubble Act]; as is evident from the preamble to the 18th section...evidently shewing that the act was looking to some grievance of late introduction."[104]

Tindal C.J. continued this more accommodating approach to companies in Harrison v Heathorn.[105] This case is of particular note for the fact the company concerned was the Anglo American Gold Mining Association; the very same company as had been held to be an illegal association in Blundell v Winsor. Not surprisingly Blundell v Winsor was cited by counsel during the pleadings, together with Duvergier v Fellows.

Although Shadwell V.C's reasoning in Blundell v Winsor was questionable, Tindal C.J. chose not even to consider it, and

satisfied himself with, once more, distinguishing Duvergier v Fellows, to reach the conclusion that:

> " The raising of transferable shares of the stock of a company can hardly be said to be of itself an offence at common law; no instance of an indictment at common law for such an offence at common law can be shewn, the raising of stocks with transferable shares being indeed a modern proceeding; and the very great particularity described in the statute seems to show that it was an offence created by the statute only."[106]

The transfer of shares may not have constituted an offence under the common law, but such a conclusion does not in itself affirm the validity of such transfers; and it is suggested that, as choses in action, shares were not capable of transfer at common law.

With the passing of the 1844 Joint Stock Companies Act, and the recognition of the right to transfer shares in the quasi-corporations created under that statute, the question as to the common law power of unincorporated companies to have transferable shares was seldom raised.[107] The focus of attention shifted to a consideration of the effect of share transfers on existing and future liabilities for the company's debts.

The 1844 Act retained unlimited liability in regard to former shareholders for three years after transfer in regard to

debts which had been contracted when the shareholder was a member and which the company could not satisfy.[108]

In regard to unregistered deed of settlement companies the courts had held, in both Duvergier v Fellows and Blundell v Winsor, that attempts to transfer shares, so as to place the assignee in the former position of the assignor through assuming all his rights and liabilities, were not possible at common law, and rendered any unincorporated company purporting to have this privilege illegal. A possible change in approach is suggested in Pinkett v Wright in which Wigram V.C. had expressed the view that:

> "The consequences which, as between a shareholder and the company, arise by operation of law alone upon a transfer of shares cannot therefore be inferred from those which attach upon the dissolution of an ordinary partnership."[109]

By 1852 in Cape's Executor's Case Lord Chancellor St Leonards, in relation to shares in an unincorporated banking company, stated that:

> " If...the case depended upon the simple general rule independently of the clauses of the deed, my opinion would be that a person buying a share in the company must also take a share in its debts and liabilities as he finds them."[110]

A similar approach was adopted by the Court of Appeal in Fenn's case[111] and Mayhew's case[112] in relation to an

unincorporated cost-book mining company. In the latter case Cranworth L.C. clearly distinguished between ordinary partnerships, in which the transfer of interest was not possible, and joint-stock companies in which such transfer was possible. The effect of the transfer <u>within</u> the joint-stock company was that the transferee was to all intents and purposes substituted for the transferor:

> " ...when a partnership is constituted of several hundred persons, and its articles stipulate that any shareholder may transfer, the meaning necessarily is, that he may so transfer as to put the transferee in the place of him the transferror..."[113]

In relation to those <u>outside</u> the unincorporated company, their rights were not affected by the transfer of shares, and the original shareholder remained liable for any debt contracted before the share transfer. Such unincorporated companies were merely partnerships in legal form, and were still subject to partnership law in respect of external liabilities.[114] The position was most appositely stated by Blackburn J.in <u>Lanyon v Smith</u>[115] in respect of a cost book mine, which was also nothing more than a partnership with transferable shares at common law :

> " The defendant became liable for this debt in common with the other partners in the mine, but when he ceased to be a partner he by no means got

> rid of his liability at common law for the debts contracted during his time, but he was not liable for any future debts contracted by the surviving partners. The surviving partners constituted a new partnership, and the defendant was not liable for their debts."[116]

The foregoing has traced the process whereby the courts came to recognise and sanction the ability of what were, in legal form, merely partnerships to have transferable shares; and thus to permit them to operate, at the economic level, as joint-stock companies. In this particular element of the wider process of reconceptualisation undertaken in regard to the share it is noticeable that the nature of the share as a form of property is not addressed in any detail.[117] It is suggested that this lack of consideration may have been deliberate. At the same time as the transferability of the share was being considered, it was being determined that it was:

> " not an interest in the real or personal property of the company...; but [was] merely a right to have a share of the profits of the company when realized and divided amongst its members."[118]

This begs the question as to the exact legal nature of this right represented by the share. In regard to registered companies it mattered not whether shares were categorised as choses in action, as they were expressly made transferable by

statute; but in unregistered companies the fact that shares were choses in action should have meant that they were not transferable at common law. It was only by considering the characteristics of the share, its transferability and its nature as a chose in action, in isolation that the contemporary legal conclusion could be reached; that the share is a chose in action with the peculiar characteristic of being transferable at common law.[119]

V. The Transferability of the Share and the Companies Act 1867.

The foregoing has demonstrated how the legal nature of the share underwent a process of reconceptualisation at the hands of the judiciary as it developed as a money-capital form. One of the key attributes of the share which generated this change, and which in turn received the benefit of it, was transferability. It was the transferability of the share that permitted the shareholder to maintain his position as a money-capitalist by allowing the realisation of his investment. As Lord Blackburn recognised, the great object in the establishment of joint-stock companies "was that the shares should be capable of being easily transferred."[120] As has been seen the 1844 Act provided for the transferability of shares and in any case the judiciary were willing to recognise such transfers apart from legislative provisions. The right of transfer was recognised as a

fundamental attribute of the share and, in the absence of provisions in the articles to the contrary, was not to be impugned.[121] This right was sacrosanct, even in cases where shares were transferred to a man of straw in order to permit the transferor to avoid liability[122], and even where the transferor paid the transferee to accept the shares.[123]

In the mid-1860s, however, the transferability of shares came up against constraints which the legislature had to remove. On the basis of an analysis of a random sample of company registrations, P.L. Cottrell concluded that during the period from the mid 1850s to the early 1880s the majority of company securities issued were ordinary shares of a value of £10 or less, with an average of 25% initially paid up.[124] During the company flotation boom which followed the Companies Act of 1862, however, companies tended to be created with shares of high denomination with a large part unpaid.[125] The justification for this practice was that the unpaid element of share capital should constitute a reserve capital fund, and thus act as security against which creditors could rely in the event of the company being wound up. In practice, however, this intention proved misconceived as the crisis prompted by the failure in 1866 of the recently converted company of Overend, Gurney soon revealed.

As regards the element of creditor security there was no guarantee that speculative shareholders would be able to cover the unpaid part of the capital. More importantly,

however, from the point of view of this thesis, the large overhanging liability prevented the shares from functioning adequately as money-capital. One reason for this was that non-speculative investors had to retain sufficient funds uninvested, and therefore unremunerative, in order to cover the unpaid portion of the share capital in which they had invested. In addition the large unpaid element effectively ensured that shares could not be readily transferred in the face of reluctance on the part of purchasers to accept the potential liability that such shares necessarily involved. This situation, in which shares tended to lose their capacity to function as money-capital by losing their transferability in practice was exacerbated by the fact that the 1862 Companies Act did not provide for the reduction of capital in any form. In re Financial Corporation the Court of appeal held that S.12 of that Act did not warrant the sub-division of shares let alone the actual reduction of a company's share capital[126]; and in The Droitwich Patent Salt Company, Ltd. v Curzon[127] it was decided that a company originally formed under a deed of settlement which permitted it to reduce its capital, lost that power when it registered under the 1862 Companies Act.

The difficulties of this situation were repeatedly cited before the 1867 Select Committee on the Limited Liability Acts.[128] The company promoter David Chadwick cited the case of Bolckow & Vaughan which had issued shares of £100

denomination on which only £25 was paid up. In his opinion the need to keep a reserve available equivalent to the unpaid part of the shares "operated very injuriously upon the capitalists of the country, and especially the prudent and small capitalists"[129] The City banker W. Newmarch estimated the extent of this injury as follows:

> "an amount of capital, probably of not less than £30,000,000, which has been invested in the shares of limited liability companies, is rendered practically unmarketable in consequence of the impossibility of reducing the denomination of the shares of those companies to some proportion more adequate to the kind of business to be carried on.The money is there and is invested in those companies, and must remain there; but the owners of that capital are unable to bring it to market at all..."[130]

H.D. Pochin, a director of a chemical company and the Mayor of Salford, offered advice:

> "I think it is important that the committee should render these properties as negotiable as possible, and I think that some alteration in the law is necessary to do that. At present, perhaps, hundreds of millions of property which is subscribed to those limited liability companies is not

negotiable, and I think that a great part of it may be made negotiable."[131]

The Select Committee accepted Pochin's advice and recommended that, with the provision of safeguards for creditors, companies should be granted the right to reduce their capital, or to reduce the amount of their shares, or both; and the recommendation of the Committee was given statutory form in the Companies Act 1867

It can be concluded, therefore, that the 1867 Act was specifically designed to provide facilities for improving the transferability of shares. M Rix underestimated the importance of the 1867 Act: the ability to reduce nominal capital was not, as she suggested, a concession simply to improve the situation of shareholders[132]; it was essential to shares generally to enable them to function in their appropriate role as money-capital.

Chapter Three: Endnotes.

1.D.G. Rice,"Legal Aspects of Shareholders Rights", Ph.D., London School of Economics, 1955. Chapter one is substantially reworked as "The Legal Nature of the Share" in "The Conveyancer" Vol.21, pp.433-447.
The same ground was originally covered by Samuel Williston in "The History of the Law of Business Corporations Before 1800" in "Harvard Law Review", 1888, vol.11, pp 105-124; & 149-166. A more thorough treatment of the subject area is to be found in P.W. Ireland's, unpublished, "The Reconceptualisation of the Share and the Origins of Separate Personality."

2. W.R. Scott, Joint Stock Companies to 1720, Vol 1 p. 45. Scott, at p. 61, touches on the process whereby concrete capital is transformed into abstract capital through its transfer; but he also mentions the reason why such a process could only be an inchoate one at that stage, the fact that the freedom of transfer was relative rather than absolute.(at p. 45.)

3.D.G. Rice, ibid. p.2. Both Williston and Ireland agree with this assertion.

4.Swayne v Fawkener, (1696), Show. P.C. 207; Drybutter v Bartholemew,(1723), 2 P. Wms. 127; Townsend v Ash,(1745),3 Atk. 336; Lord Sandys v Sibthorpe (1745) 2 Dick, 545; Lord Stafford v Buckley,2 Ves Sr. 171. These cases all concerned the New River company, but see also Howse v Chapman (1799), 4 Ves. 542.
Shares were considered real property if the company's income was derived from land. Thus shares in companies receiving tolls or customs would be realty. See Buckeridge v Ingram (1795) 2 Ves. Jun. 652.

5.Weekly v Weekly (1781) not fully reported but cited at 2 Y & C 268 at p. 281, held that shares in the Chelsea Water Works were personalty; presumably because most of the company's assets, i.e. five sixths, were personalty.

6.Buckeridge v Ingram. Supra. See Rice ibid. p. 3, note 2; and Williston ibid. p. 218, note 4.

7.In R v The Dock Co. of Hull 1 T.R. 219 the company argued that such a clause rendered its <u>property</u> personalty, and therefore not subject to land tax. The court held that the real estate of the company was to be considered as personalty as between the heir and executor, " but the Legislature did not intend to alter the nature of it in any other respect." Apart from defeating the company's claim, the implication is that without the clause the shares would also have been realty.

8.Child v Hudson's Bay Co.(1723) 2 P. Wms. 207 at pp.208-209.

9. Williston Ibid. p. 219-221. The cases he cites are: Hildyard v South Sea Co. & Keate (1722) 2 P. Wms.76; Harrison v Pryse (1740) Barnard Ch. 324; and Ashby v Blackwell and The Million Bank (1765) Ambl. 503.
The claim of D.G. Rice, ibd. p.8, that: "The company held both the property **and the shares** on trust for the shareholders." is based on a misapprehension of these cases, and is mistaken to the extent that it distinguishes between the share and the assets of the company. The true situation was that the company held property, **against a share of which** the individual had an equitable claim.

10.See chapter 1 supra.

11.Given the limited scope for both investment and disinvestment that then prevailed; the limited number of investors and the direct interest they exhibited in their investments this view was at least to some extent appropriate. See Chapter 1 Supra.

12.In Ex parte the Lancaster Canal Co., Mont & Bligh, 94. In the event it was held that the company's Act of incorporation had declared the shares to be in the nature of personalty. In earlier decisions, however, Sir John Leach M.R., in holding shares to be realty, had ignored express clauses in the Acts of incorporation declaring the shares in the companies concerned to be personalty. Tomlinson v Tomlinson, 9 Beav. 459; & Ex parte The Vauxhall Bridge Company, 1 Glyn & Jac. 101. These cases are all raised in Bligh v Brent infra.

13.This particular process of reconceptualisation starts with Bligh v Brent in 1836/37, and is complete by Ashworth v Munn in 1880. Both cases considered infra.

14.2 Y & C. 268.
See Rice, ibid. p.11; Williston, ibid., p. 218; Ireland, ibid. p.7.

15.Ibid. p.276.

16. Ibid. at p. 295.

17.Ibid. at p. 296.

18.See L.J. Ryan, "The Functions and Responsibilities of Directors Considered Historically with Special Reference to Equity", Ph. D., University College, London University, 1968. See particularly chapter 12 in which Ryan traces the historical process whereby the general meeting lost its power of ultimate control over the operation of the company to the

Board of Directors. Ryan views this process, and the active role the judiciary assumed in it, with regret. It merely reflects and substantiates, however, the argument of this thesis, that company law was moulded in response to the perception of the essentially money-capitalist nature of the typical shareholder. The general meeting lost control of the company due to the fact that the shareholders simply were not competent or interested enough to exercise such control. See further ch.7 infra.

19.Ibid. p. 295.
The nature of corporate personality will be considered in Ch.7 infra.

20.This is revealed in the second passage which demonstrates that as yet there was no notion of ultra vires in regard to joint-stock companies. This point will be considered later when the development of the ultra vires doctrine is considered in Ch.6 infra.

21.Ibid. p.14. See also p.17.

22.Rice's analysis demonstrates the failures that flow from a lack of non-legal theoretical perspective from which to comprehend legal developments. For him the change in the nature of the share was "perhaps inevitable" and would have occurred "sooner or later" p.10, in response to the inconvenience of the company changing the nature of the property it held, or of its holding mixed property p.11. Although Alderson B. does mention the difficulty of dealing with fluctuating property, at p. 298, it is clear that such consideration is not the essential basis for his decision. Rice's confusion is highlighted in his claim that the property of the company actually took the form of money p.12.

23. 3 M. & W. 422. In the course of his decision Parke B., at p. 424, stated that: " I have no doubt whatever that the shares of the proprietors, as individuals, are personalty; they consist of nothing more than a right to have a share of the net produce of all the property of the company."

24.See note4 supra.

25.Ibid. p.295-296.
For a criticism of this distinction see Williston, Ibid. at p. 218.

26.See op. cit.

27.Ibid. p. 298.
No reference was made to Howse v Chapman supra, in which the Bath Navigation company had also been incorporated.

28.7 Man. & G. 198.

29.At p. 206 Maule J. comments that :"I do not see how the method of carrying on the business can vary the rights of the parties." It is ironic that that is precisely how the rights of the partnership member may be distinguished from the rights of the member of a joint-stock company. In this case "the shareholders did not carry on one trade jointly together" p. 202, In other words they did not operate the mill collectively as a business. They simply provided the money to purchase the mill which they then mainly used in their individual capacities. On this basis the shares did not represent an interest in a joint-stock company concern, but was a joint interest in the actual property. On that basis the decision in Baxter can be distinguished from cases relating to true joint-stock companies. See in particular the judgement of Martin B. in Watson V Spratley ,10, Ex. 222 at p.240; and Keating J. in Bennett v Blain, 15 C.B. (N.S.)518 at p. 536.

30.9 Beav. 450.

31.Ibid. p.457-459.

32.11 Beav. 507.

33.Tomlinson v Tomlinson(1823) reported at 9 Beav.459.

34.Ibid. p. 517
The company in point was incorporated but it is clear from the cases that that fact would not have altered Langdale's opinions as to the nature of shares.

35.4 De G. & SM. 402

36.In <u>Thompson v Thompson</u> 1 Coll. 381,and <u>Hilton v Giraud</u> 1 De G. & Sm. 183, Knight-Bruce had reached the same conclusion in regard to incorporated companies. There it was unnecessary for him to decide the general nature of shares but the eventual conclusion reached in Ashton v Langdale is simply an extension of the view stated in the course of the former case, at p. 386, to the effect that " The shareholders are to have no estate in the real property, legal or equitable, but real property is to be held by the corporation as part of the general mass of the corporate property, real and personal, which being held and worked by the corporation, the net profits are to be divided by them among certain individuals, not one of whom has, legally or equitably, any right of possession of the land, or of upon any portion of it."

37.Ibid at p. 411.

37.Ibid at p. 411.

38.16 Sim 533 Shadwell V.C. simply stated that the shares in question "were necessarily chattels real". This was done apparently on the authority of Sparling v Parker which he cited as a perfectly plain case!

39.2 De. G. M. & G. 599.

40.11 C.B. 90.
Counsel for the next of kin relied heavily on Baxter v Brown in supporting the argument for such a distinction.

41.2 De. G. M. & G.599, at p. 619.

42.Ibid pp.620-621.

43.10 Ex. 222.

44.Ibid. p.241.

45.Ibid p.235.

46.Ibid p.236.

47.Ibid. p.238.

48.Ibid. p.244.

49.Supra.

50.A similar approach was adopted by Page-Wood V.C. in Hayter v Tucker 4 K. & J. 243 at p.251.

51.Baxter v Brown continued to cause intermitant difficulties, and although it was never overruled, it was distinguished and restricted to instances of "common partnership" by the Court of Common Pleas in a series of franchise cases; Bulmer v Norris, 9 C. B. (N.S.) 19; Acland v Lewis, 30 L.J (N.S) p.29; Bennett v Blain 15 C.B. (N.S.) 518; Freeman v Gainsford 18 C.B. (N.S.) 185.
Thus by 1885 in Watson v Black, 16 Q.B. 270, Cave J. could state in regard to Baxter v Brown that:

> " That case has been sometimes doubted and sometimes distinguished. If the Court there meant to lay down the principle that members of an association cannot by agreement among themselves divest themselves of any equitable interest in lands purchased for the purposes of association, and cannot vest those lands in trustees free from such equitable interest, that case is opposed to a cloud of authorities and is not law. If, however,

the Court there only meant to decide in that case the parties had not agreed to divest themselves of their equitable interest, the case is distinguishable."

In other words if the individuals had formed a company then Baxter v Brown did not apply.

52.20 Beav. 503.

53.Ibid. p. 506-507.

54.Romilly understood joint-stock companies as at most quasi-corporations; as essentially partnerships to which the power of suing and being sued under a common name had been granted. See p. 506.

55.6 De G. M. & G.74.
Had Crannworth not considered himself bound by the authority of Myers v Perigal it is clear that he would have been likely to have supported Romilly's view as to the nature of shares. See pp.92 & 94.

56.27 Beav. 218.

57.Ibid p. 226.

58.In Entwhistle v Davis, Equity Law Reports. 272 Page-Wood V.C. criticised and refused to follow Romilly's approach or decision in Morris v Glynn.
This case also demonstrates the way in which the emergence of the share as a money-capital form generates the notion of separate personality. See p.276 in contradistinction to the earlier view of Lord Cranworth in Edwards v Hall, supra, at p.92. See ch.7 infra.

59.(1880), 15 Ch. D. 363.

60.Ibid. p.368.

61.Ibid p. 376.
For Brett L.J. on the same point see pp.371-372.

62.Rice considers Ashworth v Munn, ibid. at pp. 21-26 and is critical of the reasoning in regard to the nature of the partnership share. Any such problems were resolved in any case by the Partnership Act 1890, section 22, which provides that partnership land is, unless the contrary intention appears, to be treated as personalty as between the partners, and also their representatives, heirs executors, or administrators, if they are deceased.

63.op. cit.
See also James L.J. at p. 370; and Brett L.J. at p. 372-373.

64.The right to participate in dividends is of course contingent on such dividends being declared and is not automatic. In the absence of any provision instructing them to pay out all available profits, the directors have discretion to decide whether to carry available profits to reserves or not. Re Buenos Ayres Great Southern Rlwy. [1947] Ch. 384; R. Paterson & Sons Ltd. v Paterson [1916] W.N. 352.

65.Bradbury v English Sewing Cotton Co. Ltd. [1923] A.C. 744 at p. 767. The definition is an expansion of the one he offered in Singer v Williams, [1921] 1 A.C. 41 at p. 59. There are resonances of Wrenbury's confusion in Schmitthoff's definition in Palmer's Company Law, p.332, where he states: "A share in a company is the expression of a proprietary relationshhip: the shareholder is the proportionate owner of the company but he does not own the company's assets which belong to the company as a separate and independent legal entity."

66.Borland's Trustee v Steeel [1901] 1 Ch. 279 at p. 288. Subsequently approved by Court of Appeal in re Paulin [1935] 1 K.B. 26, and House of Lords in the same case **sub nom** I.R.C. v Crossman [1937] A.C. 27.

67.See for example Gower, Company Law, 3rd ed. p.344. Pennington, Company Law, 5th ed., does quote the passage fully, at p. 68.

68. Humble v Mitchell (1839) 11 Ad. & E. 205; Colonial Bank v Whinney (1886) 11 Ap. Cas. 426; Harold v Plenty (1901) 2 Ch. 314; Re V.G. M. Holdings Ltd. (1942) Ch 235.
For academic statements see; Rice, ibid., pp.26-33; Schmitthoff in Palmer's Company Law 22 ed., pp.25, 322 ; Gower, Company Law, 3rd ed. p.344; Pennington, Company Law, 5th ed., pp. 67, 368.

69. C.Sweet, Choses in Action, 10 L.Q.R. 303, p. 304. And see Cotton & Lindley L.J.s in Colonial Bank v Whinney (1885) 30 Ch. 261 at pp.276 & 282.

70. Poole v Middleton (1861) 29 Beav. 646 at p. 650. See also Carruth v Imperial Chemical Industries Ltd. [1937] A.C. 707 at p. 765.
As Professor Gower has written: "... the share itself is an object of dominion, i.e. of rights in rem, and not so to regard it would be barren and academic in the extreme. For all practical purposes shares are recognised in law, as well as in fact, as the objects of property which are bought and sold, mortgaged and bequeathed. They are indeed the typical

items of property of the modern commercial era and particularly suited to its demands because of their exceptional liquidity." ibid. p.346.

71.Halsbury's Laws of England, 4th ed. vol.6, p. 2. For articles on choses in action generally see: H.W. Elphinstone, What is a Chose in Action?, (1893) 9 L.Q.R. 311; and C. Sweet, Choses in Action, (1894) 10 L.Q.R. 303. It is apparent that the term had long been used in relation to shares. Thus in 1721 the report of the Treasury Commissioners relating to the incorporation of the Bank of Ireland stated that as shares in stock were in the nature of choses in action, they were not assignable or transferable at common law. Cited in Dubois, ibid., p.106. A further, although indirect, example of this usage can be found in Stat 2 Geo. II, c. 25 passed in 1729 whereby the common law rule that there could be no larceny of a chose in action was abolished.

72.Schmitthoff simply accepts the categorisation, but whereas Pennington evinces doubts as to its usefulness, Gower attacks it as unhelpful. See supra.

73.On the basis of Pinkett v Wright, and Poole v Middleton, considered infra, Pennington, ibid. p.68, simply states that shares possessed the peculiar property of being transferable at common law at a time when other choses in action were not legally assignable.

74.The Supreme Court of Judicature Act 1873, (36 & 37 Vict. c. 66, S. 25), provided for the general assignment of choses in action at law. Such provision are now governed by S. 136 Law of Property Act 1925.

75.See the report of the Treasury Commissioners relating to the incorporation of the Bank of Ireland, note 71 supra. Also Duvergier v Fellows, 5 Bing 248, at p. 267.

76.Sweet, op. cit. p. 312. For consideration of the actual transfer of shares in these companies see, Scott, and Davies, Ch.2 supra.

77.The Companies Clauses Act 1845, 8 & 9 Vict. c.16, which provided a common form for companies incorporated for carrying on undertakings of a public nature, made similar provisions in Ss.14, 46.

78.Section 182 of the Companies Act 1985 provides not only that shares are personal estate but that they " are transferable in the manner provided by the company's articles". Previous legislation provided similarly. Thus s. 54 of the 1844 Act provided for the sale and transfer of

shares.
The Stock Transfer Act 1963 permits the transfer of fully paid up shares by a simplified procedure other than that stated in the articles.

79.Sparling v Parker; Walker v Milne; Watson v Spratley;Ashworth v Munn; supra. Pinkett v Wright; Garrard v Harding; Mayhew's case; infra.

80.6 Geo.1 c.18. See also Ch.2 supra.

81.6 Geo.1 c.18 S.18.

82.A.B. Du Bois, The English Business Company after the Bubble Act. p.p. 4-5, cites the opinion of the leading chancery barrister Sergeant Pengelly to this effect.

83. Du Bois op cit. p.40.

84.9 East 516.

85.At p. 528.

86.1 Camp. 547 & 549.

87.(1811) 14 East, 406.
See also Pratt v Hutchinson (1812) 15 East 511.

88.at p. 422. The jury had found that the company involved, the Birmingham Flour and Bread Company, had been founded for the laudable motives of supplying bread and flour more cheaply, and was beneficial to the inhabitants at large of the town. (p. 414.)

89.(1821) 2 Jac. & W. 503.

90.p. 510.

91.Reported as re The Real Del Monte Mining Company in George on Joint Stock Companies, 1825, Sweet, London, p. 46. Cited in Duvergier v Fellows & Garrard v Hardey infra.

92.3 B. & C. 639.

93.p. 644.

94.6 Geo. IV, c. 91. The provision leaving companies to the operation of the common law was introduced at the insistence of Lord Eldon.

95.(1828) 5 Bing. 248.
It is interesting to note that in argument before the court counsel suggested that shares, being choses in action, could not be transferred. (at p. 261.) But no reference to the point was made in the judgement.

96.p. 266.

97.As the company had confessed to acting as a corporation Best C.J.'s views are clearly obiter. Also the company sought to make use of a patent which was to be invalid if transferred to more than five persons. On appeal, (1832) 1 Cl. & F., Best C.J.'s decision was approved on this latter ground. For these reasons it was a relatively easy process to dsitinguish this case at a later date, as in: Garrard v Harding; Harrison v Heathorn, infra.

98.(1833) 1 My. & K. 61,p.76. Surprisingly Duvergier v Fellows was not cited before Lord Brougham.

99.p. 77-78. The deed of the company in question, The Potosi La Paz and Peruvian Mining Association, had also stated that shareholders were only to have limited liability. Lord Brougham held the clause to be nugatory in respect of strangers, but not illegal.

100.(1837) 8 Sim. 601.

101.p.612.

102.Wigram V.C. in Pinkett v Wright (1842)2 Hare 120., at p. 130.

103.(1843) 4 Man. & G. 471.

104.P.483. Tindal distinguished Duvergier v Fellows on the basis considered supra.

105.6 Man & G. 81.

106.P.140.

107. It was raised in re The Mexican and South American Company, Aston's case,(1959) 27 Beav. 474; and again in re The Mexican and South American Company, Grisewood and Smith's case, (1859) 4 De G. & J. 543; only to be dismissed by Sir John Romilly in the first case (at p. 480-482) and by Turner L.J. in the second (at p.556-557.).

108.s.56.
The Act of 1856 reduced the period of continuing liability, by then of a limited nature only, to one year for previously

incurred debts. Similar provisions in relation to past members' liability was contained in s.502 of the Companies Act 1985; now s.74 of the Insolvency Act 1986.

109.Supra note 102.

110.re The Monmouthsire and Glamorganshire Banking Company, Cape's Executor's case 2 De G. M. & G 562, at p. 574. The actual clauses of the deed favoured a similar conclusion. It is clear that St Leonard's decision is based an a pragmatic recognition of, and an accommodation with, the joint-stock company as an important form of economic organisation, which should not be rendered inoperative as a consequence of legalistic judicial disapproval, pp.573-574, & p.575.

111.re The Pennant and Craigwen Consolidated Lead Mining Company,(1854) 4 De G. M. & G 285.

112.re the Penant etc Lead Mining Co., (1854) 5 De G. M. & G. 837.

113.p.848.
For the position of the transferee see also Grisewood and Smith's case supra at p.555.

114.See Mayhew's case, supra, at p.849.

115.(1863) 8 L.T. 312.

116.p.313. Thus the transfer of shares would seem to constitute a novation as well as an assignment as Pennington claims, ibid. p.368-369.

117.In Poole v Middleton (1861) 29 Beav. 646, Romilly M.R. stated that as shares were in the nature of property, holders of them had a right to dispose of them. But as has been demonstrated supra he was of the opinion that shares represented a claim against the assets of the company.

118.Bank of Hindustan v Alison (1871) L.R. 6 C.P.222.

119.See Fry L.J. in Colonial Bank V Whinney, supra, at p. 287.

120.re Bahia and San Francisco Rly.Co (1868) L.R. 3Q.B. 584 at p.595.

121.re Smith, Knight & Co., Weston's case (1868) 4 Ch. App.20.

122.re Mexican and South American Co. De Pass's case (1859) 4 DeG. & J. 544.

123.re Hafod Lead Mining Co., Slater's case (1866) 35 Beav. 391.

124.P.L. Cottrell, Industrial Finance 1830-1914,pp.80-103 at p.88.
He did observe an overall secular decline in the size of share denominations, but not a dramatic change. His findings suggest a more complex history of share denominations than that suggested by either H.A. Shannon, The First Five Thousand Companies and Their Duration, 1932, VII Economic History, and The Limited Companies of 1866-1883,1932-33, IV Economic History; or J.B. Jeffreys' thesis Trends in Business Organisation in Great Britain since 1856, and The Denomination and Character of Shares 1855-1885, 1946, XVI Economic History Review.
A Essex-Crosby's, Joint-Stock Companies in Great Britain 1890-1930, University of London 1938 M. Comm. thesis confirms the fact that although capital was called up high levels of issued capital continued to remain unpaid even towards the end of the period.

125.On this point the various authorities cited supra concur. The boom was once again fueled by an abundance of money-capital seeking profitable investment. According to B.C. Hunt, Development of the Business Corporation, p.145, a decided plethora of cheap money had again proved propitious to the germination of corporate enterprise and speculation, and in the four years 1863-66 some 3,500 limited companies were registered with a nominal capital of £650m.

126.(1867) 2 Ch. App.718.
Turner L.J. approved of the view that it is better to have one shareholder owing a lot than many shareholders owing a little. See p.728-29.

127.(1867) 3 Exch. 35.

128.B.P.P. 1867 X (329)

129.Ibid Q.867. See on the same point W.R. Drake Q.614; and H.D. Pochin Q.2298.

130.Ibid. Q.954. See also Q.528 where he speaks of between £20m and £30m of capital invested in shares being "more or less in a state of suspended animation, in consequence of the unmarketable character of the shares." In "The First Five Thousand Limited Companies" at p.401, Shannon uses the term "suspended animation" in respect of industrial capital, rather than share capital.

131.Ibid Q.2309.

132.M. Rix, An Economic Analysis of Existing English Legislation Concerning the Limited Liability Company, M.Sc. (Econ.) University of London, 1936.

Chapter Four: Goodwill.

I. Introduction.

The problematic nature of goodwill, in its modern form[1], became apparent in the second half of the 19th century, and the beginning of the twentieth century, with the formation of joint-stock companies to take over existing commercial enterprises, and to finance new enterprises. The essence of the problem was that the price paid for such enterprises tended to be higher than the value of the concrete assets obtained by the company. This discrepancy had to be explained, and to that end the concept of goodwill was mobilised as a balancing factor in company accounts. Giving something a name, however, is not the same as either understanding, or explaining it. Any enlightenment apparently provided by mere reference to goodwill is illusory, and on closer scrutiny is revealed to be the spurious conclusion of a tautological process of reasoning. The discrepancy between the value of the business and the value of the concrete assets used by the business was called goodwill. Henceforth any discrepancy in these two measures of value was "explained" in terms of goodwill.

This atheoretical approach is the outcome of looking at the business as merely a static configuration of assets rather than as a dynamic process of profit production. It is the product of viewing the assets of the business as a

conglomeration of ordinary commodities rather than as a unit of capital in production. Once the difference in value between commodities in, and out, of production is recognised and named, it is reified and fetishised by being treated as the source of value on its own account.

When functioning industrial-capital is itself the object of transfer it becomes apparent that it has a value in excess of its ordinary, or mere commodity, value as determined by the law of value. It is this additional value, the epiphenomenon of capital in transaction, that in reality constitutes goodwill. The joint stock company with its freely alienable share, together with the related development of the specialised market in those shares, represents the transformation of functioning industrial-capital into abstract fictitious capital; and the domination of abstract money-capital, claiming interest in both content and form as its return, leads to the disappearance of profit of enterprise as a distinct economic category. Goodwill as a relatively precise accounting concept is also a consequence that process.

As it is essentially a commercial rather than a legal concept, it is proposed to examine its treatment by some leading authorities on accountancy, before proceeding to look at how the courts have viewed it.

II. The Treatment of Goodwill in Accountancy.

The traditional view of goodwill sees it as an asset; an intangible asset certainly, but a real one none the less. It is accepted that goodwill can have no existence apart from the business from which it arises, but this recognition does not prevent its analysis and treatment, particularly in accounting, as something distinct from the other assets of the business, and capable of being valued apart from those other, tangible, assets.

One of the first accountants to grapple with the problem of goodwill was L.R. Dicksee.[2] For Dicksee goodwill represented an asset, the value of which arose from an advantage which accrued to an individual in being able to represent that he was carrying on an old business.[3] It was something that could not be built up without effort and which did not crystalise until a sale of the enterprise containing goodwill took place[4]. Dicksee was the leading proponent of the "number of years purchase of net profits" method of evaluating goodwill. Under that system the amount of profit, calculated not on the basis of crude average net profit, but average net profit less interest on the average capital employed, was multiplied by a factor representing so many months or years purchase in order to arrive at the value of goodwill.[5]

Having established with some precision the basis for its assessment, Dicksee introduced imprecision in the actual number of years to be used as the multiplier in order to

compute the final value of goodwill. He was reluctant, not to say incapable, of laying down any general rules as to how this multiplier was to be determined, although he suggested a variety of possible years purchase for different enterprises.[6]

The essential imprecision of this procedure is obvious, but of more interest is the way in which Dicksee saw capital as commanding interest apart from, and prior to, the process of production. He clearly accepted the fetishised appearance of abstract capital as the source of increased value, but in so doing he failed to distinguish between money-capital and industrial-capital, and the different claims which each of these forms of capital made upon surplus value. As capital possessed the inherent capacity to command at least a minimum level of income, represented by the rate of interest, it was assumed that no capital would be extended unless it could actually command that minimum return. Any return over the rate of interest, however, it was suggested was a bonus, and goodwill represented the price that had to be paid by a prospective purchaser of an enterprise for the privilege of securing such a bonus.[7]

The type of business transfers Dicksee was primarily concerned with involved the replacement of one industrial-capitalist by another in a continuing enterprise. As the purchaser of the enterprise would not simply be acting as a money-capitalist, he would not be content to accept a

return that merely represented the interest on his capital. The purchaser would demand access to a share of profit of enterprise. This meant that total profit of enterprise could not be capitalised and appropriated by the vendor in the form of goodwill. The actual figure at which the business was valued, being dependant on the amount of profit of enterprise which the purchaser would settle for, was a matter for negotiation between the parties and could not be determined a priori.[8]

Matters were considered differently, however, with regard to the purchase of a going concern by a joint-stock company. Shareholders would be willing to pay for goodwill, the amount by which their probable dividends would exceed the interest they could earn on their capital elsewhere. The reason for this generosity was that shareholders were not "workers" but merely investors.[9] As money-capitalist shareholders were not active in the process of production, in the same way as industrial-capitalists, they were not in a position to claim any proportion of profit of enterprise, and had to remain satisfied as long as they received interest on their investments. The consequence was that the vendor of a business to a joint-stock company was able fully to capitalise and appropriate the former profit of enterprise. As regards the actual procedure for valuing goodwill to be purchased by a company, Dicksee suggested that the usual practice was:

" to base the goodwill on the ordinary net profits (the investors interest being so low as to become a negligible quantity), and to compute the rate at about twice that which a private purchaser would be prepared to pay."[10]

This would certainly give rise to higher payments for goodwill than individuals would be willing to pay, but the arbitrary nature of the procedure is immediately apparent. Firstly the datum selected, the price that a private purchaser would be willing to pay is, as has been shown, inherently imprecise. Secondly it is nonsensical to claim that the investors in a joint stock company receive negligible interest on capital, for it is precisely interest that they receive. The domination of the company form is an aspect of the transformation of the return on all capital into the form of interest; the subsumption of all capitals by money-capital; capital in its most abstract and fetishised form. It is ironic that Dicksee used interest to reach an understanding, all be it a distorted one, of profit of enterprise as an additional return accruing to industrial-capital, yet failed to apply it in order to understand the nature of the return accruing to shareholders. It is but a small step from stating that on the transfer of functioning industrial-capital, goodwill represents the difference between probable dividends and the rate of interest, to the clear assertion that goodwill represented

the capitalisation of profit of enterprise. It is not a step that Dicksee took preferring to rely on the pragmatic obfuscation of "usual practice".[11]

If Dicksee is open to criticism for a lack of any theoretical understanding of goodwill, the same is not true of his practical assertion that the vast majority of companies which failed within a short time of their inception did so as a result of the excessive price charged by the vendor.[12]

It was in an endeavour to remedy this situation that the Companies Act 1908 made it compulsory that on the sale of a business to a company which intended issuing a prospectus inviting the public to subscribe for shares or debentures, the amount payable as purchase money in cash, shares or debentures for any property acquired had to be specified in the prospectus. The amount payable for goodwill had to be specifically detailed.[13] Dicksee, however, was far from sanguine as to the efficacy of this measure, considering that investors would continue to act carelessly in the dazzle of promoters' glowing words of wealth and wisdom.[14]

Whilst not doubting the truth of Dicksee's claim and the validity of his doubts, it should be emphasised that the success of a company does not depend necessarily on the absolute magnitude of its goodwill. The prime factor is the level of profit that the company can sustain over time. That is not to suggest that the size of goodwill payments cannot act as a useful indicator as to whether a company is

overcapitalised in relation to its profits base. The greater the goodwill the higher the profit that has to be generated by the concrete capital of the company in order to maintain the value of the fictitious share capital. It can be concluded that the real problem with regard to goodwill was that predicted performances were not achieved in fact, and as a consequence the share capital failed to realise its predicted dividend, and hence sustained a loss of value. Whereas it was implicit in Dicksee's concept of goodwill that industrial-capital received an above normal return, P.D. Leake based his assessment of goodwill expressly on the existence of such "super profits "[15], defined as the amount by which revenue exceeded all economic expenditure incidental to its production.[16]

Amongst the expenses that together made up "economic expenditure" Leake included a rate of interest on the capital invested sufficient to attract that capital to its particular use. Super profits amounted, therefore, to the amount by which actual profit exceeded the prevailing rate of interest, together with an appropriate risk premium.[17] Such extra-normal profits were only temporary as competition for investment opportunities reduced returns towards the level of interest.[18] It is Leake's failure properly to distinguish between money-capital and industrial-capital, a failure of perception which he shared with Dicksee, that led to the confused, not to say confusing, procedure he adopted in

relation to valuing goodwill. Although Leake did not clearly distinguish between share-capital and industrial-capital, merely referring to capital invested [19], it is clear from the worked examples he gave in his text that super profits were to be calculated on the basis of the profit generated by the total net tangible assets employed in the business.[20] This approach gave rise to the particular peculiarity of Leake's method.

The amount of capital that had to be valorised depended on the industrial-capital operated by the enterprise. In determining the rate of return to be paid to it, however, he treated that industrial-capital as just so much abstract money-capital; to be recompensed only on the basis of interest.[21]

Leake attempted to relate goodwill to the income generated by capital, but did so in such a way as to reverse the process whereby goodwill emerges. On the basis of the assumption that the appropriate return on all capital was interest it appeared that industrial-capital, actually participating in average profit, was enjoying super profits. When industrial-capital was transferred the previous owner could require a payment to be made in recognition of this super profit, and purchasers would be willing to pay a premium to secure access to it. That premium was goodwill, and its exact size was estimated in terms of the present value of future maintainable super profits, calculated as an annuity[22], on

the basis of an assumption as to the normal return on the net capital assets being equivalent to interest.[23]
Leake, however, did not totally disregard the income yield of share capital as a means of assessing the appropriate level for goodwill, but he relegated it to a merely confirmatory role in relation to his own procedure. His awareness of the importance of the dividend return on share capital in relation to the prevailing rate of interest was evident in his consideration of a theoretical company with a nominal share value of £1, returning an annual dividend of £3, and "as safe as the bank of England". In those circumstances Leake expressed the opinion that if the prevailing rate of interest were 5%, then the value of a share might be as high as £60.[24] It is clear that at this point Leake was using the yield per share in relation to the rate of interest to determine the market value of shares; and by implication the market value of the company as a source of income, and hence the magnitude of any goodwill.
Having increased the level of risk, however, he went on to use his own method for assessing the value of the company's shares. Although meant as merely an example and a justification of his own method, the above procedure is tantamount to a recognition of the predominant position of income in assessing the value of a business for investment purposes. Such a conclusion is re-enforced when it is realised that the increase in the rate at which the exemplar

company was capitalised, using Leake's system of valuation, was due simply to the inclusion of an appropriate risk premium.[25]

The next commentator to be considered was also guilty of confusing the returns corresponding to industrial and money-capital. According to H.E. Seed's definition, goodwill arose from the fact that a particular unit of functioning industrial-capital was able to generate a return above that which would have been claimed by a similar mass of money-capital invested at the prevailing rate of interest.[26] As a consequence of his failure to consider profit of enterprise Seed misconstrued the essential nature of goodwill; locating its source in a variety of possible advantages enjoyed by a particular business over its competition.[27]

Seed accepted the general view that goodwill was a form of property, and, as such, a business asset; although not one that could be transferred apart from the business as a whole.[28] This recognition of the impossibility of separating goodwill from other business assets led him to adopt a novel method of computation for determining its actual value. Neither the value of industrial-capital, nor the value of goodwill were to be treated separately. Both were subsumed under the overall value of the enterprise as a source of income. It was the price of a business as a whole, rather than the price of the individual constitutive assets, that

was of concern to a prospective purchaser; and it was the rate of return, measured against the purchase price paid that was of most concern to him.[29]

The return which an investor would expect from capital invested in the form of fictitious share capital, was to be ascertained having regard to two factors; firstly, the prevailing rate of interest, and secondly, the degree of risk attaching to the investment.[30] The more secure the return, the more closely the share return would approach the pure interest rate of return. In recognition of the fact that the share did not perfectly correspond with pure money-capital, however, the share was entitled to claim a return in excess of that rate. The nature of this claim was a risk premium, the effect of which was to alter the rate of capitalisation.[31] Seed also recognised the link between liquidity of investment and risk premium. As he accordingly, and correctly, pointed out; a public company having its shares freely dealt with on the stock exchange would be in a position to contemplate a lower yield than a private company, and hence to capitalise on the basis of a lower rate of return.[32]

As a corollary of determining the value of a business on an earning capacity basis it followed that neither the value of the intangible assets, nor even the value of the tangible assets, affected the purchase price other than in an indirect and residual manner. The valuation of goodwill became

dependant on the process of fictitious capitalisation. It no longer had an independent existence, but was simply the outcome of subtracting the commodity value of assets obtained, from the amount actually paid for the business.[33] The value of tangible assets did not directly affect the overall valuation either. They simply offered a measure of security, to the extent that their value could be realised, should the enterprise prove unsuccessful.

Seed's practice in relation to the assessment of goodwill appears to have been in accord with the approach adopted in this thesis; but the lack of any coherent theoretical basis for his practice led him into difficulties beyond his powers of explanation. In line with the utility theory of value he adopted, the value of commodities depended on the use to which they could be put, and the value of assets employed by a business were to be measured entirely by their capacity to produce revenue.[34] This, however, led to the problem of reconciling the value of those assets in the process of production, with the value of those same assets outside the process of production. This difficulty is evident in the following passage:

> " In considering the values to be placed on tangible assets the word "value" cannot obviously be given its dictionary meaning.....since the worth of the assets as a going concern is dependant upon their utility for producing income, and in toto

would, from this point of view presumably include goodwill itself."[35]

He continued:

"It would be...wrong to attempt to assess what all the various tangible assets would realise if sold piecemeal, since it is not the intention that this should be done; it is intended that the ...assets should be used, not exchanged ..."[36]

In these passages Seed actually distinguished, and struggled to understand the distinction, between the commodity form assumed by industrial-capital in its cycle of production, and the commodity form assumed by that same capital when it is itself the object of exchange. His location of the explanation of the existence of two values in the fact that the tangible assets, i.e industrial-capital in commodity form, were to be used productively is undoubtedly correct. It is inadequate, however, to the extent that it failed to consider that, although the assets might be transferred, the potential income generated by the operation of those assets was the object of exchange. It is the possibility of transferring functioning industrial-capital as such that gives rise to appearance of the same physical assets having two values. In reality it is not the assets themselves which are important but the function they perform, and assets only function as capital in the process of production. Seed was correct in his assertion that, in relation to the exchange

value of capital its magnitude is determined by its concrete use-value, but he failed to understand that capital is the only "commodity" which has its exchange value determined in this manner, and as such is anomalous. Seed recognised the anomaly but lacked the theoretical insight to offer any more than a superficial explanation of it.

In his practical guide to the valuation of businesses for the purposes of amalgamation[37], A.E. Cutforth conflated and compounded the confusions contained in Dicksee's and Leake's earlier treatments of goodwill.[38]

His work merits attention, however, not essentially for the method of valuing goodwill recommended by him, but for its description of the method of valuation actually adopted by the financial community. Cutforth enumerated certain factors which financial experts used to value companies. The main ones being:

i) the class and general character of the business.

ii) the rate of dividends being paid on the shares.

iii) whether or not profits were being delivered up to the hilt.

iv) whether profits were rising, stationary, or falling.

v) what prior securities ranked in front of the ordinary shares.

vi) to what extent, very approximately, the ordinary share capital could be considered as covered by tangible assets.[39]

The accuracy of the valuations achieved through the application of the highly developed financial sense of these practitioners was commented on favorably by Cutforth, to the extent that he admitted that in a large number of cases, the value obtained on this basis would not greatly differ from the outcome of his "scientific" method of valuation.[40]
Given the inherent lack of precision in the scientific methods of valuation, and the correspondence in the factors taken into consideration by both scientific and unscientific methods; the similarity of outcome is less than surprising. Moreover it is suggested that the " unscientific " methods of valuing business enterprises were more logically coherent than the so called scientific methods propounded by such professional valuers as Cutforth.
The methods adopted by the financial experts were based on evaluating the enterprise as a continuing source of profitable investment. What was of prime importance from that perspective was the actual return generated. Other factors were secondary, and merely constituted the grounds for assessing the potential level of risk involved, which affected the rate of capitalisation. In the final analysis this is precisely the function performed by the scientific methods of analysis, although without the recourse to the confused, and uncertain concepts of super-profit, and years purchase, that characterised those methods of valuation.

This criticism of so called "scientific" methods of valuing business enterprises was not lost on all who considered the subject. One who was particularly scathing on such elaborate but essentially fallacious schemes was R.L. Sidey, who completely rejected any attempt to value goodwill separately from the value of the business as a whole.[41] In his view goodwill was merely the difference between the price paid for the business and the value of the assets received.[42]
A similar approach is to be found in Bonbright's magnum opus on the valuation of property for different legal purposes[43], in which he maintained that:

> " In all respects the relationship between the commercial value of a business and the so-called physical values of its assets is highly indirect and uncertain. Almost never does it justify an assumption that the "values" of the latter even roughly measure the value of the former "[44]

The reason for this disparity, according to Bonbright, was not to be found in adding on the independently determined value of some intangible asset known as goodwill, but lay in the fact that when a business enterprise was valued as a going concern its value was determined independently of its physical assets, by reference solely to the capitalised value of its future income; or as he put it:

" the value of the enterprise depends entirely on the discounted value of the prospective earnings."[45]

Having examined how accountants have dealt with goodwill in the past, it remains to give some consideration to contemporary accounting theory and practice in relation to goodwill.

In his treatment of how shares in unlisted companies were to be valued C.G. Glover adopted a position similar to that supported in this thesis. He asserted that:

" The notion that the shares of a company, other than one whose assets are easily realised, are worth the sum of its individual asset values, less its liabillities, has no basis in theory or fact."[46]

As for the super profits approach to the valuation of businesses, although he recognised its ancient pedigree, and its continued appearance in most texts, he dismissed it as leading to "highly esoteric arguments divorced from reality."[47]

According to Glover:

" In theory, the value of a share, like that of any other financial asset, is the present value of the future cash flows associated with ownership. For an individual shareholder, the cash flow consists of dividends received plus the proceeds of eventual

sale of the shares. But, for all present and future investors in total, expected cash flows consist only of future dividends, barring of course a sale or liquidation of the comapny. In other words, the eventual proceeds of sale will themselves be the capitalised value of future dividends expected to be received from then onwards. On this view, the value of the share is calculated at the present value of an infinite stream of dividends."[48]

In relation specifically to goodwill a discussion paper, Accounting for Goodwill, was issued in 1984 by the Accounting Standards Committee in response to the E.E.C. Fourth Directive on Company Law.[49] According to the Committee, goodwill could be defined as the excess of the value of a business as a whole over the fair value of its accountable net identifiable assets.[50] Having thus defined the meaning of goodwill the discussion paper went on to define the nature of goodwill as pertaining:

" to that part of the value of a business which arises from all those advantageous circumstances which generate earnings in excess of the aggregate of that which might be expected to accrue from an uncoordinated investment in the individual assets."[51]

This statement recalls earlier explanations of goodwill considered previously, and continues the classic confusion

between the return commanded by abstract money-capital, namely interest; and the return commanded by concrete industrial-capital, namely interest plus profit of enterprise. It also reveals an extreme form of capital fetishism in which concrete fixed capital appears as the source of surplus value without reference to its true source, human labour power. It is assumed that by merely transforming abstract money-capital into the concrete means of production, that those means of production are able to command a return equivalent to the rate of interest. The idea that "unco-ordinated investment in individual assets" can generate income is nonsensical. Such unco-ordinated investment would not in fact be investment in the real meaning of the word. It would simply amount to the purchase of those means of production as mere commodities, not as capital.

The means of production only possess the power of apparently self expanding value, when they are operated as capital i.e. when they are operated within a social structure based on the purchase and sale of labour power in line with the law of value. For such means of production to operate as capital demands co-ordination as a matter of necessity. The money which purchases them must be extended as capital, and they have to be operated as capital, as the means of extracting unpaid surplus labour power. To speak, therefore, as the Accounting Standards Committee does,in terms of unco-ordinated investment in assets generating any income is

to completely fail to perceive the difference between objects in themselves, and those same objects operating within a particular, capitalist, social context.

According to the discussion paper goodwill represented:

> " a form of premium over and above the aggregate of the fair value of the net assets",

the difference being explained away by the comment that:

> " the value of the whole may be greater than the sum of its separately identifiable parts "

It would to be over-complimentary to suggest that such banality represented the outcome of any thought, let alone any theoretical insight, as to the actual nature of goodwill.

III. <u>The Judicial Interpretation and Treatment of Goodwill.</u>

It is only with the development of fictitious share capital, and the reduction of the industrial-capitalist to the role of mere money-capitalist, that it becomes possible for goodwill to be treated in any absolute manner, or with any great measure of certainty. This conclusion is reflected Romer J.'s statement, in 1899, that it was only recently that the importance of goodwill, and the necessity of preventing its improper appropriation, had been fully recognised.[52] It would be inappropriate, therefore, to criticise earlier Courts for failing to demonstrate any great precision as to either the meaning or content of goodwill; indeed the Courts have tended to be satisfied with defining goodwill only to the extent of

resolving the particular case before them at any given time.[53] If precision in regard to goodwill was a product of the nineteenth century, the antiquity of the general concept of goodwill is not in doubt, and was not overlooked by the Courts[54], as can be seen from the case of Gibblet v Read.[55] Thus as early as 1744 Lord Chancellor Hardwicke spoke in terms of "the value of what is called Good-will". Although the Lord Chancellor did not offer any definition of what he understood by the term, it is evident that it was the product of a successful business operation.

The earliest judicial definition of goodwill is generally cited as that by Lord Eldon in Cruttwell v Lye.[56]

In the course of his judgement Lord Eldon expounded the opinion that:

> " goodwill which has been the subject of sale is nothing more than the probability that the old customers will resort to the old place. "[57]

However Lord Eldon's understanding of the nature of goodwill is best seen in Kennedy v Lee[58], which also provides an insight into how businesses actually were valued in practice. The essential element in the case revolved around the question of certainty of subject matter in a contract. As, however, the subject matter of the contract in question was partnership property, it necessitated consideration of the nature of such property in general, and of goodwill in particular.

The plaintiff and defendant had for some years prior to 1816 carried on a partnership business as nursery gardeners and seedsmen. In the Spring of 1816 the plaintiff gave the defendant notice of his intention to terminate the partnership agreement. Following discussions as to the best method of dissolving the partnership, Lee submitted a valuation of the partnership property to Kennedy. This estimated its worth at less than £16,000, and he offered to buy Kennedy's share of the property for £8,000. At the same time Kennedy estimated the value of the property at some £32,000.

It is not apparent how the defendant arrived at his valuation, but the method employed by Kennedy is clearly set out in a letter which he wrote to Lee. This letter states that:

> " although the business of the last year did not realise as much as the antecedent ones, yet, upon a calculation of the amounts for the last twelve years, the average of receipt has been upward of £1,500 per annum, and, upon an average of six years last, £1,000 per annum, besides the rent of houses, taxes, coals etc. which have been paid from the joint stock, making the sum in the last six years equal to £2,000...Now, the £2,000 per annum alone, at 5% is £40,000; but put it as acquired by business, and consequently attention and labour

> required, say £10 per cent clear, this makes the value of such a business so producing, worth at least £20,000 upon the least average."[59]

The above passage is a startlingly clear exposition of the method of valuing capital, not on the basis of the value of its constituent assets, but by reference to its capacity to earn profit measured in relation the return available on pure money-capital.[60]

If Kennedy's valuation was a bargaining ploy, it back-fired, when Lee offered to sell his part of the nursery on the basis of that valuation; i.e. at £10,000. Kennedy claimed to have accepted the offer and sued for specific performance.

In the course of his judgement Lord Eldon distinguished between two types of goodwill. The first type derived from a specific undertaking from the vendor that he would not compete with the business at a later date.[61]

The second type of goodwill, which Kennedy did have a claim against, arose under the following circumstances:

> " Where two persons are jointly interested in trade, and one by purchase becomes the sole owner of the partnership property, the very circumstances of the sole ownership gives him an advantage beyond the actual value of the property, and which may be pointed out as a distinct benefit, essentially connected with the sole ownership"[62]

It was evident to Eldon that, under the circumstances of the case, partnership property appeared to have a value over and above its normal value. Unable to explain this phenomenon from any change in the material circumstances of the property itself, he was forced to conclude that the increase in value was a product of the psychology of the purchaser. The value of the property increased because the purchaser was willing to pay more than its normal value for the pleasure of owning it on his own. Incapable of recognising the distinction between normal commodities and capital as a commodity, as the source of goodwill, Eldon merely offered an explanation in terms of individualistic psychological hedonism.[63]

In Cruttwell v Lye Lord Eldon had located the source of goodwill in the propensity of the customers of a particular business to continue to patronise it. In Kennedy v Lee it was located in the individual psychology of the purchaser. In Cook v Collingwood[64] he returned to the former conception, while at the same time retaining the subjective outlook of the purchaser of goodwill as the means of evaluating its worth.

In both Crutwell v Lye and Cook v Collingridge Lord Eldon, in declaring that goodwill amounted to no more than the chance of retaining the loyalty of old customers to particular premises, also held that nothing could prevent a vendor from continuing to engage in the same trade, after the sale of his business and any related goodwill. If former customers

continued to prefer to give him their custom, that might very well reduce the value of the business which he had originally sold, but the purchaser could have no right of action against him unless he had expressly covenanted to retire from that line of business.

In Shackle v Baker[65], whilst expressly confirming the general approach set out above, Lord Eldon prohibited later competition by a seller of goodwill, on the particular facts of the case which revealed fraud on the part of the vendor. Fraud was again the reason for the granting of an injunction to prevent later competition in Harrison v Gardner.[66] However, although Plumer V.C. was happy to follow Lord Eldon's exception in relation to fraud, he expressed regret at the effect of the general rule permitting later competition after the sale of goodwill.

In Johnson v Helleley[67], on the application of a surviving partner to have a business wound up, it was decided that it would be better to dispose of it as a going concern. Turner L.J. ordered that the advertisement of sale should state that the subject of sale was the goodwill of the business together with its tangible assets. He further ordered that the advertisement should state that the surviving partner would be at liberty to continue in the same line of business. Similarly in Hall v Barrows[68] Westbury L.C. declared that goodwill should be included in the valuation of a partnership business "as a distinct subject of value"; and that the

direction to value the goodwill should be accompanied by a declaration that the surviving partner would not be restrained from setting up the same description of business. By 1859 although Wood V.C. felt constrained by clear precedent to permit later competition after the sale of goodwill, he did feel able to interpret Lord Eldon's definition of goodwill in such a way as to render it less restrictive. According to his view goodwill was not related to mere locality, but meant:

> " every advantage, affirmative advantage, if I may so express it - as contrasted with the negative advantage of the vendor not carrying on the business himself - that has been acquired by the old firm by carrying on its business, everything connected with the premises, or the name of the firm, and everything connected with or carrying with it the benefit of the business. "[69]

Wood's interpretation of goodwill was expressly approved, and Lord Eldon's criticised as being "far too narrow", by Lord Herschell in Trego v Hunt.[70] In the course of his judgement Herschell expressed the opinion that it was goodwill which tended to make the business permanent, and he distinguished the newly formed business from the established one as follows:

> "The former trader has to seek out his customers from among the community as best he can. The latter

has a custom ready made. He knows what members of the community are purchasers of the articles in which he deals, and are not attached by custom to any other establishment."[71]

The change in emphasis apparent in the approach of Wood V. C. and Lord Herschell demonstrated an increased awareness that goodwill was the product of successful business activity rather than business locality or personal connection. These latter were of greater importance for the small scale one-man, or partnership, businesses, in relation to which goodwill had previously been considered. With regard to large scale impersonal joint-stcok companies matters were different.[72] Lord Herschell's opinion as to the permanent nature of the business reflected the fact that the purchaser of already functioning industrial-capital was paying for a secure flow of future income based on the historical performance of the capital.[73]

The fact that Lord Herschell perceived goodwill in such a light led him to regret the rule sanctioning later competition after the sale of businesses, where a payment had been made for goodwill. The court decided, however, that by 1895 it was too late to change the rule.[74]

IV. Goodwill as Property.

In 1800 in Hammond v Douglas[75] it was decided that goodwill did not form part of the stock in trade of a partnership.

Although it survived the death of one of the partners, it accrued to the surviving partner and did not form any part of the deceased partner's estate; it being seen merely as the former person's right to carry on the trade. The grounds for this judgement were later doubted by Lord Eldon in Crawshay v Collins[76] but were accepted as correct, and acted upon by Shadwell V.C. in Lewis v Langdon[77].

By 1855, however, goodwill was seen as a distinct business assset. As a consequence, in Wedderburn v Wedderburn[78], Sir John Romilly M.R. held that the estate of a deceased partner was entitled to participate in the goodwill of a business, stating in the course of his judgement that:

> " Goodwill manifestly forms a portion of the subject matter which produces profits, which constitutes partnership property, and which is to be divided between the surviving partners and the estate of the deceased... whenever there is a reputation and connection in business, constituting goodwill [it must be treated] as part of the assets of the concern. "[79]

Romilly confirmed this decision in Smith v Everett.[80]

Thus goodwill became seen as a distinct object of property rights having value of itself; but it remains to consider the precise nature of that property.

Lord Eldon's conception of goodwill as being tied to the physical location of a business was adopted by Sir John Leach

M.R. in Chissum v Dewes[81]. As the goodwill of a business was nothing more than the advantage attached to the possession of particular premises, then a mortgagee, entitled to possession of the business property was entitled to appropriate any goodwill. This judgement was followed in King v Midland Railway Co.[82], and in Pile v Pile[83].

These precedents were distinguished, however, in Cooper v Metropolitan Board of Works[84], in which the Court of Appeal held that, although in some cases goodwill of trade premises did pass to a mortgagee, it did not do so where it arose from and depended upon the personal skill of the owner. It is difficult, however, to draw any real distinction between the business of a tailor, as in the Cooper case; and the business of upholsterer, baker, or the business of a graving dock as in the earlier cases, and it is clear that Cooper v Metropolitan Board of Works represented a shift of emphasis, from seeing goodwill as the appurtenance of real estate to seeing it as the outcome of productive activity.[85]

As early as 1843, in England v Downs[86], Lord Langdale had challenged Lord Eldon's definition of goodwill. According to Langdale goodwill was incident to business stock rather than merely business premises. He defined goodwill as:

> " ...the chance or probability that custom will be had at a certain place of business in consequence of the way in which that business has been previously carried on. "[87]

Although Langdale continued to define goodwill in terms of the probability that customers would continue to resort to the premises, the underlying emphasis was shifted from the location itself, to the purpose for which the premises were used. Attention was concentrated on the functioning industrial-capital rather than on the premises, which were merely seen as the locus for the operation of capital. As a consequence it was possible to understand and treat goodwill as the emanation of the business activity rather than the real property, and thus to deal with it as a distinct business asset apart from any real property.

But in 1854 Chief Baron Pollock reasserted the link between real property and goodwill. In Potter v Inland Revenue Commissioners[88] he decided that where goodwill was sold apart from any interest in land, as in the case in question, it was to be treated as property subject to duty under the Stamp Act. Where, however, goodwill was sold together with real property, it merely reflected the enhanced value of the real property, and did not attract its own distinct duty. As the latter was by far the most likely occurrence this view was tantamount to making goodwill an adjunct to real property.

In 1867 The House of Lords assumed a position more in line with that previously held by Lord Langdale in its decision in Ricket v Metropolitan Railway Company.[89] This involved a claim, under the Land Clauses Act, for compensation for the loss of business suffered by a public house in consequence of

building work carried out by the defendant company. Although the work did not directly affect the public house it did prevent customers getting to it by blocking their access. It was decided that the value of a building was to be estimated with respect to the use the occupier made of it. If that use were impaired, then the occupier had sustained damage and was entitled to compensation. It is evident that the House of Lords accepted that, even in the case of a public house, goodwill was the product of commercial activity rather than mere location.

In Ex parte Punnet[90], however, Jessel M. R. expressed the opinion that on the sale of a public house the goodwill automatically went with the premises. And in Cooper Metropolitan Board of Works[91] Cotton L.J. had permitted the possibility of public houses being the only exception to the general rule that the mere mortgaging of real property did not pass any claim against goodwill. Both of these decisions failed fully to distinguish between the sale of the real property as such, and the sale of the business together with the land on which it is carried on. It is only in the latter case that the possibility of goodwill arises.

In Whitley v Challis[92] the Court of Appeal decided that a receiver was not to be directed to manage the business carried out on mortgaged property, unless the business was, either expressly or impliedly, included in the security. It was argued for the plaintiff that, just as with a public

house so with a hotel, the mortgagee was entitled to claim any goodwill attached to the property; and to realise the same, by selling the hotel as a going concern. The Court did not address this argument directly, but decided as a matter of construction that the agreement did not include the goodwill of the hotel.[93]

By 1898, however, it was clearly accepted that goodwill constituted a discrete form of property and was not dependent upon, or necessarily attached to, the real property of a business. In The West London Syndicate Ltd. v Commissioners of Inland Revenue.[94], the majority of the Court of Appeal[95] expressly rejected the argument that goodwill amounted to nothing more than the enhancement of the value of business premises. Business activity could be distinguished from the location on which it was carried out. Even in the case of a hotel goodwill was conceptually distinct from rights over land, and as such it was liable for stamp duty in its own right. According to Smith L. J.:

> " goodwill is as capable of being sold as a separate entity for what it is worth as is the tenant's interest in the lease. It may be that by the terms of the lease each must be sold, if sold at all, to the same person; but that does not prevent them being sold as separate and distinct entities; and if so sold goodwill, in my judgement, is property, and is clearly not land."[96]

Finally in I. R. C. v Muller & Co.'s Margarine Ltd.[97] it was argued for the Revenue Commissioners, on the basis of the West London Syndicate case, that as goodwill did not attach to the real property it could not be considered as situated in any particular place. It was not, therefore, eligible for the exemption from stamp duty granted on the purchase of property situated abroad. The majority of the House of Lords rejected this argument as specious. Although goodwill could be seen as a form of property in its own right, it could not be considered apart from the business activity which gave rise to it.[98]

The judges differed, however, in their individual conceptions as to the precise nature of goodwill. Lord Lindley shared the view of contemporary accountancy theory that it was something, although he was not quite sure what in any definitive terms, which added value to a business.[99] Lord Macnaghten offered the not very precise suggestion that:

> " Goodwill is the benefit and the advantage of the good name, reputation and connection of a business. It is the attractive force which brings in custom...[it] differs in its composition in different businesses in the same trade. One element may preponderate here, and another there."[100]

The most accurate description of goodwill, as the product of transferring industrial-capital, was contained in the judgement of Lord Brampton, in which he emphasised that the

purchaser of a business bought it as a going concern, and hopefully as a source of future profit.[101] Although even that judgement contained no attempt at any theoretical consideration of how the process operated, or how the actual value of goodwill was determined. It is to the latter question that attention will now be turned.

V. Share valuation procedures adopted by the Courts.

In 1863 Sir John Romilly M. R. expressed the view, with regard to the valuation of shares in partnerships, that;

> " in truth nothing can be less satisfactory than the valuation of professional valuers of property of this description.....the Court...is obliged to proceed much on guess work, without any certain data on which to found a satisfactory conclusion."[102]

It is the purpose of this section of this thesis to examine the way in which the Courts developed a generally accepted method of valuing businesses, and incidentally goodwill. The role of experts in the valuation process will be seen to be problematic, not to say contradictory on occasions. Given their lack of theoretical insight into the nature of goodwill, as revealed previously in this work, this shortcoming is not unexpected. The judiciary have also been criticised previously for lacking any conceptual understanding of the precise nature of goodwill. It will be

seen however that in responding to the dictates of pragmatism, they consistantly adopted a method of valuation which stressed the value of businesses as fictitious capital, i.e as a source of income, and relegated the value of concrete assets to a role of secondary importance.

In Mellersh v Keen[103] Romilly himself applied the method of valuing businesses at so many years purchase of profit. That he was not totally convinced as to the accuracy of this procedure is evident from his comment that it was adopted only because of his having "no better data given me by which I have the means of ascertaining the value of the goodwill".[104] Better procedures were to be developed by the Courts themselves, but before these are examined the case of Felix Hadley & Co. Ltd. v Hadley[105] reveals the method of valuation actually used in commercial circles. In the course of his judgment Byrne J. commented that:

> " There was in Birmingham in 1887 and 1888 a well recognised rule that no prudent commercial man would have advised the payment of anything for goodwill on the purchase of a business, unless upon a fair average of years a profit could be shown upon the capital engaged of from 7.5 to 10 per cent., and that further that no public company could be floated unless this could be shown upon a business not at the time a declining one."[106]

This passage demonstrates once again that commercial practice, as opposed to either accounting or legal theory, had already adopted an approach to the valuation of businesses in strict relation to the profit earning capacity of the enterprise, rather than the value of the underlying assets.[107]

It was as a consequence of the Finance Act 1894[108] that the courts initially became involved in the endeavour to accurately assess the value of shares. Before considering the actual methods adopted it is necessary to examine the provisions of that particular legislation.

S.1 provided that estate duty was to be levied and paid upon the principal value of all property which passed on the death of any person.

S.7 enacted the manner of determining the value of any property for the purposes of estate duty; subsection 5 laying down the procedure for converting value into price, viz,

> " the principal value of any property shall be estimated to be the price which, in the opinion of the Commissioners, such property would fetch <u>if sold in the open market</u> at the time of the death of the deceased. "

S.10 provided that any person aggrieved by the Commissioners' valuation might appeal to the High Court, who would then fix the amount of duty to be paid. There was a right of further appeal.

A problem arose with regard to the construction of S.7(5) as it related to shares in private companies, and one which

> " caused acute legal controversy and a great divergence of legal opinion "[109].

Farwell J's generally accepted definition of the share in Borland's Trustee v Steel Bros & CO Ltd.[110] stated that the contractual terms contained in the articles of association of a company formed one of the incidents of the share. In the case of private companies the articles usually contained provisions restricting the transfer of shares, even before they were legally required to contain such restrictions. The problem was as to the effect of such restrictive articles on the value of shares for the purposes of levying estate duty. It was never the intention for private companies to operate at the economic level as joint-stock companies capitalised in terms of abstract money- capital. Economically they remained essentially partnerships, operating on the basis of industrial-capital; although appropriating the many advantages of the corporate form.[111] Shares in such companies were not meant to be transferred. To that extent they were not required to represent, with any degree of precision, the value of the business in terms of money-capital. This is one reason why the share capitalisation of such companies was not transformed into fictitious capital in its fully developed form.

The Finance Act ensured, for the purposes of estate duty, that this transformation was completed, by requiring the valuation of the industrial-capital operated, as fictitious capital. This involved the Commissioners, and the Courts, in the anomalous process of determining the exchange-value of something that was never meant to be exchanged.

The matter was considered for the first time in Attorney General for Ireland v Jameson.[112] The majority of the Court of King's Bench held that in estimating the value of shares, regard was to be had to such special provisions as were in the articles respecting the power to transfer them: such restrictions operating to greatly reduce their value. In a minority judgement Palles C. B. held that the shares should be valued on the basis of a fictitious sale in the open market without reference to the articles.

The Court of Appeal later declined to adopt either of these alternatives, holding that the value of the shares ought to be estimated at the price which they would fetch if sold on the open market on the terms that the purchaser should be entitled to be registered, although once registered he would be subject to any restrictions contained in the articles. The Court of Appeal thus agreed with Palles C. B. that the outcome of a fictitious sale had to be considered, but whereas he ignored the articles completely, the Court of Appeal only ignored them to the extent of permitting the fictitious purchaser to become a member of the company.

Thereafter the purchaser was to be subject to the operation of the articles as they restricted his right of alienation in the future.[113]

A similar approach was adopted by Lord Fleming in the Scottish case Salvesen's Trustees v I. R. C.[114]; and the Jameson case was followed in the Irish case Smyth v Revenue Commissioners[115]

In 1936 The question was considered by the House of Lords in I.R.C. v Crossman; and I.R.C. v Mann[116] in which a majority of 3 to 1 reversed the 2 to 1 majority of the Court of Appeal, and approved the decisions in the Jameson, and Salvesen cases.

In the opinion of Viscount Hailsham L.C. the Court of Appeal had been mistaken in treating S.7(5) of the Act as making the existence of an open market a condition of liability, rather than as merely stating a mechanism for measuring value. The consequence of the Court of Appeal's view would have been that any property that could not be transferred would not be assessed for estate duty.[117]

Having considered how S.7 of the Finance Act was to be applied it remains to examine the actual methods adopted by the Courts to determine the value of shares under that section. To return to the Court of Appeal decision in A.G. v Jameson[118], the preponderant view emphasised the need to balance the earning capacity of the shares against the restrictions placed on their transfer by the articles[119],

although it was not actually called upon to determine the value of the shares.

In the Salvesen case[120], Lord Fleming considered the factors which would influence an imaginary prospective purchaser of the shares in question.[121] Foremost amongst these considerations was the profit earning capacity of the company capable of being maintained into the future. The realisable commodity value of the company's assets provided underlying security for the investment; and the restrictions on the right to transfer the shares depreciated their value.[122] Profit earning capacity was again considered to be the most important factor in determining the value of shares in Smyth v Revenue Commissioners[123], whilst the underlying commodity value of the assets remained a background factor[124]; and Smyth v Revenue Commissioners was applied in the much later Irish case of McNamee v Revenue Commissioners in which Maguire J. expressly approved of concentrating on the earning capacity of a company when it came to valuing its shares.[125] As long as industrial-capital continues to generate income it will continue to have a value as fictitious capital, even although it may have ceased to operate as capital in reality through failing to command any profit. At some stage the fictitious capital value may fall below the realisable commodity value of the assets, and then the latter value becomes of more importance in determining the value of the

business. In the Smyth case Hanna J. can be taken as having decided that point had not yet arrived.

In McConnel's Trustees v C. I. R.[126], however, Lord Fleming reached the opposite conclusion. In regard to a land holding company which had never declared a dividend, he refused to consider it as a going concern, and valued its shares in line with their proportionate claim against the realisable value of its property.[127]

The procedure for valuing shares in companies, in which the commodity value of the assets is greater than their capital value, can be found in the decision and reasoning of Rowlatt J. in re Courthope.[128]

This case concerned a company in which the realisable value of its assets, consisting of cash, loans, and a large mortgage, greatly outweighed the value of company as a source of income. Rowlatt J., however, refused simply to pull the company to pieces in order to reach the value of those assets. The matter had to be considered through the supposed purchaser in the market, but he was in no doubt that a prospective purchaser would only buy shares in the company with a view to having it wound up, in order to realise the underlying assets.[129]

The assets in the McConnel, and Courthope cases were peculiar in that they consisted of easily realisable assets. Such is not the case with more usual company assets; the concrete means of production such as machinery, raw materials and

stock. How these assets were to be valued was considered in Dean v Price.[130]

At first instance Harman J. considered three potential methods of valuing a company's assets. The first method was to value them as capital in line with the profits they generated. The second method was to value the assets as a "going concern ". As such the assets would have a value in excess of their individual commodity value.[131] The third method was to value the assets on a break up basis.

The auditors' adoption of the third method, was rejected by Harman J. in favour of the second approach.

On appeal Lord Denning highlighted the contradiction in Harman J.'s approach. "Going concern" did not just mean producing; it specifically meant producing income. Where the assets of a company had ceased to operate as capital, they would not be purchased as such. In the case in question the assets had no value as capital as they had persistently failed to generate any income let alone profit.

The large fall in the value of the assets from their cost price merely reflected the realities of the second-hand market in all commodities.[132]

The case of I. R. C. v Crossman[133] is of particular interest in that it would seem to contradict the contention of this work that the judiciary came to accept capitalisation of profit as the method of determining the value of businesses, and hence goodwill. Finlay J. apparently endorsed a

complicated method of valuation based on a 5 years payment of super-profits. This method was suggested by a witness for the plaintiff, the eminent accountant, Lord Plender.[134] The Crown on the other hand appear to have based their valuation on a capitalisation of the yield on the shares.

It is suggested that Finlay J.'s support is for the outcome of Plender's method, rather than the method itself, in that it gave a value, approximately half way between the values contended for by the plaintiff, and the Crown. In other words it represented a method of achieving a reasonable compromise. Finlay J might have thought it satisfying to use the evidence of the plaintiff's witness to arrive at a value greater than that desired by the plaintiff, and it is evident that the tone of his judgement revealed approval for the valuation methods adopted by the Crown.

With regard to the opinions of experts, the views of Romilly M. R. in Coventry v Barclay have already been mentioned. This theme was taken up by Dankwerts J. in Holt v I.R.C.[135] where he spoke of their views as inevitably uncertainty and controversial.[136]

In spite of the discrepancies in the valuations put forward, it should be noted that there was conformity amongst the witnesses as to the appropriate procedure to be used to reach the valuation. All stated that of foremost importance was the yield to be expected on the shares. With which opinion Dankwerts J. concurred.[137]

The words of Dankwerts J. as to the conjectural nature of share valuation were echoed in the Judgement of Plowman J. in re Lynall deceased.[138] More importantly, however, the underlying method of valuation also remained essentially the same. According to Plowman J. the three principal factors which affected the valuation of shares were: the appropriate, or required, dividend yield; the prospective, or actual, dividend yield; and the possibility of capital appreciation.[139]

In the preceding review of cases involving the valuation of shares for the purposes of the Finance Act, it has been maintained, in the face of judicial assertions as to the difficulty of the process involved, and the need to resort to simple guesswork, that the Courts have adopted essentially the procedure of valuing capital in line with its earning capacity. It is the contention of this thesis that the valuation of commodity capital can be reduced to a more comprehensible, and precise, formulation, than is evident in the expostulations of the majority of, either Judges, or accountancy experts. In support of this contention one need only cite the many works of theory and practice produced in the field of investment analysis.[140] Indeed mathematical formulae have been developed for measuring the value of stochastic cash flows.[141] One final case will be cited, however, to confirm the validity of the contention.

In the course of delivering the Decision of the Privy Council in Attorney General of Ceylon v Mackie[142] Lord Reid stated that witnesses for the appellants had adopted a theoretical approach to the question of valuing shares based on the assumption that it was possible to estimate the future average maintainable profit, from past profit, using a mathematical calculation; and by means of some further such arithmetical calculation to determine the price which a prospective investor would pay for shares giving such an income.[143] This is precisely the contention of this thesis. The Privy Council, however, declined to accept this method of valuation as appropriate, and decided that the shares in question should be assessed in line with the value of the tangible assets owned by the company. This decision might appear, at first sight, to dispose of this thesis at a stroke. An examination of the judgement, however, reveals that it was the particular circumstances of the company which precluded an application of the theoretical approach.
The profits and losses of the company had fluctuated so violently in the past that as the Court pointed out it was:

> " not possible in this case to derive by an arithmetical calculation from past results anything which could properly have been regarded ...as an average maintainable profit."[144]

In regard to the system proposed by the Crown witnesses the Court expressed the opinion that:

" It may be that these assumptions would be justified in many cases. Where the past history of a business shows consistent results or a steady trend and where there has been no disruption of general business conditions it may well be possible to reach a fair valuation by a theoretical calculation. "[145]

It is suggested, therefore that the Mackie case, far from invalidating the procedure proposed in this thesis, actually gives judicial approval to it. As the judgement of the Court makes abundantly apparent this case is in the nature of the exception which proves the rule and demonstrates its general applicability.

The Courts have also become involved in valuing shares as a consequence of the powers they have been given, under various Companies Acts, to protect minority shareholders.[146] For amongst the discretionary remedies available to the judiciary to deal with an abuse of a majority position was, and is, the power to order the purchase of the minority shareholders interest, either by the other sharholders or the company itself.

The first case in which this possibility was considered was Meyer v Scottish Textile and Manufacturing Co. Ltd.[147] in which the 1st Division of the Court of Session ordered the purchase of the plaintiffs' shares at a value which they

would have had but for the effect of the respondents' oppressive conduct.[148]

A more detailed expostion of the valuation process involved in such a procedure was provided in Nourse J's judgement in re Bird Precision Bellows Ltd.[149] In the case of a private unlisted company, not having a history of paying significant dividends, the appropriate method of valuation was on an earnings basis. The maintainable profit earned by the company should be capitalised using a multiplier selected to provide an appropriate yield, and price to earnings ratio, in the light of the risk involved. The value of the net tangible assets should only be considered to perform a secondary role and should only be considered as a means of estimating the security of the investment. In the case of a quasi-partnership, although there is no universal rule, the minority shareholding should normally be valued on a pro rata basis, as a proportionate part of the company's total worth, and no discount should be permitted in account of the fact that it is only a minority holding.[150]

A similar approach to the valuation of shares in a quasi-partnership was adopted by Staughton J. in Buckingham v Francis[151], although there the question of valuation arose by way of consent orders rather than the minority protection provisions of the Companies Act. In the course of his judgement Staughton J. expressly rejected the calculation of goodwill as an independent asset on the basis of so many

years purchase of super profits, preferring the approach which maintained the value of a company to be the sum representing capitalised future profits.[152]

This extended examination of cases involving the valuation of shares has demonstrated how the Courts have consistently approached their task of evaluating businesses as going concerns, by capitalising earning capacity in line with a minimum rate of return required, the latter being underpinned by the prevailing rate of interest. Following this procedure it can be seen that goodwill can have no distinct existence apart from the process of valuing capital as such.

It remains only to consider Findlay's Trustees v A. T. C.[153] which directly concerned the valuation of goodwill of a newspaper. Two witnesses for the appellants, both prominent figures in the newspaper industry, expressed the view that the goodwill should be ascertained as a distinct asset on the basis of 3 years purchase of average net profit. However, accountants called as witnesses by both sides agreed that the correct method of valuing goodwill was to ascertain the value of the business and all its assets as a whole, and then deduct from that figure the value of the tangible assets. The resultant figure giving the value of goodwill.[154] This latter method met with the express approval of Lord Fleming who delivered the judgement of the court. In doing so he rejected the alternative procedure as not "entirely satisfactory", and going on to express the opinion that:

" It is to be presumed that the hypothetical purchaser having obtained all the relevant information would consider in the first place the risks which are involved in carrying on the business, and would fix the return which he considered he ought to receive on the purchase price at a rate per cent. The only factor which he would then require to determine would be the annual profits which he would derive from carrying on the business. The determination of these two factors would enable him to fix the capital value of the business "[155]

That is a precise and cogent statement of the approach of this thesis, and reflects the transformation of concrete industrial-capital into abstract fictitious share-capital.

Chapter Four: Endnotes.

1. The concept is itself an old one. Its first recorded appearance occurs in a will dated 1571. That the difference between the normal commodity value of objects and their value as capital was clearly understood at an early date is shown in the following anecdote involving Doctor Samuel Johnson. In reply to the question as to the value of a brewery he was disposing of in the role of executor of an old friend, he responded

> " We are not here to sell a parcel of boilers and vats, but the potentiality of growing rich beyond the dreams of avarice. "

In other words, what was up for sale was not mere commodities, but capital with its proven command over surplus value.
Both cited in T.A. Hamilton Baynes, Share Valuation.

2.L.R. Dicksee & F. Tillyard, Goodwill and its Treatment in Accounts, 3rd edition, Gee & Co., London, 1906. Dicksee produced his first edition in 1897.

3.Ibid. p.49.

4.Ibid. p.92.

5.Ibid. p.85. Dicksee assumed, for the main part, that the new proprietor would assume an active role in the operation of the enterprise, and an allowance, therefore, had to be set against potential goodwill representing the value of the work so done.

6.A trading business might be bought from anything from one to five years purchase, and a manufacturing business might require from one to four years purchase. On the other hand a professional concern would only involve from one to three years purchase, whereas a newspaper might command a purchase period of ten years.

7.Ibid. pp. 80 & 85.
It is only on the basis of the presumption that the return on capital, in all its forms, is mere interest that industrial-capital, which actually commands a return in line with the average rate of profit, appears to command an above normal return. See infra.

8.It was because of this range of potential valuation that Dicksee showed such lack of certainty in his formulae for establishing the value of goodwill.

9.Ibid. p.86.

10.Ibid pp.86-87.

11.Ibid. p.87.

12.As authority for this claim Dicksee cited the Comptroller of the Companies Department, ibid p.103.

13.Companies Act 1908 s.81(g).

14.Ibid. p.87.

15.Leake, P.D., Commercial Goodwill, Pitman & Sons, London, 1921.

16.Ibid. p.18.

17.Ibid. pp.19-23.
"...money demands at least some minimum annual interest or wage, increasing with the degree of risk incidental to its employment. Easily marketable gilt-edged securities may yield 5% per annum, which is a reason for assuming 5% to be the minimum annual wage or hire of money" p.23.

18.Ibid. p. 25.
Leake recognised that super profit could continue to appear in the accounts of a particular enterprise, but he maintained that this apparent continuation was in fact a new and distinct goodwill arising from the endeavours of its new directors.

19.See e.g. pp.18, 22, 23, 25.

20.E.g. pp.51 & 72.

21.Ibid p.23.

22.No attempt is made here to deal in detail with Leake's method for estimating the value of goodwill, for it is not the intention of this work to criticise the practicalities of his theory, but merely to highlight the fallacies that undermine it.

23.Goodwill does not emerge because concrete capital receives above normal profits: it emerges because money-capital does not receive profit of enterprise. Leak's false conclusion is the consequence of his accepting that which it should have been his function to explain: the transformation of concrete capital into abstract capital and the apparent domination of money-capital over industrial-capital. It is through this process that goodwill appears, and it is only as a consequence of this process that the return on fictitious capital generally assumes the form of interest.

24.Ibid. p.69.

25.Leake himself recognised this fact. Op.cit.

26.Seed, H.E. Goodwill As A Business Asset, Gee & Co., London, 1937, at p.8.

27.Amongst these possible advantages were included: the personality, skill or influence of the proprietor; the reputation of the commodities produced; the particular situation of the business premises; the possession of a monopoly; or a reputation for fair dealing.
Although any one of those factors may help to raise a particular company's return above the average rate of profit, none of them can be considered in themselves the source of goodwill.

28.Ibid. p. 27.

29.Ibid. p. 99.

30.Ibid. p. 102.

31.It was in relation to size of risk premium, that the separate, and accurate valuation of the tangible assets assumed importance.

32.Ibid. p.123.

33.This clear from the worked example shown on p.102.
"... assume that the future maintainable profits of a business are...£60,000 per annum. Let us further imagine that a reasonable return to require on invested capital...is 12.5%. The exchange value of the business will be:

60,000 x 100 /12.5 i.e. £480,000.

Let us assume that the values of the tangible assets so arrived at aggregate £240,000.

The value of the business was____£480,000

The value of tangible assets ____£240,000

And there is left as the price
payable for goodwill ____£240,000 "

34.Ibid. pp.97-99.

35.Ibid. p.126.

36.Ibid. pp.126-127.

37.Cutforth, A.E., Methods of Amalgamation and the Valuation of Businesses For Amalgamation and Other Purposes, London, 1926.

38.Cutforth recommended a sliding scale procedure for capitalising " super-earnings", in which the actual super-profit is divided into two or three blocks, the blocks being capitalised at a progressively diminishing number of years purchase. See pp. 137-143.

39.Ibid. p.149.

40.Op. cit.

41. R. L. Sidey, The Valuation of Shares. Although published in 1950, this book was an expansion of a chapter in his earlier work, Companies, Formation Management and Winding-up, published in 1923, some fourteen years before Seed's work was published.

42.The actual value of the business was computed by capitalising the average net annual return enjoyed at a rate which took into consideration the degree of risk involved.

43.Bonbright, J.C., The Valuation of Property: A Treatise on the Appraisal of Property for Different Legal Purposes, 2 vols., The Michie Company, Charlottesville, 1937.

44.Vol.2 p. 265.

45.Ibid. p.264.

46.Glover C.G., The Valuation of Unlisted Shares, Accountants Digest, No. 132, Spring 1983 at p. 23.

47.Ibid. p.25.

48.Ibid at p.15.
Glover suggets that, in practice, the value is best assessed on the basis of capitalising either dividends or earnings; depending on the nature of the company and the size of the share holding, with the former being more favoured. See pp.15-23; & 28-30.
The actual rate of capitalisation is dependent on the risk involved, pp.25-28; with a discount for lack of marketability of shares in unlisted companies, pp 13-15.

49. Article 37 of the Directive stated that it should be a legal requirement in all Community countries that goodwill be written off from accounts over a period of not more than 5 years, or the useful economic life of the goodwill.
These requirements became embodied in SSAP 22, Accounting for Goodwill, issued in December 1984.
Attention will be concentrated on the response of the Accounting Committee to the Directive, but it will be appreciated that any critique of the theoretical

underpinnings of the response apply equally to the Directive.

50.P.17.

51.Op. cit.

52.David v Mathews [1899] 1 Ch. 378.

53.Dicksee, ibid., p.43.
Precision of definition is not furthered by the adoption of "humorous" zoological analogies as in Whiteman Smith Motor Company v Chaplin (1934), 2 K. B. 35. Nonetheless as will be seen the Courts' pragmatic treatment of goodwill reveals an approach similar to the one proposed by such accountants as Seed, Sidey, and Glover.

54.As Allan, The Law Relating to Goodwill, p. 2-3, pointed out there are indications in the year-books and the old reports of traders agreeing to retire from their business in favour of others, but any legal question tended to relate to covenants in restraint of trade. This particular text is even more atheoretic in nature than corresponding accountancy texts, being satisfied to set out the various cases relating to goodwill.

55.9 Mod. 459.

56.(1810) 17 Ves. 335.

57.Ibid p.346.

58.3 Mer.442.

59.P.445.

60. In is surely not coincidental that the short term rate of interest actually was 5%, the maximum permitted under the Usury law. See Homer, S., A History of Interest Rates, chapter 13.
In the case of the transfer of industrial-capital to joint-stock companies, in which the shareholders assume a role of akin to that of the money-capitalist, the basis for the rate of capitalisation is the prevailing rate of interest. In Kennedy v Lee, however, the purchaser intended to retain the role of industrial-capitalist, and, therefore, insisted on receiving a return which permitted him, at least partial, access to previous profit of enterprise. Hence the rate of capitalisation was fixed at 10% rather than merely 5%.

61.Such express covenants were enforceable and clearly distinct from the implied prohibition on later competition, considered infra. See Shackle v Baker, 14 Ves.468.

62.P. 452.

63.In so doing he could well be seen as the precursor of later economists such as Bohm-Bawerk, and Irving Fisher!

64.27 Beav. 456.

65.14 Ves. 468.

66.2 Mad. 198.

67.2 D.J.& S.446.

68.4 D.J.& S.150.

69.Churton v Douglas, (1859) 28 L.J. Ch.841, at p.845.

70.(1896) A. C. 7.

71.At p. 18. Herschell did not consider the possibility of companies being floated to undertake new enterprises having an element of goodwill from the outset.

72.In the words of Wood V.C., ibid. at p.845: "...it would be absurd, as it seems to me, to say that when a large wholesale business is conducted, the public are mindful whether it is carried on at one end of the Strand or the other, or in Fleet Street...or any place, and that they regard that and do not regard the identity of the house of business, namely, the firm."

73.This latter opinion conflicts with the general opinion of accountants who tend to see goodwill as a wasting asset.

74.See p. 20. Trego v Hunt was of course decided at a time when the House of Lords was bound by its own previous decisions.
Lord Herschell's view as to nature of the legal authorities was endorsed by other members of the Court. See Lord Macnaghten at pp. 23-24; and Lord Davey at p. 27.
In Trego v Hunt the House of Lords also turned its attention to the subsidiary question whether the vendor of goodwill could directly solicit the clients of his former business. It is clear from the judgments that the House of Lords were of the opinion that if authority precluded them from preventing the vendor of goodwill from competing at a later time; then at least he would be stopped from making use of any information he might have gained in the course of his former

business. They held, therefore, that such contact was unlawful. This might be considered a small matter, and one which did not greatly assist the purchaser of goodwill, but it was all that the House of Lords found in its power to do; and it was symptomatic of the general disfavour towards those sellers of goodwill who later competed with the business they had sold.

75.5 Ves. Jun. 539.

76.15 Ves. 218.

77.7 Sim. 421.

78.22 Beav. 84.

79.Ibid. at. p. 104.

80.27 Beav. 446.

81.5 Russ 29.

82.(1860) 17 W.R.113.

83.(1876) 3 Ch. D. 39.

84.(1883) 25 Ch. D. 472.

85.The only exception to this new approach cited by Cotton L. J. was the case of public houses. These, he considered, acquired any goodwill simply from location, rather than as a consequence of the effort of their proprietors. In so holding he was confirming the opinion of Jessel M. R. expressed in Ex parte Punnet in re Kitchen. (1880) 16 Ch. D. 226.
But see cases infra.

86.1843 6 Beav. 269.

87.at p. 277. Emphasis added.

88.(1854) 10 Ex. 147.

89.(1867) L.R. 2 H.L.175.

90.in re Kitchen. (1880) 16 Ch. D. 226.

91.Supra.

92.(1892) 1 Ch. 64.

93.The court held that the word hotel only referred to the building and did not connote the business carried on therein. Whereas Truman & Co. v Redgrave,18 Ch. D. 547, was an example where the goodwill of a business had been expressly charged; Campbell v Lloyd's, Barnett's and Bosanquet's Bank,(1891) 1 Ch. D. 136 must be taken as an example where the goodwill was impliedly mortgaged. In both cases a manager was appointed by the court.
The peculiarity of the decision was later commented on by Kekewich J. in re Leas Hotel Company. Salter v Leas Hotel Co. [1902] 1 Ch. 332, at p. 334. It was his decision which was overturned by the Court of Appeal in Whitley v Challis.

94.(1898) 2 Q. B. 507.

95.Smith and Rigby L.J.J. According to Smith, at pp. 513-514, "...goodwill is capable of being sold as a separate entity...[it] is property, and is clearly not land." Vaughan-Williams L.J. held the goodwill not to be separable from the premises.

96. Ibid. pp. 513-514. Emphasis added.
In his minority judgement Vaughan-Williams L. J. apparently favoured the old view that saw goodwill as annexed to land. See pp. 530-531.

97.(1901) A. C. 217.

98.See particularly Lord Macnaghten at p.224.

99.See p.235.

100.P.224.

101.At pp. 231-232.

102.Coventry v Barclay (1863) 33 Beav. 1. at p.13/14.

103.28 Beav 453.

104.At p. 457.

105.77 L.T.R.131
As with the more famous case of Salomon v Salomon & Co this case involved the transformation of a previously unlimited one man business into a limited company.
Byrne J. held that, in the absence of fraud, the company had no right of action against Hadley with respect to the excessive price which it was alleged had been paid for goodwill.

106.Ibid p.134.

107.Such a view did not find favour with Byrne J., for whom goodwill had a distinct existence in the reputation and connection of the business. See p.134.

108.57 & 58 Vict. c. 30.

109.Per Maguire J, in McNamee v Revenue Commissioners (1954) Ir. R. 214, at p. 218.

110.[1901] 1 Ch. 279. See chapter 2 supra..

111.See Ch.2 supra.

112.(1904) 21 I. R. 644.

113.The clearest judicial statement on the fundamental importance of transferability is to be found in the dissenting judgement of Lord Hanworth in re Paulin deceased, 152 L.T., 98, in the course of which he stated, at p.105, that:

> "The price at which shares in sound industrial undertaking will be sold on a stock exchange is not determined by the yield of the dividend alone. Such shares are not treated as first-class gilt edge securities are treated, as liquid assets, that is to say, saleable at any time, in any quantity, at the current price of money. Attention is paid to the ease with which such a share can be realised in an emergency..."

114.(1930) A. T.C. 43.

115.(1931) I. R. 643.

116.[1937] A.C. 26

117.The restrictions were to be taken into consideration in determining the value of the shares on the hypothetical open market. As Hailsham L. C. pointed out if such shares as were being considered were to be valued without regard to the restrictions they bore, then they would have commanded a price at least twice as great as that actually suggested.

118.Note 112 supra.

119. According to Lord Holmes, at p. 239:

> " The dividend of 20% per annum paid for years, and likely to continue, would attract men who buy securities to hold as an investment and not to sell...On the other hand, the price would not be as

high as that of a security, equally good in other respects, that could be disposed of at any time in the open market."

See also Lord Ashbourne at p. 227

120.Note 114 supra.

121.Although he expressed the view that the estimation of the value of shares by the highly artificial standard laid down in the Finance Act must be a matter of opinion and did not admit of precise scientific or mathematical calculation this did not prevent him from applying such a standard. At p. 55.

122.See pp: 48, 51, 55.

123.Note 115 supra.

124.Ibid. See particularly p.656.
No issue can be taken with Hanna J.'s method of valuing shares; his application of the method is more problematic. The business in question a nominal capital of £30,000. According to Hanna J. the total share capital was only worth £33,750, as opposed to the value of the assets at £40,000. Thus the value of the business as fictitious capital was actually less that its value as simple commodities.
This shortfall is an example of what Cutforth would have called " badwill ", and it can only be concluded that the industrial-capital was operated in an extremely inefficient manner. No support can be given to Hanna J.' s opinion that the company was in an extremely prosperous condition.

125.(1954) Ir.R.214, at p.228.

126.(1927) S.L.T.14.

127. Although the conclusion arrived at by Lord Fleming may be correct, his terminology is at best inaccurate, and confused; and at worst reveals a total failure to conceptualise the contemporary joint-stock company form. At one point, p.16, he actually stated that " A share in a company represents a share in the assets or capital belonging to that company."

128.(1928) 7 A.T.C. 538.

129.Rowlatt J. felt that as the shareholding in question was only a minority one, the hypothetical purchaser/speculator would expect a level of profit of 50% on the undertaking, given the risk involved in the possibility of meeting resistance to the winding up, and valued the shares accordingly.

130.(1953) 2 All.E.R. 636; & (1954) 1 Ch. 409.

131. See p. 641.

132.See particularly p. 429 where he considers " negative goodwill".

133. Supra.

134.It is not intended to rehearse criticisms made previously of this type of method of valuation; although it has to be said, that it is only with some latitude that Lord Plender's extremely arbitrary procedure can be dignified by the appellation method.

135.(1953) 2 All E.R. 1499.

136.P. 1501.
It is not impugning the integrity of the experts to point out that the actual valuations put forward ranged from 12 shillings and tuppence, to 30 shillings. It is little wonder that Dankwerts J referred to these valuations, and even his own one, as the outcome of guesswork, at p. 1509.

137.At p.1509.

138.(1968) 421.

139.At p. 444.
The third of these factors is emphasised by Plowman J. because of the particular facts of the case. Although a private company with restrictions on transfer it would be apparent to any hypothetical prospective purchaser of shares, that the company would be forced to go public sooner or later. This would lead to the possibility of making a substantial capital gain when the transfer restrictions were removed.

140.In his Theory of Investment Value, p.55, J.B. Williams quotes the contention of R.F. Weise that: "The proper price of any security, whether a stock or bond, is the sum of all future income payments discounted at the current rate of interest in order to arrive at the present value." See also the various works on this topic referred to in the bibliography.

141.According to O. Bohren: " The certainty equivalent and risk adjusted discount rate (RADR) models have long been used for evaluating stochastic, multiperiod cashflows." Journal Of Business Finance and Accountancy, Vol. 10, no.1. An assessment of such mathematical models is beyond the competency of this thesis!

142.(1952) 2 All. E.R. 775.

143.At p. 778.

144.At p. 778; emphasis added.

145.At p. 778.

146.Stautory minority protection from oppressive conduct was first introduced in s.9 of the 1947 Companies Act, and was consolidated in s.210 of the 1948 Companies Act. Section 75 of the 1980 Act, subsequently consolidated in s.459 of the 1985 Act granted protection in the face of merely unfairly prejudical conduct.

147.1957 S.C. 110.

148.The actual method used to value the shares is not revealed in the report although Lord Sorn, at p.156, does comment on the conflict of the expert opinions provided to the court.
The decision was later approved on appeal by the House of Lords in Scottish Co-operative Wholesale Society Ltd. v Meyer [1959] A.C. 324.

149.[1984] 3 All E.R. 444, at pp 456-458.

150.Nourse J.'s decision was subsequently approved on appeal by the Court of Appeal in re Bird Precision Bellows Ltd. [1985] 3 All. E.R. 523.

151.[1986] 2 All. E.R. 738.

152.Ibid p. 741.
Risk was taken into consideration in determining the rate of capitalisation.

153.(1938) A.T.C. 437.

154.The two accountants, perhaps not unnaturally differed in the practical application of this agreed theoretical approach.

155.At p. 443.

Chapter Five: The Law Relating to Company Distributions.

I. Introduction.

It is not without some trepidation that this thesis pursues its course into that "vast and complex subject", the law relating to capital maintenance and the distribution of companies' assets.[1] The task to be undertaken is made more difficult by the need to confront criticisms of the legal treatment of capital maintenance and company distributions, emanating from the distinct but cognate disciplines of Economics and Accountancy. Such difficulties are further compounded by the lack of theoretical consistency in relation to those topics within those disciplines.

From the perspective of Economic theory capital may be understood as either a quantum or a res; as either an abstract fund of value or alternatively as concrete objects. From the former point of view, plant and machinery do not, in themselves, constitute capital but merely represent the concrete embodiment of the fund that is capital. From the latter, materialist, perspective, capital only exists in its physical embodiment. Which of these approaches has actually predominated within economic theory has changed over time. If the quantum approach appears to reign at the moment, it reflects a return to the approach of the classical economists such as Smith, Ricardo and Marx and evidences a reaction to a materialist interregnum. The predominance of the materialist

conception of capital can be dated from the 1870's and it is suggested that it is no without significance that it was at that very time that the judiciary also began to adopt a materialist concept of capital.[2]

Having established two possible economic theories of the nature of capital, it still remains to point out Kaldor's contention, made as late as 1956, that: "income is not generally subjected to any searching or systematic analysis in economic textbooks."[3]

Accountancy theory on the other hand generally has tended to perceive capital as a fund, and has tended to understand profit as an addition to that fund. Such a view has been the consequence of, and at the same time has confirmed, a concentration on the balance sheet as the means of determining profit. This quantum approach continued practices adopted prior to the industrial revolution, and although such practices were adequate for dealing with the typical enterprise operating at that time, they were less suitable for the conditions and enterprises operating in the second half of the nineteenth century. The development from speculative ventures operated on the basis of terminable stocks and involving essentially mercantile enterprises, into continuing enterprises operating on the basis of a permanently invested capital, especially when assuming the form of extensive fixed capital, required a change in emphasis from looking at profit as the product of a

particular venture to a consideration of a periodic flow of income.[4] According to Barton, however, no serious consideration appears to have been given to the concept of periodic income in accounting until the late 1930's.[5] The irony of such a situation was not lost on Hatfield who, in 1927, expressed the view that:

> "It is a peculiar fact that while all business is carried out for profits...while the ascertainment of profits enters into the sum and substance of accounting...the term is still vaguely and loosely used and without satisfactory definition by either economist, man of affairs, jurist or accountant."[6]

It can be seen therefore that neither Economic theory nor Accountancy practice were able to offer consistent assistance to the judiciary in their task of developing legal concepts of capital maintenance and profits. Even in the absence of such external theory, however, the Courts could not avoid addressing such matters in the cases that came before them. In doing so, and in endeavouring not to restrict the operation of joint-stock companies, they developed the permissive rules that subsequently have been the subject of criticism from the perspective of later economic and accounting theory[7].

It is hoped that once again the insight provided by the theoretical framework of this thesis will illuminate the obscurity that envelops this particular legal area. Attention

will be focussed on the emergence of dividend law as it existed prior to the Companies Act 1980, with the purpose of showing that, just as the legal nature of the share changed in the course of the nineteenth century, so the legal principles which governed the distribution of company dividends also underwent a process of reconceptualisation, reflecting changes in judicial perception of the company as an essentially money-capitalist investment form. As a consequence, dividend law was restructured in such a way as to emphasise the need to ensure a continued flow of income for shareholders at the expense of maintaining a fixed capital fund for creditors.

II. Capital Maintenance and The Balance Sheet Determination of Profit.

Capital maintenance and dividend distribution only became problematic in respect of outside creditors with the advent of limited liability.[8] In the partnership members retain full personal responsibility for the firm's debts. As the members' assets are available to settle partnership debts it is not necessary for the partnership to maintain a fixed capital fund as security for creditors.[9] Joint-stock companies registered under the 1844 Act were seen as incorporated partnerships; having limited liability expressly denied them, they were in a similar situation to partnerships and required no special rules relating to distribution.

Limited liability, however, brought with it potential problems for creditors. As creditors could only claim against the capital of the company it became seen by the judiciary as imperative to ensure that such capital was dedicated permanently to the business of the company and was not returned to the shareholders. The initial objective of dividend law was, therefore, the preservation of the rights of creditors through the preservation of a fixed level of capital.

In relation to statutory companies the Companies Clauses Consolidation Act of 1845 had expressly provided that companies were not to make any dividend payments whereby their capital stock would be in any degree reduced.[10] But whereas the Companies Acts of 1855 and 1856 had applied an insolvency test to company distributions[11], that provision was not re-enacted in the Companies Act of 1862 which was silent in regard to the payment of dividends.[12] In the absence of legislative provision it fell by default to the judiciary to establish distribution rules.

It has been generally accepted that the historical process through which the judiciary established rules regulating capital maintenance and dividend payments can be divided into two discrete periods. The first period prior to 1889, under the influence of Sir George Jessel M.R., was supposedly marked by the enforcement of a strict balance sheet based capital maintenance doctrine. The second period from 1889

until 1980, initially under the influence of Lord Lindley M.R., supposedly witnessed the subversion of the previous rules and their replacement by more permissive, not to say excessively lax, provisions which effectively undercut the doctrine of capital maintenance.[13]

As regards the first of these two periods the traditional view is that:

> "A single unifying idea runs through the decisions in dividend cases before the year 1889. This idea was premised on the view that the provisions of the Acts regarding the capital of a company and more especially its reduction, made it clear that the legislature would have frowned upon any dividend payment which would have left the company with a sum of assets less, in value, than its nominal paid-up capital."[14]

An examination of the cases reveals, however, that this view is mistaken in its imposition of a false historical periodisation which in its turn is a consequence of imposing a uniform interpretation on those cases. As will be seen the judiciary initially did assume a balance sheet approach to the determination of profits, in that distributions could only be made when the value of assets exceeded the value of nominal paid-up capital. It is suggested, however, that the move away from this approach to one based on the surplus in the profit and loss account occurred much earlier than has

previously been suggested; and that Lord Lindley did not so much initiate this shift, as give it direct expression and justification.[15]

In Macdougall v Jersey Imperial Hotel Company Ltd.[16], in which the defendant company had not even finished the construction of its hotel and thus had produced no profits, it was held that the payment of interest out of capital was illegal. Page-Wood V.C. based his decision on public policy in holding that such payment would break the contract between the shareholders and the Legislature on behalf of the public, whereby the former were granted limited liability on the security of the capital provided to the company.

Although the decision was clearly based on a desire to provide creditor protection, it merely decided that capital could not be returned to shareholders in the form of interest/dividend payments.[17]

In Macdougall's case Page-Wood did not have to consider whether the capital fund had to be maintained under all circumstances but it cannot be doubted that the judicial concept of profit in relation to joint-stock company enterprises during the 1860s was a balance sheet one. Vice Chancellor Kindersley applied such a test in relation to a deed of settlement company[18] and a company registered under the 1844 Act[19], and a similar approach was adopted in Stringer's case[20], and in Rance's case.[21] In the former, the justification for such an approach was again stated to be the

need to retain the integrity of the capital fund supplied by the shareholders as a form of creditor protection.[22]

The credit for the precise formulation of the original capital maintenance doctrine based on the balance sheet determination of profits, however, has previously been attributed to a number of decisions delivered by Sir George Jessel M.R. towards the end of the 1870s and in the early 1880s.[23] The first of these decisions was re Ebbw Vale Steel, Iron and Coal Company[24].

As has been seen[25], the Companies Act of 1862 did not permit the reduction of capital in any form. The Companies Act 1867 was introduced in order to increase the negotiability of shares, by permitting companies with shares bearing a large unpaid element to reduce their nominal share capital, in order to lessen the uncertainty inherent in such overhanging liability. Such reductions as were permitted by the Act required the approval of the Court, and in re Ebbw Vale Steel etc Co. Jessel M.R., with expressions of regret, interpreted the 1867 Act in such a way as to deny its applicability where companies had actually suffered a loss in the value of their concrete capital. Such companies were precluded from writing down their share capital to the level of their assets. The implication of the decision was that companies which suffered a loss of capital would not be able to pay dividends while their capital remained impaired, with the corollary that any

loss would have to be made good before dividends could be paid in future.

Such an interpretation of the judgement strongly supports the conclusion that dividends were to be determined in law by reference to a company's balance sheet. If such were not the case there would have been no need for companies to reduce their nominal capital. Moreover it was apparently the desire to pay dividends that prompted the application to reduce capital.[26]

The effect of Jessel M.R's decision was of such consequence that it led to its forming one of the main objects of consideration of a Parliamentary select committee.[27] This in turn provided further evidence as to the contemporary conception of profit, to the extent that the witnesses did not question the use of the balance sheet to determine a company's level of profit. Those who considered the matter focussed their attention, more narrowly, on the power to write down share capital in line with losses in the value of concrete capital, and thus actually validated the use of the balance sheet approach.[28]

The evidence of the Registrar of Companies, W.H. Cousins, provided some surprising information, in that his submission to the committee reveals that 23 companies apparently had, either reduced paid up capital, or returned capital to the members, purportedly in pursuance of a scheme of capital reduction under the 1867 Act.[29]

One such, apparently unauthorised, reduction of paid up capital was approved by Bacon V.C. in re Credit Foncier of England[30], and the prevalent attitude amongst the judiciary, prior to the Ebbw Vale case, was reflected in the opinion of Sir R. Mallins V.C. who, in giving evidence to the select committee, stated that he saw no need to alter the 1867 Act[31], and described his procedure for dealing with an application for a reduction of capital as follows:

> "I do not make the order for reducing capital till I am satisfied [that all the debts are paid or provided for], therefore, in that case, whether the capital has been called or not called seems to me immaterial. If they are in a position to pay their debts they may very properly reduce their capital..."[32]

Following the report of the select committee the Companies Act 1877 was enacted, giving companies the power to reduce all types of capital.[33]

In reaching his decision in re Ebbw Vale Steel etc Co. Jessel revealed a large measure of confusion as regards the meaning of capital, either generally or specifically.[34] This confusion led him to justify his refusal to approve the requested capital reduction in a way that was essentially incompatible with his balance sheet concept of profit. In interpreting the provisions of the 1867 Act he asked, and answered, the following question:

"...what does reduce its capital mean...? I should think it meant an actual reduction. <u>This is not an actual reduction, because the capital has been lost. It is merely acknowledging that to be lost which is lost.</u>..That is not a reduction of capital: part of the capital has gone already: it has been reduced by a very unpleasant process"[35]

It is apparent that Jessel understood capital as a **res**, rather than as a **quantum**: as a particular stock of money subscribed by the shareholders, or the assets represented by that stock; rather than an abstract fund, equivalent in value to the nominal amount of share capital issued by the company.[36] In the case in question the stock of capital originally supplied by the shareholders had been depleted, and as there was no intention to reduce the unpaid element on issued shares, there could be no capital reduction. What was lost could not be reduced.

The logic of this conception of capital, however, would dictate equally that what was lost could not be restored. To attempt to do so, from the perspective of Jessel's justificatory view of capital as a res, would be to introduce new capital in place of the lost capital. Yet Jessel also apparently espoused a balance sheet view of profit, which by treating capital as a quantum, would require that the original capital fund should be restored.

Thus the concept of capital maintenance that is implicit in Jessel's decision in re Ebbw Vale Steel etc. Co. is revealed to be based on two essentially contradictory views of capital as a res and, at the same time, a quantum.

In re National Funds Assurance Company[37] Jessel M.R. held that interest on shares could not be paid out of capital, on the basis that:

> "The limited company trades upon the representation of being a limited company with a paid-up capital to meet its liabilities. It is wholly inconsistent with that representation that the company, having its capital paid-up, should pay it back to its shareholders and give its creditors nothing at all."[38]

Although this case was not a dividend case as such, it is suggested that it represented a shift in attitude on the part of Jessel, towards a clearer understanding of capital as a res; i.e. as essentially a stock of money on the basis of which the company traded and to which creditors looked for security. The case decided that the capital fund was to be dedicated permanently to the company's business and was not to be returned to the shareholders; but it did not address the question whether it had to be maintained permanently at its initial level, as his earlier balance sheet approach to profits would have dictated.

In Davison v Gillies[39] the articles of a company required that an allowance for depreciation and repairs be made before profits were declared. Jessel decided, on the basis of the particular articles, that the company had no right to pay dividends until capital lost through a failure to undertake proper maintenance had been reinstated.
According to French, Jessel followed the logic of a balance sheet based capital maintenance doctrine in reaching this conclusion, but an examination of the case suggests that such an interpretation is somewhat partial.[40]
Jessel was aware that the word profits by itself was susceptible of more than one meaning. It is clear that he saw it as sound commercial practice to make allowance for depreciation, and as obligatory where profits were to be paid only from net profits. That, however, begs the question as to provisions which did not relate to net profits. Jessel did not directly address the matter but he was of the opinion that:

> "...looking at the accounts of the company it appears to be a flourishing company...but I am still bound by the articles to say that no dividend is to be paid except out of profits [also as determined by the articles] ..."

Such comment admits of the possibility of the payment of dividends in the light of less stringent articles, and hence of the possibility of a relaxation of the capital maintenance

doctrine as previously stated in regard to re Ebbw Vale Steel etc. Co.

An actual example of such a possibility can be found in the related case of Dent v London Tramways Co.[41], in which Jessel permitted the payment of dividends on preference shares, in spite of the fact that the company had suffered a capital loss of some £114,460 due to its failure to take proper account of depreciation as required by the articles. The debentures had been issued on condition that they would receive 6% per annum, "dependent upon the profits of the particular year only", and Jessel interpreted this as meaning

> "the surplus in receipts, after paying expenses and restoring the capital to the position it was in on the first of January in that year."[42]

The Dent case is the first example where a Court had recognised the legitimacy of a company paying dividends irrespective of the fact that there was no possibility of a surplus in its balance sheet, and it is, therefore, clearly a case of signal importance. Previous commentators have paid it scant regard, however, preferring to maintain the mistaken view that Jessel M.R was an inflexible proponent of "a rigid rule forbidding any dividend payment which would have reduced the remaining assets below the figure of the company's nominal paid-up capital."[43]

Yamey interpreted Dent's case as being decided on the basis of a "notion of fair play" towards the preference

shareholders, and not to represent any fundamental change in the general capital maintenance rule.[44]

Whereas French saw Dent's case as "one small exception...to the well established and well understood [capital maintenance] law."[45]

Alhough J.L. Weiner recognised the conflict between Dent's case and the Ebbw Vale Steel Co. case, he failed to recognise that it represented a change in perception on the part of Jessel merely suggesting limply that:

> "perhaps... the implications of these acts [Companies Acts 1867&1877] had not as yet been considered by the courts."[46]

Only C.A. Coooke clearly recognised the full significance of Dent's case, as prefiguring the later, and more radical decisions of the Court of Appeal under the guidance of Lord Lindley.[47]

The purchase by a company of its own shares was declared unlawful and void, as constituting an unauthorised diminution of the company's capital, by Jessel, in re Dronfield Silkstone Coal Company[48]. Recalling Jessel's concept of capital as a res and the distinction he drew between capital reduction and the loss of capital as revealed in re Ebbw Vale Steel etc. Co., it is important to note that this case involved what Jessel would have considered to be capital reduction. Not only had the company directly returned its capital to the shareholder in consideration for the shares,

but it had also purported to waive the right to have the outstanding uncalled portion of the share paid to it. In both of these ways the security of creditors would have been reduced.

The Dronfield case, therefore, related to the validity of returning capital to shareholders. To that extent it involved capital maintenance, but it did not represent a return to a balance sheet view of profits.[49]

The locus classicus of the balance sheet based capital maintenance doctrine is generally thought to be the Court of Appeal decision in Flitcroft's case.[50] As Jessel stated in that case:

> "A limited company...cannot reduce its capital except in the manner and with the safeguards provided by statute...[it] cannot in any other way make a return of capital"[51]

The payment of dividends from capital was held to amount to an unlawful reduction of capital, and not to be capable of ratification by the shareholders. As justification for the decision Jessel referred to the need to offer protection to the creditors of such companies thus:

> "The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor, therefore, I may say, gives credit to that capital, gives credit to the company on the faith of the

representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders..."[52]

The above passages were cited by Yamey[53] as supporting a balance sheet approach to profit, but the sections underlined clearly do not permit such a wide conclusion to be drawn. They merely state that capital could not be reduced by being returned to the shareholders, and no more. They do not state that concrete capital had to be maintained at the level of the issued share capital under all circumstances; nor do they declare that the concrete capital could not be diminished through the vagaries of normal business activity.

It is suggested that Yamey was guilty of conflating what were in fact two distinct doctrines.[54] One, the capital maintenance doctrine, related to and prohibited the return of capital to shareholders; while the other, an as yet inchoate form of dividend law, admitted the possibility of paying dividends even in the face of an impairment in the level of capital.

Such an error is understandable, for although it is maintained that two distinct doctrines did exist, it is not suggested that the relationship of the two, nor their theoretical basis, was ever considered by the judiciary, although the operation of the emergent dividend law can be

seen in Dent v London Tramways Co. Although the Dent case is the only authority for the approach to dividend law suggested by this thesis, it has to be pointed out on the other hand, and in spite of French's claim to the contrary[55], that the alternative view, which sees dividend law as the product of a balance sheet based capital maintenance doctrine, was never "thoroughly tested" in the Courts prior to 1889.[56]

The capital maintenace doctrine and dividend law can be rendered compatible in either of two ways. Firstly it is possible to insist that capital maintenance and dividend law meant the same thing; i.e. that the level of concrete capital operated by the company should not be permitted to fall below the value of the issued capital. Such an approach is underpinned by a conception of capital as a measure of value, and it is the approach which Yamey suggested the Courts actually adopted.

The foregoing has demonstrated, however, that the predominant conception of capital within the judiciary, as reflected in the decisions of Sir George Jessel, was as of a res. The logic of that view was equally capable of accommodating, if not actually dictating, the treatment of capital maintenance and dividend law as discrete doctrines, whilst at the same time allowing the reconciliation of the two, otherwise apparently irreconcilable, doctrines. If capital were understood as a particular fund, or its material embodiment, then it was possible to insist on that fund being permanently

dedicated to the company's business, and on its not being returned to the shareholders. To that extent the integrity of the capital fund had to be maintained. It was equally possible, however, to permit dividends to be paid despite an impairment of that capital. This latter procedure would not amount to a return of capital, for the original capital would be maintained, although in a reduced state. It would merely represent a distribution of income in the face of that loss of capital. Lord Lindley, in his later decisions, merely gave direct expression to this conclusion which was implicit in the logic of treating capital as a res.

Further support for the assertion that the conception of the capital of a limited company prevailing amongst the judiciary, towards the start of the last quarter of the nineteenth century, was that of a res, rather than a quantum, is provided by the decision of the Court of Appeal in Guinness v Land Corporation of Ireland.[57]

According to Bowen L.J.:

> "the capital of the company is to be a fund for carrying on the business of the company in the first place, and also a fund from which the creditors of the company may expect to obtain payment of their demands."[58]

Whilst, in the course of considering the precise meaning of the word "capital", Cotton L.J. offered the opinion that it was:

"the fund which is to pay creditors in the event of the company being wound up. From that it follows that whatever has been paid by a member cannot be returned to him...It is, of course, liable to be spent or lost in carrying on the business of the company..."[59]

The peculiarity of the Guinness case was that it arose upon a friendly action to determine the legal status of the company's articles, which expressly provided for the use of the capital supplied by holders of what were designated B shares, in order to pay the preferential dividends of other shares designated A shares. It, therefore, did not directly involve a question of dividends. It is suggested, however, that the judicial conception of capital evident in the judgements, not only as constituting a particular fund of capital, but as a fund which could be impaired without injustice to the creditors, lends support for the proposition that the contemporary capital maintenance doctrine was not dependent on a balance sheet computation as has previously been thought. It is further suggested that, in relation to capital maintenance, the perception of capital as a particular res, at the very least, permits of the possibility of the existence of a less severe dividend law than previously has been assumed to have operated at the time. Confirmation of the fact that capital maintenance and dividend law were seen as distinct doctrines, although

without the relationship between the two being fully worked out, is provided by Leeds Estate, Building and Investment Company v Shepherd.[60]

As regards capital maintenance, as the judgement of Stirling J. reveals, it was clearly settled; and it did not relate to a balance sheet approach:

> "The capital may be lost in the course of such application, and creditors or other persons dealing with the company must take that risk..."[61]

The capital of the company was thus perceived and treated as an object in its own right; to succeed or fail as the case may be. The protection offered to creditors rested, not on the fact that the capital fund would be restored to its original level, but rather in the assurance that:

> "no part of the capital will be returned to the shareholders except in the cases and under the safeguards in and under which a reduction of capital is permitted by the various Acts of Parliament."[62]

Thus the capital fund was also seen as separate from the shareholders, whose claim was against its product rather than the fund itself. This latter perception led to the formulation that:

> "The law prohibits the payment of dividends out of capital..."[63]

The relationship of the two doctrines was not considered, however, and the problematic question of their potential lack of compatibility was not addressed. As regards the responsibility of directors who actually paid dividends out of capital Stirling J. expressed the opinion that the law was "not yet completely settled".[64] It is suggested that statement was appropriate for dividend law generally.
In 1887, in Trevor v Whitworth[65], the opportunity arose for the House of Lords to authoritatively determine the legality of companies buying their own shares, and in so doing to consider the capital maintenance doctrine. In deciding that such purchases were unlawful, the House of Lords approved the reasoning of Jessel M.R. rather than that of the Court of Appeal in re Dronfield Silkstone Coal Co., and affirmed the capital maintenance doctrine as stated previously by Stirling J in Leeds etc. v Shepherd.
Lord Herschell stated the law in the clearest language:

> "...the whole of the subscribed capital, unless diminished by expenditure upon objects defined by the memorandum, shall remain available for the discharge of its liabilities...A part of it may be lost in carrying on the business operations authorized. Of this all persons trusting the company are aware, and take the risk. But I think they have a right to rely, and were intended by the Legislature to have a right to rely on the capital

> remaining, undiminished by any expenditure outside these limits, or by the return of any part it to the shareholders."[66]

Again it has to be admitted that Trevor v Whitworth was not a dividend case, but it does clearly demonstrate that the judiciary perceived capital as an object in its own right in the form either of

> "cash in the coffers of the company, or of buildings, machinery, or stock available to meet the demands of the creditors."[67]

It is maintained that such a view of capital, being incompatible with a balance sheet view determination of capital maintenance,[68] provided the theoretical foundation for what amounted to a fundamental, although as yet implicit, reconceptualisation of the law relating to dividends which had taken place; and which was about to find overt expression in the decisions of Lord Lindley.[69]

III. A Critical Assessment of the Balance Sheet Based Approach to Capital Maintenance.

The shift in emphasis from the balance sheet as the determining factor in terms of capital maintenance and profit was encouraged by the patent inadequacies of such documents either to give an accurate representation of the circumstances of a company or to provide real protection for company creditors. It might be a matter of some surprise to

those who support the accepted view of Sir George Jessel as the chief proponent of the balance sheet as the method of determining profit, to note that he himself held such documents in very slight regard. In his evidence before the 1877 Select Committee on the Companies Acts, in response to a suggestion that balance sheets should be registered and circulated to members, he stated that:

> "I do not think they would be less fraudulent than they are now. As I have said before, I have utter distrust for these pieces of paper, called balance sheets."

Although he went on to state, with at least a measure of irony, that their main failing was not so much fraud as a "desire to make things pleasant".[70]

The first shortcoming in balance sheet approach lay in the fact that the rule that paid up capital had to be maintained intact, could be complied with on the basis of a number of valuation procedures in respect of a company's assets. For example assets could be valued at their historical cost price, or at the price they would fetch if sold, or alternatively at their worth to the company. Each method providing a different value for the same assets. Whereas Yamey cited the case of Rance's case[71] as showing that the Courts were willing to accept the accountant's definition of value[72]; Brief rejected such a view on the ground that the

cost principle was not even accepted by all accountants prior to 1889.[73]

In any case uncertainty about the valuation of fixed assets was compounded by even greater uncertainty in respect of depreciation allowances. As to the amount to be allocated in any one year's accounts in relation to the cost of long term fixed capital, Hicks stated:

> "...there is no firm economic solution. Neither has the accountant found a solution - only a name and a set of (essentially arbitrary) rules. The "depreciation quotas" must add to unity, but that is all that is known, at all firmly, about them."[74]

Apart from such accountancy problems there was also the fact that there was no provision for the independent valuation of non cash consideration provided in return for the allotment of shares.[75] Shares subscribed for had to paid for[76], but there was no requirement that payment had to be made in cash.[77] Section 25 of the 1867 Companies Act required the registration of contracts for the allotment of shares for non-cash consideration, but that did not alter the validity of such consideration[78]; and although the Courts insisted that shares could not be issued at a discount[79] they declined to enter into the question of valuation where the consideration was real and not colourable.[80]

It has been stated that this refusal on the part of the judiciary to intervene and to adapt "the general doctrines of

contract law to the needs of the situation" was because they were "paralysed by the magic of the doctrine that consideration must be real but need not be adequate."[81] It is suggested that such a claim does not accurately represent the case and that the refusal of the Courts to investigate the real value of non-cash consideration accurately reflected the fact that, with the emergence of share capital as a distinct form of fictitious capital, it was simply not appropriate to assume that share capital should be represented by capital assets of an equivalent value.[82]

The third major point which the balance sheet approach failed to address was the fact that creditors were not primarily concerned with the value of a company's assets but were more interested in its liquidity; it ability to pay its debts immediately without having to wait for the value of concrete assets to be realised.

As a consequence of these failures neither shareholders nor creditors could fully rely on balance sheets as accurate statements of a company's situation. Such fundamental flaws encouraged, if they did not require the replacement of the balance sheet view of capital by a conception more suitable to the contemporary joint-stock company form.

IV. The Reconceptualisation of Dividend Law.

The first express disavowal of the balance sheet approach to dividend law and capital maintenance occurred in Lee v

Neuchatel Asphalte Co. Ltd.[83] It was alleged, although in the event not proven, that the value of a mining concession held by the company had become depreciated, and thus that a large part of the company's capital had been lost. The plaintiff sought an injunction to prevent the payment of a dividend until the alleged loss of capital had been made good.

It was held by the Court of Appeal, affirming the decision of Stirling J., that: firstly, there was not sufficient evidence of the claimed depreciation or loss of capital; and secondly, apart from the question of depreciation or loss, even if the property of the company was not sufficient to make good its share capital, there was no obligation to make it good out of revenue.

Previous commentators have underestimated the extent to which the initial decision of Stirling J., delivered in February 1888, reflected a change in judicial perception of the share capital of companies.[84] In Stirling J.'s opinion:

> "...the capital of the company at the time of its formation really consisted of the aggregate of the assets taken over from the various selling companies under the agreement...[which] was merely a scheme for ascertaining and declaring the interests of those companies in that aggregate in accordance with the agreed value of their several contributions thereto, and unless it can be shown that, after payment of the dividend, the assets now

belonging to the defendant company will fall short of those belonging to the company at the time of its formation, it cannot, in my judgement, be said that the dividend is being paid out of capital."[85]

In emphasising the fact that the Neuchatel company had been the mechanism whereby previously discrete units of industrial capital were centralised Stirling J. clearly distinguished between the concrete assets of the company and its share capital. The company's share capitalisation represented the value of those previous businesses as capital, and did not represent a fund of industrial-capital in its own right. In other words the nominal share capital of the company represented, and assumed the form of fictitious capital.

In relation to the capital maintenance doctrine this perception raised the question as to whether the creditors of the company should be entitled to claim against a fund equal to the value of the share capital, or whether their claim should be restricted to the value of the concrete capital. Stirling J. decided the question in favour of the latter approach. In the event of the company being wound it was the commodity value of the assets owned by the company to which creditors had to look for security: the value of those assets as capital was a purely internal matter.

Stirling J.'s decision in Lee's case can be seen as adapting rather than challenging a balance sheet determined capital maintenance doctrine. When the case reached the Court of

Appeal, however, that particular approach to capital maintenance was attacked head on.

Cotton L.J. followed Stirling J.'s procedure in distinguishing between the nominal value of share capital and the commodity value of the assets of a company, and basing his decision on the reluctance of Courts to investigate the value of assets transferred to companies as consideration for shares, concluded that:

> "...there is no obligation in any way imposed upon the company or its shareholders to make up the assets of the company so as to meet the share capital, where the shares have been taken under a duly registered contract, which binds the company to give its shares for certain property without payment in cash."[86]

Where, however, Stirling J. had held that the fund of value represented by the original assets of the company had to be maintained, Cotton L.J. permitted even that fund to be diminished. In the absence of impropriety or fraud, the manner of how profits were to be divided and dealt with, and out of which fund dividends they were to be declared, was a matter of internal regulation.[87]

Cotton L.J. understood capital as a res rather than a quantum, and justified his statement of capital maintenance of that basis. The capital maintenance doctrine was effectively reduced to a prohibition on directly returning

capital to shareholders, and depended on the nature of the concrete capital operated by the company.[88] Where shareholders provided cash for their shares it would be a direct return of capital if the company were immediately to give back any of the money so collected. Where the capital remained in the form of money or left that form only temporarily as in the case of circulating capital, any payment from it would be equally a return of capital and contrary to the capital maintenance doctrine. Where the fund of money-capital was transformed into concrete assets it would similarly be a direct return of capital if those assets were sold, their monetary value realised, and that value returned to the shareholders in the guise of dividends. Where, however, the money-capital was transformed into the material means of production in the form of fixed capital, then the product of that concrete capital could be returned to shareholders as dividends, without the need to maintain the original value of the money-capital so represented. The justification for this permission, effectively to diminish the capital value, and indirectly to return capital to the shareholders, was located in the essential nature of fixed capital, which was retained as the material embodiment of capital at the same time as it was used productively. Cotton L.J. did not directly consider the situation of the creditor in his conceptualisation of capital maintenance, but Lindley L.J. remedied this failure in his judgement. He

stressed that dividend distributions should always be dependent on solvency. Before paying any dividends, companies should ensure that they were in a position to pay their creditors.[89] Having established a solvency test as the prerequisite for the payment of dividends, he concluded that, as long as a company retained sufficient assets to pay its creditors, the question of how it drew up its accounts was an internal matter.[90] On that basis he concluded that in respect of questions as to what expenses were to be charged to capital, and which to revenue:

> "Such matters are left to the shareholders. They may or may not have a sinking fund or a deterioration fund, and the articles of association may or may not contain regulations on those matters. If they do, the regulations must be observed; <u>if they do not, the shareholders can do as they like so long as they do not misapply their capital and cheat their creditors</u>."[91]

Lindley pointed out, as Cotton L.J. had done, that the 1862 Companies Act provided no directions as to how dividends were to be determined, concluding that:

> "all that is left and very judiciously and properly left to the commercial world. It is not a subject for an Act of Parliament to say how accounts are to be kept; what is to be put into a capital account,

> what into an income account, is left to men of business."[92]

Lindley rejected a balance sheet determination of profit, and proposed replacing it with a concept based on the excess of income over expenditure.[93] The absence of any provision in the Companies Act either requiring capital to be made up if lost[94], or precluding the payment of dividend so long as the assets were of less value than the original capital[95], permitted him to reach the conclusion that:

> "...if the company retains sufficient assets to pay its debts, it appears to me that there is nothing whatever in the Act to prevent any excess of money obtained by working the property over the cost of working it, from being divided amongst the shareholders, and this in my opinion is true, although some portion of the property itself is sold, and in some sense the capital is thereby diminished."[96]

It is apparent that Lindley L.J.'s judgement reflects a change in the manner in which joint-stock companies were perceived, and understood. For him the company was less important as a static conglomeration of assets than as a source of income. Implicit in this approach is an appreciation of the distinction between the share as a claim against income, and the share as a claim against the assets

which generate that income; and a recognition that its value depends on the former rather than the latter.

The reassessment of the relative rights of creditors and shareholders was a consequence of this altered perception. If the situation of creditors could be safeguarded in some other way, as Lindley proposed, then why should the company be required to retain its assets at a particular level? He recognised that the income of a company was a more adequate measure of its success than its assets, and that under certain circumstances the need to maintain even the value of the original assets, as Stirling J. had proposed, might inconvenience, not to say cause hardship to, the shareholders of the company who depended upon it for their income.

This concentration on income flow is demonstrated in the hypothetical example, cited by Lindley, of a company founded to start a daily newspaper, which had sunk £250,000 before its receipts equalled its expenses. Was such a company to be refused the right to distribute any income before the £250,000 was made good? In his view the answer was clear:

> "If they think their prospects of success are considerable, so long as they pay their creditors, there is no reason why they should not go on and divide profits, so far as I can see, although every shilling of the capital may be lost. It may be a perfectly flourishing concern..."[97]

This realisation of the essential importance of income over assets led Lindley to criticise as false, the appearances generated and accepted by accountancy practice. As he made clear, the static balance sheet method of determining profit was best suited to the circumstances of a one-off enterprise, or at the winding up of a company. It was not appropriate to the assessment of the situation of a company whilst it was still functioning.[98]

The judgement of the third member of the Court of Appeal, Lopes L.J., although not as extensive as the other two judgements, also declared that dividends might be paid out of profits arising from the excess of receipts over expenses, as long as such a procedure was not expressly prohibited by its articles of association. He felt that it was lawful for a company to pay dividends even when its available property did not equal its share capital, and that:

> "for the purposes of determining profits, accretion to and diminution of the capital are to be disregarded."[99]

This statement highlights the relationship of shareholders to the concrete capital of the company. They own fictitious share capital, which represents a claim against profit; they do not own the concrete capital. The strict logic of this conclusion, to which Lopes L.J. apparently adhered, dictated that just as sharehollders were not responsible for remedying any impairment to the concrete capital, so they should not

benefit from any accretions in the value of the concrete capital.[100]

It must be borne in mind that the actual facts of Lee's case involved a mining company operating wasting assets, and that it was not proved that the assets had depreciated in fact. It is possible, therefore, to claim that all the comments considered previously were merely obiter dicta, or at least were only applicable to companies which also operated wasting assets.[101]

As was expressly stated in Lindley L.J.'s judgement, the intention of the Court of Appeal in Lee's case was to free businessmen from the strict application of a capital maintenance doctrine based on the need to retain assets of equivalent value to the nominal value of issued share capital. The case had been decided on the basis of the lack of provisions in the Companies Acts, but scant regard was extended to the earlier judicial authorities or current practice within the legal and accountancy professions, which assumed a balance sheet definition of capital maintenance.[102] The Court of Appeal's decision in Lee's case simply ignored that opinion, and substituted its own conception of dividend law without any endeavour to accommodate previous views. The contemporary edition of the Law Quarterly Review praised such an intention and eulogised the good sense of modern judges who declined to "apply a Procrustean formula to mercantile as well as political operations".[103] As Yamey

pointed out, however, in their efforts to free businessmen from "the straight waistcoat of legal formulae", as again the L.Q.R. put it, the Court of Appeal had sanctioned practices frowned upon by specialists in company accounting.[104]
Nor was it merely the accountancy profession which viewed the decision in Lee's case with disfavour.
In the 6th edition of his Company Precedents, the eminent contemporary company lawyer F.B. Palmer devoted considerable space to a consideration of the precise manner in which profits were to be ascertained for the purposes of paying dividends. With respect to the decision in Lee's case he expressed his considerable surprise at it thus:

> "Lord Justice Lindley's great eminence as an expert in the law relating to partnerships and companies, compels attention to the views expressed by his Lordship...But there can be no doubt that the views so expressed came as a surprise to lawyers and to accountants and to business generally; for the impression had very generally prevailed that lost or depreciated capital, unless written off, had to be made good before income could be treated as profit."[105]

That other lawyers agreed with Palmer is evident in the fact that in the month following the Court of Appeal's decision in Lee v Neuchatel Asphalte Co., March 1889, Kekewich J., in declaring that profits were to be calculated as a prudent man

of business would calculate them, held that with regard to wasting assets an allowance had to be made for depreciation precisely in order to prevent the capital from indirectly entering into profits.[106]

Of the practicality of the method proposed in Lee's case Palmer commented acerbically that:

> "It must be admitted that the system propounded by the Court of Appeal is not unlikely to mislead the public, and especially those who deal with a company in reliance on its having its paid-up capital available undiminished by dividend amongst its shareholders. It goes far to render the protection supposed to be afforded by the Act a delusion and a trap."[107]

Although Palmer was certainly correct as to the manner in which the judgement in Lee's case was received by the accountancy profession[108], his criticism was misguided on a number of counts. Firstly he accepted as unproblematic the supposed protection offered to creditors by the balance sheet view of capital maintenance, and failed to consider the weaknesses which rendered such an approach fallacious in practice. Secondly, and just as importantly, he failed to recognise that a company's success and its value were best measured by the amount of income it generated rather than the value of the assets it owned. It is at least arguable that the protection offered to company creditors by the solvency

rule, as proposed by Lindley, provided a more effective safeguard than the spurious capital maintenance doctrine, with its uncertain, and inaccurate valuations of tangible assets, together with the inclusion of intangible assets. In any case, as at least one accountant has recognised, the real security of the creditor is more apt to be the successful operation of the corporation than the sale value of the assets of the company.[109]

The extent to which the Court of Appeal's attempt to clarify dividend law met with resistance and disapproval must not be underestimated. Even the note in the L.Q.R., previously referred to as praising the decision, stated that the manner in which the Court had dealt with the existing capital maintenance doctrine, particularly as expressed in Trevor v Whitworth, was "not quite satisfactory".[110] Whilst in Lubbock v British Bank of South America[111] Chitty J. expounded a classic balance sheet definition of profit, and attempted to restrict any application of the Court of Appeal's method as stated in Lee 's case, to enterprises involving wasting assets.

In the light of the criticism and misunderstanding of Court of Appeal's decision in Lee's case, it is not surprising that when Lindley got a second opportunity to adjudicate in relation to dividend law he did so in a more considered fashion intended to offer, for the first time, a coherent theory of capital maintenance.

According to F.B. Palmer:

> "In the last edition, the writer, referring to the views expressed by Lindley L.J., in Lee v Neuchatel, suggested that it might be well to wait for further elucidation before acting on these views. And it appears now that this advice was not altogether unsound, for the learned judge has himself found it necessary to change his ground."[112]

That change of ground occurred in the course of his judgement in Verner v General and Commercial Investment Trust.[113] The company involved was an investment company. Although the market value of some of its investments had fallen, thus materially reducing the value of its assets, the income from them had exceeded the expenses in a particular year. One of the trustees brought an action against the company to restrain the declaration of a dividend, on the ground that until the loss of capital was made good, any dividend payment would be made out of capital.

In the Court of first instance, Stirling J. pointed out the discrepancy in regard to the question of capital maintenance, between the decision of the Court of Appeal in Lee's case, and the opinion of Jessel M.R. in re Ebbw Vale Steel etc. Co.; and although expressing a preference for Jessel's view, he felt himself bound to follow the decision in Lee's case.[114]

On appeal Lindley L.J. delivered the judgement of himself and Smith L.J.[115]

By 1894 two distinct rules relating to company distributions had crystalised; one stated that dividends could only be paid out of profits, whilst the other stated that capital had to be maintained and could not be returned to the shareholders.[116]

It was widely believed that these rules had been merely different expressions of the one rule, that concrete capital had to be maintained at a level of value commensurate with the nominal value of issued share capital, and were apparently explicable only on that basis. The difficulty facing the Court of Appeal in Verner's case was the problem of providing a coherent alternative explanation of the rules, while at the same time maintaining their distinctness, and, most importantly, permitting companies to pay dividends in the face of capital impairment. For the first time the changes which were implicit in earlier decisions had to be given express justification. A task which was achieved by Lindley L.J. redefining the operation and scope of the rules relating to company distributions.

In considering the capital maintenance doctrine Lindley started from the conception of capital as a res; thus capital meant "the money subscribed pursuant to the memorandum of association, or what is represented by that money". Capital maintenance required that the capital of a company should not

be returned to its shareholders, but the perception of capital as a res led to the "obvious" conclusion "that dividends cannot be paid out of capital which is lost" and, therefore, dividends paid in the face of lost capital need not necessarily amount to a payment out of capital.[117] In this way the possibility of paying dividends in the face of an impairment of capital was admitted, where a capital maintenance doctrine, which designated capital a quantum, would have precluded such a possibility.[118]

In order to complete the process of redefinition attention had to be focussed on the other rule, that dividends should only be paid from profits. In Lee's case Lindley had asserted, baldly and with little effort to justify the claim in the light of previous practice, that income had merely to exceed expenditure before dividends could lawfully be paid. In Verner's case this formula was restated in the form that "a dividend presupposes a profit in some shape", with the stated consequence that it would be unjustifiable in point of law if receipts were paid out in the form of dividends without the expenses entered into for the purposes of gaining those profits being deducted.[119]

Such a formulation was sufficiently wide to accommodate a balance sheet based capital maintenance doctrine, but Lindley went on to use the economic concepts of fixed and circulating capital, first used by Cotton L. J. in Lee's case, in order to subvert such an approach. By distinguishing fixed and

circulating capital, apparent contradictions could be reconciled; capital could and must be maintained, in its circulating form, while at the same time being permitted to depreciate, in its fixed form. Profit, therefore, was redefined, not on the basis of a balance sheet surplus but, as the increase in circulating capital over a particular trading period.

The whole reconceptualisation is encapsulated in the following passage:

> "It has been already said that dividends presuppose profits of some sort and this is unquestionably true. But the word "profits" is by no means free from ambiguity. The law is much more accurately expressed by saying that dividends cannot be paid out of capital than by saying that they can only be paid out of profits. The last expression leads to the inference that the capital must always be kept up and be represented by assets which, if sold, would produce it; and this is more than is required by law. Perhaps the shortest way of expressing the distinction which I am endeavouring to explain is to say that <u>fixed capital may be sunk and lost, and yet the excess of current receipts over current payments may be divided</u>, but that floating or circulating capital must be kept up, as otherwise it will enter into and form part of such excess, in which

case to divide such excess without deducting the capital which forms part of it will be contrary to the law."[120]

As in Lee's case the rights of creditors were protected by a solvency test.[121]

The effect of the decision in Verner's case was not just that the balance sheet was no longer of central importance in relation to capital maintenance or in the determination of profits, but perhaps more importantly this shift in perspective was given a theoretical justification, even if was no more than a fallacious application of spurious economic categories.[122]

The accountancy profession's view of Lindley's attempt to establish dividend law on a new footing, emphasising income rather than assets, remained critical.[123] As for the legal profession, F.B. Palmer was certainly not convinced of the validity of the reasoning or the outcome of Verner's case. In his view:

> "The Court of Appeal thus allows the greatest possible liberty to shareholders, and affords the least possible protection to creditors, and if these propositions are all to be accepted as correct, it is obvious that the law is in a defective condition."[124]

A similar attack in Palmer's Company Law[125], was later criticised by H.R. Hatfield, and stimulated him to offer a defence of Lindley's system of dividend law. According to

Hatfield many of the critics of the Verner case ignored the possibilities of accounting technique, as well as disregarding the express words of the decision.[126] Hatfield based his defence on the following passage in Lindley's judgement:

> "...there is no law which compels limited companies in all cases to recoup losses shown in the capital account out of receipts shown in the profit and loss account, although care must be taken not to treat capital as though it were profit...Further, it is obvious that capital lost must not appear in the accounts as still existing intact. The accounts must shew the truth; and not be misleading or fraudulent."[127]

It is suggested that the above passage reveals that not only was Lindley aware of the difficulties which might follow from the improper use of his scheme, but that it was also located within the context of a wider consideration of company accounting. It is further suggested that, just as Lindley provided protection for creditors by means of a solvency rule, so he intended to provide protection to shareholders through the requirement that company accounts should reveal any loss of capital; and thus place at the disposal of the shareholders, either present or future, accurate and sufficient information to determine the true condition of the company.[128]

Support for this suggestion that accounts could be, and should be, drawn up so as to reflect the true position of a company, even where dividends had been paid out in the face of capital losses was provided by Hatfield. In demonstrating how accounts could be drawn up in line with the wishes of Lindley L.J., Hatfield commented that:

> "The matter is simple - all that is needed is clearness and honesty - and the facts can be presented in various satisfactory forms. The undesirability of paying dividends while capital is diminished has nothing to do with the necessity of truthfully showing what has taken place. That such is seldom or never done is perhaps unfortunate, but it does not depend altogether on the much criticised decisions of the courts."[129]

The various criticisms of what Lindley L.J., and the other Court of Appeal judges, were attempting to achieve were fundamentally misdirected. The general claim that the reforming decisions were out of touch with the commercial or economic aspects of company practice were the consequence of a failure of perception on the part of the critics.[130] Lindley's concepts of capital maintenance and dividend law did consider those aspects; but did so from a perspective which perceived the joint-stock company as an essentially money-capital form, rather than as merely a mechanism for centralising and operating industrial-capital, as his critics

tended to view it. From Lindley's perspective, the value of the income which concrete industrial-capital produced was more important than the value of the concrete capital itself.[131] It cannot be denied that if a sum of value, extended as industrial-capital, fails to secure an increment in the course of its progress through the circuit of capital production, then no profit has been made and the sum of value has failed to function as capital. It follows that, from the perspective of industrial-capital, the balance sheet method is the appropriate mode of determining profit, and capital can best be seen as a quantum of value.

The share, however, being a money-capital form is not constrained by the same absolute procedures which measure the success of industrial-capital. The capital market fixes the value of share-capital essentially on the basis of the income commanded by the share. Whether or not the industrial-capital has suffered depreciation in the course of generating the income does not affect the essential mechanism of valuation. It merely alters the risk premium which is added to the rate of interest in order to determine the actual rate at which the income is capitalised.

The operation of the stock-exchange, therefore, gives rise to the anomalous situation that value introduced into the process of production can retain the form and function of money-capital, whilst failing to function as industrial-capital.

In order for the market to make appropriate calculations, however, it is essential that it is supplied with accurate and sufficient information relating to the particular circumstances of the company whose shares it is valuing. It is suggested that it is to that end that Lindley's comments as to the nature and content of company accounts were directed.

Implicit in Lindley's decisions is an awareness that it was upon the foundation of a continuous flow of income, in the form of dividends, that the whole structure of fictitious share capital was constructed. The essential point being that shareholders were dependent on dividends, not just to provide income, but also to ensure that their capital continued to function as money-capital. Shares which provided a flow of income retained a value as money-capital; a value that could be realised through transfer in the stock exchange. Temporary fluctuations or fundamental shifts in the income generating capacity of the underlying concrete industrial-capital could be accommodated through changes in the market price of the shares representing claims against that capacity. Changes in the value of the concrete industrial-capital could be compensated for in a similar manner.[132] Where, however, shares can no longer provide dividends, they cease to have value as money-capital, and cannot be realised for more than the break up value of the concrete-capital. Such a situation would be likely to prove disastrous not only for the

shareholders, but for creditors of the company, especially the ordinary unsecured trade creditors, who would find what appeared in the balance sheet view as substantial concrete security, sublimating before their claims had been met. By permitting shares to continue to command an income, even at the expense of capital, Lindley allowed those shares to continue to operate as money-capital, and the underlying industrial-capital to continue to function, although at a reduced level.

Lindley's judgements in relation to dividend law can best be understood in the light of the development of the share as an essentially rentier property form, upon which the holders were dependent for their income; and in the context of a fully developed stock market, competent to accurately assess the capital value of any continuous flow of income. This perception of the share form is not without a measure of paradox, in that it assumed that the rentier shareholder, whose interests were being protected, was competent to understand the accounts, whose accuracy provided his protection.

From the perspective of economic theory Lindley's materialist treatment of fixed capital in the determination of profit found a startlingly clear approval in the following passage from A.C. Pigou:

> "A distinction should be drawn between changes which, while leaving the element still as

productive as ever, bring nearer the day of sudden and final breakdown, and physical changes which reduce its current productivity and so rentable value. With the former sort of change, until the breakdown occurs, the capital stock is, I suggest, best regarded as intact, just as it is best regarded as intact despite the nearer approach of a day that will make a part of it obsolete."[133]

There can be little doubt that Pigou, writing some forty years after Lindley. would have endorsed his treatment of capital generally and his treatment of fixed capital in particular.

If, as has been suggested, Verner's case can be understood as a response to the criticisms of the earlier decision in Lee's case, then re National Bank of Wales Limited[134], evidenced a desire to resile from even the minimal limitations on the payments of dividends set out in Verner's case.

In the face of previous losses of circulating capital the directors of the bank had paid dividends on the surplus in their current profit and loss account, in effect treating each year as a discrete period for accounting and dividend purposes.

When the case came before the Court of Appeal, Lord Lindley, who was by then Master of the Rolls, delivered the decision of the Court, reversing the decision of Wright J., and approving the payments. As in his earlier decisions Lindley

adopted a conception of capital as a res, even where it consisted of so much money, and this permitted him to conclude that the payments in question were not paid out of any part of the money constituting the nominal paid up capital of the company, but:

> "were paid not withstanding the loss of such capital, and without making it good."[135]

Such was Lindley's disingenuous justification for allowing the indirect return of capital to the shareholders of the company, and the further reinterpretation of profit as the surplus on a company's profit and loss account.

The underlying explanation for the National Bank of Wales decision was the desire to give an increased measure of autonomy to businessmen in the conduct of their companies affairs, by removing the constraints of rigid legal doctrines which circumscribed their potential for action in particular circumstances. In Lindley's view businessmen should be given the power to determine business activity. Having been forced in Verner's case, in order accommodate professional legal and accountancy opinions, to recognise the continued applicability of the capital maintenance doctrine, all be it in the highly attenuated form set out in that case, the National Bank of Wales case evidences a desire on Lindley's part to deny even that limited formulation of the doctrine.

Thus:

> "...it may safely be said that what losses can be properly charged to capital, and what to income, is a matter for businessmen to determine, and it is often a matter on which opinions of honest and competent men will differ...There is no hard and fast legal rule on the subject."[136]

Lindley accepted that not all debts could be charged to capital, but it appears that the only such charges to be considered not "reasonable" or "obviously improper"[137] were those which involved the fabrication of fictitious surpluses in the annual profit and loss account[138], and in any case those were "cases in which no honest competent man of business would think of charging...to capital."[139]

In his judgement in this case Lindley revealed that he was not unaware that the continued payment of dividends in the face of previous losses of capital might be unwise, but he saw no need for the law to prohibit such payment, expressing the view that honest and prudent men of business would replace a large loss of capital by degree, and would reduce dividends without stopping them entirely, until the loss had been made good.[140] Again this demonstrates the predominance of the need to provide income over the need to maintain capital at a particular level.

Much has been made of Lindley's requirements as regards the need for company accounts to accurately reflect the company's

situation, with regard to both profit and loss and balance sheet accounts, as a prerequisite for the successful operation of his permissive regime in relation to dividend law, and once again support for this suggestion can be fond in the instant case. For although in the National Bank of Wales case, the annual receipts had exceeded the annual outgoings, and, therefore, there had been no payment out of capital, Lindley stated that:

> "...it does not at all follow that the course adopted by the directors in declaring dividends year after year as they did was legally justifiable. It cannot be denied that the balance sheets and profit and loss accounts concealed the truth, as now known, from the shareholders, and were, as it now turns out, grievously misleading. The shareholders were never told that the paid up capital was being constantly diminished by bad debts, as now appears to have been the case."[141]

It is submitted that the above passage demonstrates the validity of previous claims that Lindley's opinions were founded on the requirement of full and clear accounting information being made available to shareholders, in order that they might assess the actual situation of their investment, and determine whether or not their dividend was a product of the profitable operation of the company or represented an indirect return of capital.

If Verner marked a recantation of the opinion stated in Lee's case, then the National Bank of Wales case marked a recantation of the recantation; a negation of the negation, in order to permit businessmen the maximum scope in determining their own affairs. The most pressing of which would appear to have been ensuring the continuation of a regular flow of income, irrespective of where it might come from.

As might be expected, Lindley's judgement in the National Bank of Wales case did not meet with the approval of either the accountancy or legal professions. The Accountant wrote of questions of appropriate commercial behaviour being "reduced to a financial go-as-you-please with an undecipherable minimum of principle by the quinquennial decisions of the Court of Appeal.[142] In the legal sphere Palmer maintained his opposition to Lindley's decisions.[143]

When, however, the National Bank of Wales case came before the House of Lords, sub nom Dovey v Corey[144], the same desire not to hamper the operation of commerce by the application of strict legal rules was evident in the judgements of the majority of their Lordships. The House of Lords decided the case on other grounds, but given the furore that had followed the previous decisions of the Court of Appeal with respect to the capital maintenance doctrine and dividend law, the House of Lords clearly felt they could not ignore that part of the decision, although they considered it only with reluctance,

and any comments made were necessarilly obiter. Such views as were expressed suggest a sympathy with Lindley's general approach. According to Lord Chancellor Halsbury questions relating to capital maintenance and dividends were not amenable to treatment by the application of abstract general rules,as:

> "The mode and manner in which a business is carried on, and what is usual or the reverse, may have a considerable influence on deciding the question what may be treated as profits and what as capital. Even the distinction between fixed and floating capital, which may be appropriate enough in an abstract treatise like Adam Smiths "Wealth of Nations" may with reference to a concrete case be quite inappropriate."[145]

Similarly Lord Macnaghten, in a judgment with which Lord Shand concurred, expressed the view that he:

> "...did not think it desirable for any tribunal to do that which Parliament has abstained from doing - that is to formulate precise rules for the guidance or embarrassment of business men in the conduct of business affairs."[146]

It is suggested that this rejection, by the majority of the House of Lords[147], of the fixed/circulating capital distinction as too rigid was tantamount to a rejection of the even more rigid balance sheet based capital maintenance

doctrine, and an approval of Lindley's opinion that there should be no hard and fast legal rule on the matter. Dovey v Cory, therefore did not so much represent a repudiation of the Court of Appeal's endeavors to circumvent the balance sheet based capital maintenance doctrine, but more a deprecation of the formula by which it had achieved that end.[148]

In deciding why the House of Lords adopted such a liberal approach, it is clear that the importance of the share as a money-capital form impressed itself on the Lord Halsbury. As he pointed out:

> "...people put their money into a trading concern to give them an income, and the sudden stoppage of all dividends would send down the value of their shares to zero and possibly involve its ruin."[149]

This passage precisely expresses the change in attitude which was evident amongst the judiciary, from a concern with safeguarding creditors by insisting on the maintenance of a fixed security fund, to a desire to protect the interests of shareholders in a steady flow of income, even at the cost of permitting the company's capital to be reduced by being indirectly returned to its shareholders in the process.

The weakness in such an approach as that supported by both the House of Lords and the Court of Appeal was that although the persons whose interests were being protected were recognised to be money-capitalist, the protection offered to

them assumed them to have the competence of industrial-capitalists, with regard to being able to understand and take the appropriate action on the basis of accounting information.

As Yamey pertinently expressed the matter:

> "...the typical shareholder is no longer a business man cognisant of the subtleties of the law and its language, but a passive provider of capital perhaps altogether ignorant of the ways of the law and business men. It is submitted, too, that though a policy of allowing business men to say what the law ought to be maybe praiseworthy where the law can only affect experienced commercial men it is not necessarily suitable where the rights of those outside the business world may be involved."[150]

In practice the lack of legal control in relation to capital maintenance and dividend law would pass power into the hands of the Directors of the company; and it was increasingly from the depredations of directors that shareholders most needed protection.

V. Subsequent Develpoment

Prior to the Companies Act of 1980 the judiciary permitted companies the maximum of economic freedom in regard to the distribution of dividends, provided always that creditors were protected by the solvency rule.[151] The highpoint of this

permissive approach was Dimbula Valley (Ceylon) Tea Co. Ltd. v Laurie in which it was held that an unrealised capital profit resulting from a revaluation of assets could be treated as being available for distribution as dividend. As Buckley J. stated:

> "I do not say that in many cases such a course of action would be a wise commercial practice, but for myself I see no ground for for saying that it is illegal"[152]

The Act of 1980, however, placed dividend law on a statutory and less permissive basis. Now all companies are required to make distributions only from profits available for the purpose. These are defined as the company's accumulated realised profits less its accumulated realised losses[153], and such profits or losses may originate from either revenue or capital.[154] Public companies are in addition precluded from making any payment which would reduce their net assets to less than the value of their paid up share capital plus undistributable reserves.[155] The effect is that, at least in the case of public companies, the wheel has gone full circle and they are once again subject to a balance sheet determination of profit available for distribution.[156]

Chapter Five: Endnotes.

1.E.A. French, The Evolution of the Dividend Law of England, in Studies in Accounting Theory, eds. Baxter and Davidson 3rd ed., p.306.
Gower describes dividend law as that "baffling branch of the law"' and Farrar recognises it as a "difficult" area of law.

2.J. Hicks, Capital Controversies: Ancient and Modern, American Economic Association, May 1974, pp.306-316, cited amongst the leading proponents of the materialist conception of capital such eminent figures as E. Canan, A. Marshall, A. C. Pigou, and J. B. Clark.
Although the change in approach occurred at the same time as the rise of Marginalism, the two are not necessarily synonymous, as some marginalists, most notably E. Bohm-Bawerk and W.S. Jevons remained committed to a quantum theory of capital. Irving Fisher adopted a materialist approach to capital although he maintained that its value represented estimated future net income: The Theory of Interest, p.13-14.

3.N. Kaldor, An Expenditure Tax, Parker & Harcourt, Ch.11.

4."...permanent investment together with the transferability of shares, made the separation of income an economic necessity."; A.C. Littleton, Accounting Evolution to 1900, Ch.XII,p. 213. See also: A. Barton, An Analysis of Business Income Concepts, I.C.R.A. occasional paper no.7; J. Hicks, Capital Controversies, supra.

5.Ibid. pp.9,&12.
With regard to the contemporary situation, Barton concluded that:
"Current accounting practice still provides little guidance as to what accountants are measuring as income in their annual reports, and one cannot formulate a profit concept from current practices. The situation is much more complex and practices more diverse...and management has considerable discretion in how it chooses to determine periodic income."
Barton concluded his paper thus; "Life would be easy for the accountant if there were just the one simple and unambiguous concept of income possible, such as the gain in cash on hand, but the facts of business life are otherwise and he must recognise this. Given the abstract and complex nature of the concept of periodic income, the requirement that auditors must attest to the truthfulness of the measure of periodic income is a most unfortunate one..."p.61.
That the Companies Act 1985 has not radically altered the situation as regards the uncertainty of accounting concepts is revealed in a speech made by D. Hanson, a managing partner in the accountancy firm Arthur Anderson, reported in the Guardian of April 4th 1989. As he stated; "Our experience is

that companies will generally follow standards that are clear and comprehensible, but leave any doubt or grey areas or options and they will suit themselves." As a consequence he thought that the current legal requirement for accounts to show a "true and fair view" needed to be stiffened by a presumption that such an opinion complied with accounting standards.
Coincidentally an article critical of the way in which companies measured their profits appeared in the same paper on the following day.(April 5th p.15.) It was entitled "Company Accounts: still trying to figure it out.", and in it the writer suggested that as a consequence of the availability of different, but equally justifiable, accounting practices,"company accounts are not worth the paper they are printed on."

6.H.R. Hatfield, Accounting, p.30.

7.According to A.B. Levy, Private Corporations and Their Control vol 2 p.491, there were "obviously some contradictions between the various decisions, and it would be hard by collating them to evolve a general rule." As will be seen infra in considering Dovey v Corey, such an outcome was precisely the intention of the Courts.

8.The original Charter of the Bank of England provided that "no dividends shall at any time be made...save only out of the interest, profit or produce arising by or out of the said capital stock or fund..." The Act of Parliament, 5&6 Will. & Mary c.20, in pursuance of which the charter was granted contained no such provision, but in 1697 when Parliament authorised the increase in the company's capital it expressly provided that any recipient of dividends paid from capital would be personally liable to the Bank's creditors to the extent of the payment. 8 & 9 Will. 111, c. 20, s.49.
It would appear therefore that these provisions represent two distinct statutory standards rather than simply different formulations of the one rule; and that the latter rule was specifically aimed at providing protection for creditors.

9.Stevens v The South Devon Railway Company (1851) 9 Hare 313, correctly states the law as it applied to partnerships at p.326. Unfortunately Turner V.C. was dealing with a statutory joint-stoock company and so his application of partnership principles was totally misguided.

10.8 & 9 Vict. c.16, s.121.

11.18 & 19 Vict. c.133, s.9; and 19 & 20 Vict. c.47, s. 14.

12.Article 73 of the model articles set out in table A of the Act, 25 & 26 Vict. c. 89, did provide that "no dividend shall be declared except from profits arising out of the business of the company", and the model balance sheet appended to Table A clearly implied a balance sheet determination of profit available for distribution as dividends. But as Table A was not compulsory those provisions cannot be considered mandatory.

13.French, ibid. As he accurately pointed out the development of dividend law "can broadly be described as an example of judicial law-making, upon which was superimposed an exercise of judicial law reform.", ibid. p.306.
B. Yamey, Aspects of the Law Relating to Company Dividends, M.L.R. April 1941, 273 agreed with this approach. On the other hand J.L. Weiner, Theory of Anglo-American Dividend Law, 28 Columbia Law Review 1928, 1046, tended to minimise the difference between the two periods and in so doing gave the false impression of continuity in the judicial approach to capital maintenance.

14.Yamey, ibid. p. 274. See also p.275 for a view of the categorical nature of such a rule
See also French, ibid. at p. 308.

15.Both French and Yamey, ibid. overemphasise, and at least to a degree misinterperet, the roles of the two Masters of the Rolls; Sir George Jessel and Lord Lindley. In so doing they tend to simplify the historical process they study.

16.(1864) 2 H & M 528.

17.Page-Wood V.C. also demonstrated an awareness that the return of capital to shareholders could lead to internal problems, especially given the transferability of shares, and was a breach of the contract between the members. Ibid. p.535.
His decision was approved and followed in re Alexandra Palace Co. (1882) 21 Ch.D.149. See also Masonic General Life Assurance Co v Sharpe [1892] 1 Ch. 154; and re National Funds Assurance Co. infra.

18.re Portsmouth Banking Company, Helby's, Stoke's, and Horsey's cases, (1866) 2 Equity Law Reports 167, at p.175.

19.Binney v The Ince Hall Coal and Canal Company, (1866) 35 L.J. Ch.363, at p. 367. Apart from the method of determining profits this case is remarkable for the manner in which Kindersley treats capital as a debt of the company. For a refutation of this conception see Lord Lindley's judgement in Lee v Neuchatel Asphalte Company, infra.

20.Re Mercantile Trading Company (1869) 4 Ch. App. 475, pp.492, 495.

21.re County Marine Insurance Company, (1870) 6 Ch. App. 104.

22.p.498. Although Selwyn L.J. did not expressly state that the creditor fund had to be maintained under all circumstances, that is the implication of his reasoning given his acceptance of the balance sheet as the proper way of determining profits.

23.French, ibid p.307 note 11, cites re Ebbw Vale Steel Iron and Coal Company; re National Funds Assurance Company; Dent v London Tramways Company; re Dronfield Silkstone Coal Company; and re Exchange Banking Company (Flitcroft's case) as the main cases in which Jessel established the doctrine. Each of these cases will be considered infra in order to assess the validity of the claim.

24.(1877) 4 Ch.D.827.

25.Chapter 3 supra.

26.The submission of counsel for the company can be seen as supporting this interpretation at p.830; as can Jessel himself at p. 831.
re Direct Spanish Telegraph Company (1886) 34 Ch. D. 307, is argued and decided on the basis of such an interpretation. In Verner v General and Commercial Investment Trust, [1894] 2 Ch. 239, considered infra, it was suggested that the reason for the reduction in the Ebbw Vale Steel etc. Co. case was simply to increase the marketability of the shares by concentrating available profits on a smaller share capital. Stirling J., at pp. 247-48, rejected such an interpretation and supported the view that Jessel M.R. had required a balance sheet determination of profit.

27.Select Committee on the Companies Acts 1862 & 1867. B.P.P. 1877, VIII.

28.See evidence of W. Newmarch at Q.s 262,331 and 371; and particularly J. Morris at Q.829.

29.See Q. 30 and the appendix to the Report of Select Committee. The total number of companies reducing their capital was 71. Before reduction this represented a total nominal share capital £59,098,000. After reduction the nominal capital was £22,271,200.

30.(1871) 11 Eq. 356.
After Jessel's decision in the Ebbw Vale case, Bacon declined to approve a reduction of share capital to the level of a

company's impaired concrete capital in re Kirkstall Brewery Company Ltd.,(1877) 5 Ch. 535.

31.Q.2550.

32.Q.2557. Emphasis added.

33.40 & 41 Vict. c.26. Although the committee had considered much wider issues than simply permitting the reduction of capital and sought to improve the operation of the company law system, its general findings and recommendations were ignored.

34.At p. 831 he referred to share capital being lost when he must have meant concrete capital.
At p.832 he referred to nominal capital representing security for creditors when he must have meant unpaid issued capital; then at p. 883 he once again referred to nominal capital, but this time he must have meant paid-up issued capital.

35.p.832.

36.Whether the shares were fully paid up or not was immaterial as the uncalled part represented a portion of the total fund available to the company and against which creditors could ultimately claim.

37.(1878) 10 Ch.D.118.

38.Ibid. p.127. Emphasis added.

39.(1880) 16Ch. D.347 n.

40.Ibid., p.311.
French does admit that the case was decided "largely" on the articles, but he still overestimates the general applicability of the decision in his desire to characterise Jessel as a clear proponent of the balance sheet approach to capital maintenance. See infra.

41.(1880) 16 Ch. D. 344.

42.Ibid., p.354. Emphasis added.

43.Yamey, ibid., p.275.

44.Ibid., p.292-93.
Support for this interpretation is apparent in the Irish case of Kehoe v The Waterford and Limerick Railway Co.(1888) 21 I.L.R. 221, in which the Master of the Rolls stated his view that the rules determining the availability of profits for distribution should be the same in respect of ordinary and preference shares. It is ironic, however, given the fact that

he was in fact doubting the correctness of Jessel M.R.'s decision in Dent's case, that his view was to be confirmed, but in a way contrary to his own preferred method, and incidentally Yamey's, view of the contemporary law.

45.Ibid., p. 314.

46.Theory of Anglo-American Dividend Law, 1928, 28 Columbia Law Review no.8 p.1046,at p.1052.

47.The Legal Content of the Profit Concept, 1936, 46 Yale Law Journal,436, at p. 440.

48.(1880) 17 Ch.D. 76.

49.Jessel's decision was overturned on appeal, ibid, but his reasoning was later expressly approved by the House of Lords in Trevor v Whitworth, considered infra.

50.re Exchange Banking Company (1882) 21 Ch.D. 519.
Both Yamey, ibid p.274-75, & French, ibid. p.308, claim its support for that particular form of the doctrine.

51.Ibid.,p.533. Emphasis added.

52.Ibid., pp. 533-34. Emphasis added.

53.Op cit.

54.French, ibid. p.308, categorically, and it is suggested wrongly, asserts that the two doctrines were synonymous.

55.Ibid.,p.308

56.Yamey, ibid., p.277, contradicts French on this point.

57.(1882) 22 Ch.D.349.
Once again French, ibid. p.308, mistakenly cites this as supporting authority for the balance sheet view of profits, maintaining that "it contained a unanimous reaffirmation of the rule".

58.Ibid. p. 379.

59.Ibid. p.375, emphasis added.

60.(1887) 36 Ch.D. 787.

61.Ibid., p.797.

62.Ibid., p.797-78.

63.Ibid., p.800.

64.Ibid., p.799.

65.(1887)12 App. Cas 409.

66.Ibid., p.415.
See also p.420 and Lord Watson at p.423.

67.Lord Herschell, ibid., p.416.

68.Surprisingly French,ibd.,p.313, quotes a passage from the judgement of Lord Watson, in which he expressly stated that "Paid up capital may be diminished or lost in the course of the company's trading..." as supporting the conclusion that a company's concrete capital had to be maintained at the level of its issued share capital.

69.That some members of judiciary, and perhaps more importantly businessmen, continued to recognise the need for lost capital to be written off before the payment of dividends could be permitted can be seen in re Direct Spanish Telegraph Company (1886) 34Ch.D. 307.

70.B.P.P. 1877 VIII, Q.s 2253 & 2254.

71.(1870) 6Ch. App.104.

72.Ibid., p. 276.

73.Brief, 19th Century Capital Accounting, pp.147-48.
For a consideration of the continued problems see Barton, supra.

74.Ibid. p.312.

75.Companies Act 1985 ss.103 &108 now require expert valuation of such consideration before the allotment of shares in public companies.

76.Evans's case L.R.2 Ch. 427; Migotti's case L.R.4 Eq.238; Baron de Beville's case L.R.7 Eq.11; Pell's case L.R. 7 Eq. 14; Drummond's case L.R.4 Ch. 772.

77.Liefchild's case L.R. 1 Eq. 231; Drummond's case, supra; Forbes and Judd's case L.R. 5 Ch. 270; re Baglan Hall Colliery Co L.R. 5 Ch. 346; Jones' case L.R. 6 Ch. 48;Maynard's case L.R. 9 Ch. 65.

78.Fothergill's case L.R.9 Ch.65; Andersons case 7 Ch.D.75; re Wragg Ltd. [1897] 1 Ch.796.

79.Initially the issue of shares at a discount was approved by Chitty J in re Ince Hall Rolling Mills Co. Ltd.; and re Plaskynaston Tube Co., both 22 Ch.D.542. But these decisions were disapproved in re Addleston Linoleum Co. 37 Ch.D. 191; and overruled in re Almada and Tririto Co. 38Ch. D.415, which decision was confirmed by the House of Lords in the Ooregum Gold and Mining Company of India v Roper[1892] A.C. 125.

80.Although some judges, notably Romilly M.R. in Pell's case, supra; and Stuart V.C. in Leeke's case L.R.11 Eq. 100, favoured enquiring into the value of consideration provided for shares, they were in a small minority and re Wragg, supra, decided the point definitively against such a possibility.

81.O.Kahn-Freund, Company Law Reform, M.L.R. April 1944,p.64.

82.That the Court adopted such an approach can be seen in re Wragg, supra, in its treatment of the questionable valuation of goodwill.
That Kahn-Freund adopted a different, and misconceived view is revealed in the following passage: "That every penny of the alleged issued capital of a company should be represented either by an actual payment into the coffers or by an enforceable liability of a shareholder to the company, this would seem to be one of the governing tenets of every sound system of company law."p.60.

83.(1889) 41. Ch.D. 1.

84.Yamey, ibid., p.277.

85.Ibid.,p.9.

86.Ibid.,p.16.
This substantiates the contention stated earlier that the Courts did not inquire into the value of non-cash consideration because they were fully aware that share capital generally did not equate with assets value.

87.Ibid.,p.17.
As he pointed out, p.17, there was nothing in the Companies Act which required dividends only to be paid out of profits [determined on a balance sheet basis]. As Table A model Articles were not obligatory, the fact that there was a regulation to that effect in them merely showed that such a provision was not compulsory.

88.Cotton L.J.'s judgement apparently accepted the distinction, suggested by counsel for the company, between circulating capital which was parted with and returned in the short term and fixed capital which was sunk once and for all.

89.Ibid., p.22, & 24.
S.9 of the 1855 Joint Stock Companies Act had originally applied a solvency test for distributions. Although it was re-enacted in s.14 of the 1856 Act; it found no place in the 1862 Companies Act.

90.Ibid.,p.25.

91.Ibid., p.25 Emphasis added.

92.Ibid., P.21. See also p.22 where he stated that the payment of dividends was " a business matter left to business men."

93.Ibid., p.24.

94.Ibid., p.22.

95.Ibid., p.23.

96.Ibid., p.24.

97.Ibid. p.22.

98.Both Littleton, ibid.p.216 and Barton, ibid.p.9, provide support for this criticism of the inappropriate use of the balance sheet.

99.Ibid., p.27.

100.Lubbock v British Bank of South America 2 Ch.D 198, apparently represented an immediate derogation from this position, in that it permitted the distribution of a profit realised on the transfer of concrete capital. The case was actually decided on the basis of a balance sheet surplus being present, although it was perhaps justifiable, within the reasoning set out in Lee's case, under the particular circumstances of the case which could, in some ways, be equated with a winding up of the original banking business.

101.It is precisely on this ground that the American writer P. Reiter questioned the whole line of cases which followed from the Lee case, maintaining that: "English law cannot be regarded as finally and unequivocally settled until such time as the House of Lords has spoken." Dividends Profit and the Law, p.83.
Unfortunately the House of Lords never did settle the matter directly, but it is suggested that Dovey v Corey, see infra, settled the matter indirectly, although not in the way approved of by Reiter. It took the 1980 Companies Act to alter the law in the manner he supported.

102.As confirmation it only has to be asked why the 1877 Companies Act was passed, if companies did not have to write down their capital before paying dividends, or why did companies such as the Direct Spanish Telegraph Company (1896 24 Ch. D. 307.) make use of the procedure of that Act as late as 1896?

103.1889, 5 L.Q.R., 221.

104.Yamey, ibid., p.279.

105.Palmer's Company Precedents 6th Ed. p. 431.

106.Glasier v Rolls (1889) 42 Ch.D. 436.
When the case came before the Court of Appeal; L.J.J. Cotton,Fry and Lopes, they did not comment on this point but merely allowed the appeal on the basis of Derry v Peek, 14 App. Cas 337, which had only just been decided.

107.Op cit.

108.See Hatfield, Accountancy, p. 264; Yamey, ibid. p.278-79.

109.P.Mason, Profits and Surplus Available for Dividends, (1932) 7 Accountancy Review,61. Also Kehl Corporate Dividends, p.17.

110.The reference to a conflict with Trevor v Whitworth is somewhat surprising, given that the notewriter went on to justify the decision in Lee's case by distinguishing between the loss of capital and the return of capital to the shareholders. As has been demonstrated previously Trevor v Whitworth actually provided support for the possibility of such a distinction.

111.Supra.

112.Palmer's Company Precedents, 6th Ed.,p.431.

113.(1894) 2 Ch. 239.

114.Ibid., p.245-260.

115.Kay L.J., although agreeing with Lindley's conclusion, apparently, at p. 268, supported the balance sheet method of determining profits.

116.Although French, ibid. p.318, maintains that it was Lindley who first treated the two rules as distinct doctrines, in Verner's case; as the foregoing has demonstrated the doctrines had diverged at an earlier stage than this, and can be seen as distinct even in the decisions

of Jessel M.R. after re Ebbw Vale Steel etc. Co.

117.p.265. Somewhat surprisingly Lindley was prepared to follow Lubbock v British Bank of South America, in permitting shareholders to benefit from capital appreciation.

118.As was stated supra this line of reasoning was implicit in Jessel's conception of capital as a res.

119.Ibid.,p.266.

120.ibid.,p.266.

121.p.268.

122.According to Ballantine & Hills, ibid p.254:"The English Courts...have invented certain verbal sophistries or fictions to rationalize their judicial legislation."
It is ironic that Adam Smith's concepts of fixed and floating capital were used to justify a materialist conception of capital when Smith himself had clearly understood capital to be in the nature of a fund.

123.The Accountant,1894, p.176 described the judgement as fearsome and wonderful. Cited in Yamey, ibid. p.280.

124.Company Precedents, 6th ed, p.436.

125.11th edition, p.220-221.

126.H.R. Hatfield, Accounting, 1927, p.275.

127.p.267. Emphasis added.

128.In re Barrow Haematite Steel Co.[1900] 2 Ch. 857, Cozens-Hardy J. suggested an approach similar to the one suggested here.

129.Ibid. p.278.

130.Palmer, op. cit.

131.Ballantine & Hills, ibid p.255 acknowledge this point when they state that:"The English rule is to be justified, if at all, only on the basis that present earning capacity may demonstrate such financial conditions as to make dividends permissable in the discretion of the directors in spite of capital deficit and even in the absence of actual annual profits."

132.As Kehl.ibid p.17, stated: "By and large the twentieth century corporation was not viewed as constantly in danger of dissolution: economic responsibility was more certain.

Changes in the market level might cause large-scale reorganization, but for causes which dividend regulation could hardly eradicate." The reverse procedure is equally possible.

133.A.C. Pigou, Net Income and Capital Depletion, Economic Journal, June 1935,p.238.

134.[1899] 2 Ch. 629.

135.p. 668.

136.p.671. Emphasis added.
See also the opinion of Romer L.J. in the argument at p.655.

137.p. 670.

138.p.671.

139.p.669.

140.p.669.

141.p.671.

142.the Accountant, 1889, p.892.

143.Company Precedents, 7th edition, p.764; Company Law, 3rd edition, p.156-58.

144.[1901] A.C.477.

145.Pp.486-87.

146.p.488.

147.Lord Davey approved of the use of the distinction between fixed and circulating capital as being not open to objection as a statement of the law.p. 494.

148.C.A.Cooke, 46 Yale Law Journal 436,completely misconstrued the,, House of Lords decision in his contention that: "the House was inclined, so far as it committed itself, to doubt whether a company, which had made a definite loss of fixed capital, may have a profit for dividend purposes until that loss has been provided for."

149.p.487.

150.Ibid. p.298.
French ibid.p.324-325, apparently failed to take this point into consideration in his suuport of the provision of utmost

commercial freedom to shareholders as long as creditors were protected. Rash distribution decisions would affect not just the incompetent shareholders who might endorse such decisions but would equally affect later, and equally incompetent shareholders.

151.In Bond v Barrow Haematitie Steel Co. [1902]1 Ch.D.149 Farwell J. attempted to insist on depreciation of fixed assets by treating even buildings as circulating capital, but such a clearly disingenuous attempt was criticised by the Court of appeal in Ammonia Soda Company Ltd. v Chamberlain. [1918] 1Ch.266.
In re the Spanish Prospecting Co. Ltd. [1911] 1 Ch. 92, Fletcher Moulton L.J. expressed a preference for determining profits on the basis of a balance sheet surplus p.98, but he had to admit that the dividend fund might "in some cases be larger than what can rightly be regarded as profits",p.101.

152.[1961] Ch. 353 at p. 373.
Buckley declined to follow the earleir Scottish case Westburn Sugar Refineries v I.R.C.[1960] T.R.105.

153.Companies Act 1980 s.39(2); 1985 Act s.263(3).

154.Companies Act 1980 s.45 (4); 1985 Act s.280(3)

155.Companies Act 1980 s.40; 1985 Act s.264.
Alternative requirements apply to investment companies: Companies Act 1980 s. 41; 1985 Act ss.265-66.

156.See Pennington's Company Law Ch,11, pp.451-463.

Chapter Six: Ultra Vires as Investment Protection.

I. Introduction.

The intention of this chapter is to demonstrate the way in which an appreciation of the underlying economic structure of the joint-stock company provides the means to an understanding of the emergence and development of the doctrine of ultra vires as it applied to companies.

II. The Chartered Corporation.

The contemporary view is that the ultra vires doctrine has no application in relation to such corporations:

> " At common law a corporation created by royal charter has power to deal with its property, to bind itself by contracts, and to do all such acts as an ordinary person can do and so complete is this corporate autonomy that it is unaffected even by a direction contained in the creating charter in limitation of the corporate powers."[1]

The initial authority for this assertion that the ultra vires doctrine did not apply to chartered corporations is the Case of Sutton's Hospital[2], as reported and commented on by Lord Coke. That report, itself not above criticism[3], was subsequently restated and refashioned into its contemporary form[4], and doubts have been expressed as to its accuracy, in the light of earlier authority.[5] The alternative view is that

the capacity of chartered corporations could be restricted as long as the restriction did not itself conflict with other common law rules, and that the undertaking by a chartered corporation of activities wholly foreign to the purposes for which it was incorporated would be void.[6]

Whilst this alternative suggestion is convincing, and is supported by the possibility of an action of **scire facias** to revoke a royal charter, it is taken too far when it is suggested that such corporations were restricted in a similar way to statutory or registered companies[7]; or that in the action of scire facias can be located the germ of the later ultra vires doctrine.[8] Such statements tend to give the ultra vires doctrine a legal pedigree which it does not warrant, and present the history of company law as a much smoother process of evolution than it was in fact. Whether or not non-commercial chartered corporations could be restricted in terms of their capacity is not really relevant to a consideration of ultra vires as it came to be applied to commercial undertakings.

When commercial companies were initially granted royal charters of incorporation, it was assumed that they had the same capacity as a natural person. It was the assumption that the activities of an incorporated society were not limited by the terms of its charter, that led to a trade in charters in the 18th century.[9] A number of successful **scire facias** actions in 1720 against companies operating under such

transferred charters[10] proved the error of such opinions; but even then it is still not appropriate to suggest that these companies were subject to ultra vires as it is now understood. For as in the earlier cases involving non-commercial corporations the fault was seen in terms of the abuse of privilege rather than as a matter of capacity. As long as the company operated did not patently mis-use its charter it had full capacity.

III. Statutory Companies.

Ultra vires, as it came to be understood and applied in its contemporary meaning, first made its appearance in cases involving statutory companies, that is companies granted incorporation by virtue of a special Act of Parliament.[11] The principles, as they were later to be applied, were foreshadowed in Maudsley v Manchester Canal Company[12] which prefigured by some fifteen years the first definitive case on the point: Colman v Eastern Counties Railway Company. decided in 1846.[13]

The Eastern Counties Railway Company had been incorporated by Act of Parliament. It had constructed and ran a railroad from London to Manningtree, some ten miles from the port of Harwich. The Directors of the Company were of the opinion that it would increase the traffic and profits of the railway if a steam packet company could be formed to link Harwich with the Continent. To this end the Directors, on behalf of

the Eastern Counties Company, proposed to promote such a company, to guarantee its profits and to secure its capital. Colman, a shareholder in the railway company, objected to these proposals and was granted an injunction to restrain the Directors from entering into the proposed arrangements.

A motion to dissolve the injunction was heard by Lord Langdale M.R. In these proceedings counsel for Colman argued on the basis of partnership principles that the Directors were precluded from pursuing any object alien to that which the shareholders had agreed to. It was argued that in companies incorporated by special Acts of Parliament objects specified by their constituting Acts could not be altered "except by the common consent of all the shareholders."[14] Counsel for the Company also accepted the applicability of partnership principles, but argued that the proposed course of action was not an extension of the Company's business into a new trade, but was necessary for the successful continuation of the existing business.

It was open to Lord Langdale to decide the case on the basis of partnership law and given the nature of the pleadings before him, it is perhaps surprising that he declined to do so. In the course of his judgement Langdale recognised that companies of the kind of the Eastern Counties Railway Co. were of recent origin, and admitted that, as yet, neither the legislature nor the courts had been able to understand all the different lights in which their transactions ought to be

viewed. Evidencing no disquiet about judicial policy making, Lord Langdale took this task upon himself. His conclusion was that such concerns had to be controlled by a strict interpretation of the Act of Parliament under which they were incorporated. As he expressed it:

> "the powers which are given by an act of parliament, like that now in question, extend no further than is expressly stated in the act, or is necessarily and properly required for carrying into effect the undertaking and works which the act has expressly sanctioned."[15]

and later:

> "I believe they have the powers to do all such things as are necessary and proper for the purpose of carrying out the intention of the act of parliament, and they have no power of doing anything beyond it."[16]

It has to be borne in mind that such statutory companies as railway companies were extended, not only the privileges of incorporation and limited liability for their members, but were also given extensive powers of compulsory purchase in order to facilitate the construction of their trackways. These powers to interfere with the private property rights of individuals merited close scrutiny by the Courts and the need to protect the public from abuse of such powers can be seen as one reason why Langdale favoured a rigorous interpretation

of statutes of incorporation. In basing his judgement on this ground Langdale was apparently following a well established body of precedent. In the Colman case, however, the corporate power to be exercised was not one of compulsory purchase as in Webb v Manchester and Leeds Rlwy Co.[17], nor would it have harmed a third party as in Blakemore v Glamorgan Canal Co[18]. Its exercise might even have been of considerable public as well as private benefit. In applying a doctrine developed for the protection of third parties from the abuse of corporate powers, to the internal affairs of the company Langdale greatly extended, not to say misapplied the principle.
The actual reason for the judgement would appear to lie in Langdale's express intention to stabilise and safeguard the railway company as an outlet for investment; an intention clearly expressed in the following passage:

> ".....if there is one more desirable than another, after providing for the safety of all persons travelling upon railways, it is this, that the property of railway companies should be itself safe; that a railway investment should not be considered a wild speculation, exposing those engaged in it to all sorts of risks, whether they intended it or not. Considering the vast property that is now invested in railways, and how easily it is transferable, perhaps one of the best things that could happen to them would be, that the

> investment should be of a safe nature, that prudent persons might, without improper hazard, invest their monies in it.[19]

Lord Langdale recognised the qualitative difference between joint-stock companies and partnerships. Where the management of a business was left in the hands of a small number of people, and the majority of members of a company were either uninterested, or incompetent to understand or participate in the process by which their dividends were generated, then there was clearly scope for the potential mismanagement of that process. Langdale offered protection against this potential abuse but he did so in a manner designed, not simply to safeguard the interest of the immediate shareholder, but rather in a manner designed to ensure the stability of the entire system of investment. The general community, and the individual shareholder would derive the greatest benefit from a secure and stable structure of investment. Langdale was aware that it might be in the interest of shareholders to pursue profit wherever the opportunity might arise, but given the nature of shareholders in joint stock companies, and the ready transferability of shares, he was of the opinion that such uncontrolled, and perhaps ill-considered, pursuit of gain would tend to destabilise the investment market as a whole, and might result in loss to the immediate shareholder or, and perhaps more importantly, his later replacement. To preclude this

eventuality, and to protect shareholders from the potentially ruinous consequences of their own quiescence, incompetence or cupidity, Langdale restricted statutory companies to the pursuit of the objects declared in their constituting Act of incorporation, and expressly denied to shareholders the power to acquiesce in any transaction beyond the scope of those objects.[20]

In Salomons v Laing [21] Langdale held that a railway company could not lawfully purchase shares in another company, nor give it financial support, without express authority so to do in its Act of incorporation.

The decision of Lord Langdale in Cohen v Wilkinson[22], that it was a departure from the purpose of incorporation for a company which had as its object the carrying of a railway from Epsom to Portsmouth to propose to construct only a part of the line from Epsom to Leatherhead, was confirmed by Lord Chancellor Cottenham [23], and followed in Bagshaw v Eastern Union Railway Company.[24]

In Munt v Shrewsbury and Chester Railway Company[25] Lord Langdale asserted categorically that companies which were possessed of funds for objects which were distinctly defined by Act of Parliament, could not be allowed to apply those funds to any other purpose whatsoever, " however advantageous or profitable that purpose may appear to the Company or to the individual members of the company."

Although the Court of Chancery developed the doctrine, and did so in cases involving dissentient shareholders, it is implicit in those decisions, and at times explicitly stated[26], that the Court of Chancery was merely providing a means whereby the dissentient member could enforce a legal right.

This view was confirmed by a Court of Law in East Anglian Railway Co. v Eastern Counties Railway Co.[27] In view of the later course of events it is important to highlight the clarity and emphatic language of this judgement. As regards whether the illegality of ultra vires contracts lay in some express prohibition or, alternatively, in some lack of authority, the Court unequivocally supported the latter view:

> "It is clear that the defendants have a limited authority only, and are a corporation only for the purpose of making and maintaining the railway sanctioned by the Act; and that their funds can only be applied for the purposes directed and provided for by the statute."[28]

and later:

> "they can do nothing not authorised by their act, and not within the scope of their authority"[29]

The judgment of the Court of Common Pleas in the East Anglia Railway Co.v Eastern Counties Railway Co. was approved, and applied, by the Court of Exchequer Chamber in Macgregor v the Dover and Deal Railway Co.[30]

Thus it can be seen that by 1852 the doctrine of ultra vires had been clearly established with regard to Statutory companies.

The problems faced by the judiciary in the mid nineteenth century lay in understanding the qualitative changes which had occurred in forms of economic organisation, and in deriving a legal framework adequate to the requirements of the new joint-stock company form. The development of the ultra vires doctrine represented an attempt to give legal substance to the perception of the qualitative distinction between joint-stock companies and partnerships as economic forms.

Not all of the judiciary, however, were sensitive to this distinction. Some of them continued to apply the principles of partnership law to joint-stock companies.

An example of this latter approach may be found in Vice Chancellor Turner's judgement in Simpson v Dennison.[31]

It is implicit in Turner's judgement that the question of authority to enter into particular transactions was an internal matter to be decided by the wishes of the members. That view exhibits no idea of the company being anything other than the reflection of the individual members and their wishes, and fails to comprehend the externality of those members to the actual process of production; an externality which, according to Lord Langdale, had necessitated the

application of the distinct company law principle of ultra vires.

Other judges, while recognising the economic differences between partnerships and joint-stock companies, focused their attention on legal form assumed by the economic organisation. Parke B's judgement in the South Yorkshire Rlwy. & River Dun Co. v the Great Northern Rlwy..Co.[32] is an example of this approach. Parke distinguished between partnerships, which were the creation of the partners and corporations, which were the creation of the law. The former simply constituted the sum of its individual members and depended, in the final analysis, on consensus. The latter, in accord with the Common Law conception of corporations as expounded by Coke and Blackstone, were to be considered as distinct legal persons of full capacity which existed in law completely separate from their constituent members. Being privileged with full legal capacity the corporation did not have limited powers but was free to enter into any transaction it cared to. Statutory corporations were not to be treated as full legal personalities but were to have the scope of their activity and authority circumscribed by their Acts of incorporation. Parke's exposition of ultra vires as that which is "forbidden expressly or by implication by the Acts of Parliament relating to those Companies."[33], in expressing it as a matter of prohibition rather than authority, departed from earlier

authorities in which that particular interpretation had been canvassed and categorically rejected.[34]

This concentration on the distinction between the two meanings of ultra vires, one connoting express statutory authority, the other either express or implied prohibition, was more than merely a matter of semantics. The two interpretations may meet but the latter idea of express prohibition gave a greater measure of latitude to the company than did the former.

By concentrating on the legal form rather than the underlying economic form Parke failed to grasp the underlying purpose and need for ultra vires. From his legal formalistic perspective the doctrine appeared as a derogation from Common Law principles applicable to corporations. From that viewpoint, which failed to consider the novelty of the economic form with which it had to deal, any problems were to be solved by the application of the principles of the Common Law of Corporations. In so doing it failed to recognise that what was required was not simply an adaptation of existing principles but essentially new principles.

It can be seen that a failure to adequately consider the economic nature of the organisation to be dealt with led potentially to two conflicting legal models. From one perspective the joint-stock company was simply a large partnership subject to partnership law; from the other it was simply a corporation subject to the Common Law of

corporations. A third approach emerged later.[35] This conflated the other two approaches by acknowledging the importance of the legal form while applying partnership principles within the corporation. None of these approaches, however, was adequate to regulate what was essentially a new economic form for centralising money-capital.

Baron Parke's prohibition approach to ultra vires was taken up by Erle J. in the Mayor of Norwich v the Norfolk Rlwy. Co.[36] ,in which he held that the funds of a company, which had been raised for a particular purpose, could not be dissipated in contracts unconnected with that purpose.

It followed from this that such companies would have had the contractual capacity to enter into any transaction which was connected to its purpose of incorporation, although not expressly authorised.

Erle J.'s vehement disapprobation of the ultra vires principle was due to the manner in which it operated to reverse the usual application of the rules of Contract, in so far as it justified, rather than redressed breaches of contract. It is apparent that it was only the weight of authority that prevented Erle J. from discarding the doctrine altogether.[37] Yet again legal formalism outweighed economic requirements.

Lord Campbell adopted a more orthodox approach in stating that express authorisation was the sole criterion for deciding the capacity of such a company.[38] The third judge to

give a decision with regard to ultra vires was Coleridge J. He substantially agreed with the approach of Erle J. in adopting an implied prohibition approach.[39]

Erle J. continued to follow the lead of Parke B. by concentrating on legal form in order to attack and curtail the effect of ultra vires principle in his minority judgement in Bostock v the North Staffordshire Rlwy. Co.[40]. In that case he observed that the consequences of the doctrine in respect of contracts were good grounds for not extending its application to estates in land. He also suggested that only those contracts which operated so as to defeat the purpose of incorporation would be ultra vires. Thus he proposed to give statutory companies even greater latitude in controlling their own affairs.

Later in 1855 the question of ultra vires finally came before the House of Lords in Eastern Counties Rlwy. Co. v Hawkes.[41] In the course of his judgement Lord Chancellor Cranworth after reviewing the earlier cases, both in Law and Equity, in which the principle of ultra vires had been developed, concluded that:

> "It must, therefore now be considered as a well settled doctrine that a company incorporated by Act of Parliament for a special purpose cannot devote any of its funds to objects unauthorized by the terms of its incorporation, however desirable such an application may appear."[42]

Having made this clear statement the Lord Chancellor went on to hold that the transaction in question was within the scope of incorporation. On both of these points Lord Brougham concurred.

Lord St. Leonards agreed with the opinions of the other two judges that the contract in question was not ultra vires the company. He differed, however, from the interpretation of ultra vires so emphatically stated by the Lord Chancellor, and accepted by Lord Brougham.

It is a peculiarity of this case that it arose from an appeal from a judgement actually delivered by Lord St. Leonards in a lower court. In Hawkes v E.C.R.C.[43] he had attacked attempts by companies to take advantage of the ultra vires doctrine in order to avoid contractual agreements. St. Leonard's judgement in that case had been handed up to the Court in the S. Yorks. Rlwy. Co. case[44] and it clearly influenced Baron Parke ; although it merely elicited a somewhat acerbic comment from Martin B. on the subject of judicial creativity. Hawkes v E.C.R.C. was also cited by Erle J. in the Mayor of Norwich case.[45]

Given his disapproval of ultra vires, a disapproval in which Erle and Coleridge JJ. shared, and given the undoubted influence of his own judgement in Hawkes v E.C.R.C. on those judges, it is hardly surprising to find Lord St. Leonards in turn approving of their judgments in the Mayor of Norwich case, when the Hawkes case appeared before him for a second

time. His elevation gave him the opportunity to place his imprimatur on an interpretation which, if he did not originate, he did much to develop.

According to St. Leonards:

> "incorporated companies have all the powers incident to a corporation, except so far as they are restrained by their Acts of Incorporation. Directors cannot act in opposition to the purpose for which their company was incorporated, but short of that, they may bind the body just as corporations in general may"[46]

Such an interpretation is far removed from, and essentially irreconcilable with that of the Lord Chancellor given in the same case and quoted previously.

The question as to whether or not incorporated joint-stock companies should have been granted more or less autonomy to pursue their business activities as they saw fit was ultimately a question of policy. Yet if the judiciary were making policy decisions, they were not wholly unfitted to do so, or unaware of the commercial environment in which their pronouncements were to operate. It is a matter of some interest to note that in the next case that falls to be considered the Shrewsbury & Birmingham Rlwy. Co. v North Western Rlwy.. Co.[47], both Lords St. Leonards, and Wensleydale, the former Baron Parke, retired from the case

and declined to give any judgement, on the grounds that they were both shareholders in the defendant company.[48]
Although in the Shrewsbury & Birmingham Rlwy. Co. v the North Western Rlwy. Co. Lord Chancellor Cranworth did not ground his decision on ultra vires, he did permit himself to consider the principle. In so doing he adopted an implied prohibition approach; expressing approval of the manner in which Parke had stated the principle in the South Yorks. case.[49] This outcome can only be described as somewhat strange in that it conflicted with his more carefully considered judgement in Eastern Counties Rlwy. Co. v Hawkes.[50] This may simply demonstrate the confusion that had arisen within the judiciary with regard to the foundation upon which ultra vires was based.
In A.G. V Great Northern Rlwy.[51] Vice Chancellor Sir R.T. Kindersley adopted an implied prohibition approach to ultra vires, as he also did in the Earl of Shrewsbury v the North Staffordshire Rlwy.[52] Statutory companies had all the powers of common law corporations, unless those powers were expressly or, impliedly, curtailed by their Acts of incorporation. Within the limits set by any such prohibition the company could conduct its business as it chose. Kindersley conceptualised Statutory companies as incorporated partnerships functioning within a sphere of operation which was only restricted by prohibitions contained in their Acts of incorporation. Directors only had the power to bind the

company to contracts within the normal business activity of the company as stated in its Act of incorporation. This limitation on the powers of the directors, however, in no way limited the powers of the company. It remained free to enter into any transaction not expressly or impliedly forbidden to it. Shareholders were assumed to be industrial-capitalists and on the basis of this misconception they were granted ultimate control of the company's potential activity. Whether the company wished to carry out the transaction was determined by the will of the members. As in partnership law unanimity was required before the company could transact new business.[53]

In Taylor v Chichester & Midhurst Rlwy. Co.[54] Blackburn J. supported, and expanded on, the distinction between two types of ultra vires made in the Earl of Shrewsbury case by Kindersley V.C. His reasoning was based on what he perceived to be the twofold intention of the legislature in passing special acts of incorporation. This twofold intention involved private as well as public benefit, in that the corporations were created to further some private trading speculation while at the same time bestowing some benefit on the general public.[55]

With regard to the first purpose of incorporation, that of private speculation, Blackburn understood the incorporated company as merely an extended form of partnership; a combination of industrial-capitalists. The consequence of

this failure of perception was the inappropriate use of partnership principles to regulate the joint-stock company. As a consequence he recognised unanimity of purpose within the membership as grounds for permitting the company to enter into transaction not originally authorised by its Act of incorporation[56], and thus the company, at least potentially, had full legal capacity with regard to normal commercial transactions.

With regard to the question of public interest, matters were somewhat different. The legislature had determined that some acts were prohibited as far as the particular corporation was concerned; and any contracts to do such prohibited acts were "illegal".[57]

Thus for Blackburn ultra vires was a matter of legality rather than capacity. Corporations were empowered to enter all contracts which were not by law forbidden to them. His antipathy to ultra vires is apparent throughout his judgement and it is clearly his intention to limit "those scandalous cases which have reduced the word repudiation to a term of opprobrium" by restricting its application as far as possible.[58]

Blackburn J. was joined in his opinion by Willes J. Their judgments, however, represented only the minority opinion. The majority followed the East Anglian Rlwy. Co. case[59] without attempting to distinguish or curtail its effect.[60]

The variety of approaches evident in Taylor v Chichester & Midhurst Rlwy. Co. is merely symptomatic of the general confusion prevailing amongst the judiciary in regard to the precise nature of the ultra vires doctrine. The opportunity to clarify the situation arose when that case was taken on appeal to the House of Lords.[61] Unfortunately the Court declined to avail itself of the opportunity.

In avoiding the main issue in the case the House of Lords left the matter in as much, if not greater, confusion than before.

This confusion, as to exactly how ultra vires operated with regard to companies incorporated by special Act of Parliament, was not finally resolved until the post Ashbury v Riche[62] cases of A. G. v the Great Eastern Rlwy.[63] and Baroness Wenlock v the River Dee Co. [64] As these cases applied and refined the law related to registered companies, as stated in Ashbury v Riche, consideration of them will be postponed until the emergence of ultra vires as it applied to registered companies has been examined.

IV. Deed of Settlement Companies.

Attention so far in this chapter has been concentrated on joint-stock companies incorporated either by Royal charter or by special Act of Parliament. Not all joint-stock companies, however, were incorporated by such procedures. After 1844 most companies were incorporated and regulated by virtue of

general registration Acts and prior to that date many joint-stocks had been organised as unincorporated companies, or at best, as quasi-corporations by virtue of royal or legislative grant[65]

In the sight of the law non-incorporated joint-stock companies were no more than extended partnerships.[66] Although they gave rise to particular problems, in terms of both internal and external relationships, these were dealt with by the adoption, and where necessary adaptation, of the ordinary principles of partnership law.[67]

One internal problem arose from the fact that the day to day management of a company's business was restricted to a small number of Directors rather than left to the members as a whole.[68] A related problem arose from the fact that the company could only operate on the basis of majority rule.[69] Directors were perceived as active partners, and their power to bind the shareholders, the passive partners, was restricted, on the basis of the agency doctrine of implied authority, within the scope of the day to day business of the company as stated in the Deed of Settlement.[70] No business could be transacted outwith that scope unless the agreement of every shareholder had been acquired.[71]

In the same way as the partnership agreement formed a common contract to which the partners were bound; so the deed of settlement of a joint-stock company bound its members and directors.[72]

In Davies v Hawkins[73], which involved a joint-stock brewery company, Lord Ellenborough reluctantly non-suited an action against a member of the company, for ale he had received, on the basis that the he had not assented to a change in the constitution of the company "which could not be made without the consent of the whole body of subscribers."[74]

And in Natusch v Irvine[75], in which a company had sought to extend its insurance business to include marine insurance, Lord Eldon granted an injunction to the plaintiff, to prevent his being compulsorily involved in any business to which he had not agreed.[76]

The central importance of the Deed of Settlement raised the question whether a dissenting individual member would be bound by an alteration to the business, made in pursuance of a provision in the Deed of Settlement expressly purporting to give the majority the power to make new by-laws, or alter existing ones. [77]

The Deed of Settlement of the British Iron Company provided that a three quarter majority at a general meeting would be necessary, and sufficient to "amend, alter or annul, either wholly or in part, all or any of the clauses of the ...deed, or of the existing regulations and provisions of the company..."[78] Nonetheless, in Smith v Goldsworthy[79], it was decided that the above provision did not permit the majority to alter the constitution of the company, but was restricted

to matters involving the conduct and management of the affairs of the company.[80]

The corollary of the above principles was that the unincorporated joint-stock company had the power to extend its objects clause if all the shareholders agreed with the extension.[81] As a further consequence of that power it followed that the company also had the power to unanimously ratify contracts entered into by the Directors in excess of their authority: the shareholders merely effecting, post facto, that which they had power to do prior to the transaction.[82]

Alterations to the Deed did not themselves have to be made by deed [83] and could be informal in nature.[84] It would appear also that passive acquiescence was sufficient to constitute approval.[85]

It would be clearly inappropriate to claim that unincorporated joint-stock companies were subject to the operation of the doctrine of ultra vires as it is now understood. There was no legal limitation on the capacity of the company to contract, but there were internal limitations on both the powers of the Directors to bind the company, and the powers of the majority to alter its constitution. As these limitations were designed to protect the interest of the individual shareholder it was open to that person to remove, or relax, them if he so chose, but he could not be forced to do so. It was, in the final analysis, for the

individual members as a body to decide whether the company should enter into a novel transaction not covered by the Deed of Settlement.[86]

The assumption behind this formulation was that the individual was competent to take such a decision; in other words, it was based on the erroneous perception of the joint-stock company as a means of uniting industrial-capitalists who would, in particular circumstances, actively participate in the undertaking. As will be seen this misperception was to be continued in regard to joint-stock companies when they became subject to the Registration Acts.

V. The 1844 Joint Stock Companies Act.

If the Common Law recognised partnership and recognised corporation, but knew no tertium quid[87], the Act of 1844 introduced such an object: the quasi-incorporation, or incorporated partnership.[88]

The idea of quasi-incorporation referred to the fact that the company's corporate status dissolved upon insolvency, whereupon it resolved into an ordinary partnership. At common law the members of a corporation were responsible for its debts only to the extent to which they had agreed to be bound.[89] In the registered company, as a consequence of the fact that members were expressly denied the privilege of limited liability, they retained full residual responsibility for the debts of the company, and creditors were at liberty

to sue individual shareholders to the extent of the whole of the company's debt.[90]

Initially the courts saw the quasi-corporation as merely a particularly privileged partnership, and their treatment of it as such was supported by both the general approach, and the specific wording of the 1844 legislation. Although the Act provided for the incorporation of a company after complete registration, it continued to refer to it as a partnership. It also continued to follow established practice in requiring the submission of a deed of settlement containing "the business or purpose of the company"[91], but the company was authorised "to perform all...acts necessary for the purposes of such company, and in all respects as other partnerships are entitled to do."[92]

Given the purpose and the approach of the legislation [93],it is hardly surprising that the courts continued to utilise the partnership principles adumbrated in earlier cases involving unregistered companies when they were called upon to deal with registered companies.

The powers of registered companies to enter into particular contracts, and the related question of the power of directors to bind their company, were first considered in Ridley v the Plymouth, Devon and Stonehouse Baking and Grinding Company, and The Knightsbridge Mill Company v the same defendant.[94] In the first case the plaintiff was the sub-lessee of premises of which the defendant company was the tenant. As a

consequence of the failure of the company to pay its rent the landlord distrained on the sub-lessee, who then sought to enforce an agreement for indemnity, purportedly entered into on behalf of the company with the approval of its directors. The matter was decided on the authority of the directors to bind the company. The Deed of Settlement of the company stated that the quorum for a directors meeting was five, and as only four directors had been present at the meeting which had agreed to the indemnity it was held to be invalid. Joint-stock companies were extended partnerships, but as their size precluded the operation of normal partnership rules relating to the implied authority of individual members to bind the other members, the question then became "who ha[d] authority to bind them?"[95]

The answer was the directors of the company as stated in the Deed of Settlement. As, however, the shareholders in registered companies retained complete personal liability for the debts of their company they required protection from unassumed risks. Protection from unlimited liability was provided by limiting the authority of the directors within preset limits stated in the Deed of Settlement. As such documents were required to be registered[96], outsiders were fixed with constructive notice of their contents, and could not enforce a contract against the company entered into by the directors in excess of their stated authority.[97]

In considering such "quasi-corporations" Parke B. observed that:

> "it is competent for them to say that the contract was not made by their agents having authority to bind them"[98]

The Deed of Settlement only represented the general authority of the directors, however, and the company as a body could, by unanimous assent, give them particular authority to enter into a contract outwith their usual limits, and the sanction of the members could be express or implied.[99]

The second case Knightsbridge Flour Mill Company v The Plymouth etc. Co.[100] concerned an action against the defendant company for flour supplied by order of its secretary, the debt having been acknowledged by a meeting of directors consisting of less than the required quorum. Counsel for the plaintiff attempted to distinguish the earlier case on the ground that the flour had been consumed by the company in the course of their trade. In rejecting this argument as fallacious Platt B. stated that:

> "The company consists of many persons who may never be near the premises, and who do not consume goods, or contract for them, or know anything about them except through their agents. A man may very well trust five directors with power to trade for him, and yet decline to trust a smaller number."[101]

This passage encapsulates the manner in which the court perceived the directors of a company as the agents of the individual shareholders, and the way in which the shareholder protected himself by restricting the authority of those directors/agents to render him liable for particular transactions. At the same time it reveals a paradoxical failure of perception, for although Platt highlighted the externality and passivity of the typical shareholder the form of protection offered to remedy that situation provided him with the powers of an active principal.

The above cases suggest a number of conclusions in respect of the earliest registered companies. Firstly it would appear that the doctrine of ultra vires, applied only to directors and not to the company as a whole.

Secondly they suggest that the objects clause of a registered company merely set the limit on the usual authority of the directors, giving them the implied power to enter into any contracts in pursuit of those objects.

As a corollary of these factors, the company as a body had no restrictions placed on its[102] capacity, and could, with unanimous consent, sanction or ratify individual transactions outwith the scope of the directors' usual authority.

These conclusions are supported by Smith v the Hull Glass Co.[103] and Greenwood's case[104] in which joint-stock companies and partnerships were treated as analogous.

By 1857 Baron Parke had been transmuted into Lord Wensleydale, but his views on the operation, and regulation, of joint-stock companies had not changed. In Ernest v Nicholls[105] he confirmed the opinions he had expressed in the above cases.

The Deed of Settlement determined the scope of the directors' usual authority and in that respect it affected third parties. However, in order to reduce the effect on third parties, a distinction between form and substance was developed in regard to provisions of such documents.[106] Failure by the directors to comply with merely formal provisions of the Deed, as opposed to matters of substance, would not permit the company to avoid a contract.[107]

The distinction is explained in the following observation by Lord St. Leonards:

> "...if the directors do acts in violation of their deed, in a matter in which they have no authority, in that case it is not a question of mere form, for that form is substance. The thing is not within their power, it is ultra vires, and those acts are together null and void. But in a case [where] the act to be performed is within the powers of the directors...and they neglect to do it...[the court] will not permit the company to take advantage of such neglect"[108]

It is evident from this passage that even Lord St. Leonards understood ultra vires, as it applied to registered companies, as a question of the authority of the directors not as a matter involving the capacity of the company. There has been some debate as to the manner in which alterations to the objects of a company registered under the 1844 Act were to be made. Horrwitz' claim[109] that by a mere majority resolution was sufficient where the deed so provided cannot be sustained.[110] On the other hand Hornsey's suggestion that any alteration in the objects had to be made by the submission of a new Deed of Settlement[111], is probably no more accurate.[112]

As a consequence of the judicial perception of such companies as merely privileged partnerships, and of ultra vires as a matter of directors' authority, ultimate control of the company's business was a matter within the competence of the shareholders collectively, and as such would have been open to alteration by unanimous agreement without formality.[113]

VI. The 1856 Joint Stock Companies Act.

The 1856 Act replaced the single Deed of Settlement by two constitutional documents: the memorandum, and articles of association. The Act, however, provided for the alteration of the articles only.[114] This development reflected the distinction that had previously emerged between the internal management of the company's business, over which the majority

had control; and the question of the company's constitution, including the nature of its business, which was a matter for the company as a whole.[115]

The cases decided under the 1856 Act tend to be concerned mainly with defining the ambit of majority power[116]. But the fact that the company as a whole retained the power to alter such features of its constitution as the nature of its business is implicit in many of the decisions.[117] This is most clearly revealed in Simpson v Westminster Palace Hotel Company[118], in which the reasoning of the House of Lords was still based on partnership law both in regard to the extension of the company's business[119], and the operation of ultra vires.[120]

The courts were not called upon to consider the actual effect of a transaction outwith the company's objects as stated in its memorandum of association, but entered into with the unanimous approval of the members. It was not necessary, therefore, for them to take into consideration the fact that members of registered companies could have had the benefit of limited liability as from 1855. The contemporary lawyer and writer, E.W. Cox, had considered these factors, and concluded that the partners, as a group, would retain the right to decide their business activity, but would enter into unauthorised business only at the expense of losing the corporate privilege of limited liability.[121]

Whether the courts would have adopted this approach is a matter of conjecture, but Cox's approach was one which might well have found favour with the courts. It certainly contains the underlying perception, prevalent amongst the judiciary, of the registered joint-stock company as essentially a partnership to which the privilege of corporate form has been extended.

VII. Ratification.

One aspect of the judicial perception of registered companies as merely extended partnerships was apparent in the manner in which the courts recognised the power of shareholders to ratify ultra vires transactions.

Deed of Settlement companies had been empowered to ratify transactions entered into by the directors in excess of their company's stated objects, and ratification could take the form of express approval or could be implied through passive acquiescence.[122] The same power was extended to companies registered under the 1844 Act.[123]

The justification for recognising ratification through acquiescence was based on perceived fairness:

> "Shareholders cannot lie by, sanctioning, or by their silence at least acquiescing in, an arrangement which is ultra vires of the company to which they belong, watching the result: if it be favorable and profitable to themselves to abide by

> it and insist on its validity; but if it prove unfavorable and disastrous, then to institute proceedings to set it aside."[124]

This reaction was based, however, on the false premiss that shareholders were capable of taking, and actually took, an active part in the operation of the company's business.

The cases arising from the winding up of the Agriculturalists Cattle Assurance Company Ltd.[125] reveal the way in which the courts conceptualised, and dealt with, ultra vires issues.

In Spackman v Evans [126] the majority of the House of Lords[127] held that an ultra vires transaction could have been validated if previously authorised, or subsequently ratified, by the **unanimous** agreement of the shareholders. Such agreement could be given either expressly or by means of acquiescence.[128]

From the perspective of contemporary orthodoxy the decision can be justified on the ground that the question at issue merely concerned:

> " an act which was ultra vires the directors, an unwarranted exercise of a power possessed by the company, rather than with a usurpation by the company of a power not contained in its deed of settlement."[129]

But to do so is to impose an anachronistic distinction[130] which did not exercise the minds of the majority of the court

who continued to see the company's constitution as a matter within the control of the members as a whole.[131]
Given that companies registered under the 1844 Act were unlimited it was thought appropriate that the shareholders be given the protection of controlling the constitution and composition of their company. Once again it has to be emphasised that such an approach is posited on the understanding that shareholders would be capable of exercising such power as was extended to them, in the event that they would even wish to exercise it. This point is highlighted in two conflicting judgments in Spackman v Evans. Lord St. Leonards' dislike of the ultra vires doctrine and his highly critical opinion of quiescent shareholders came together in the following rhetorical question:

> "Are we to hold that an owner of a £20 share in this concern, residing in the Highlands of Scotland, and wholly neglecting the interests of the trade in which he is interested, may sleep for twelve years perfectly silent, never inquiring, never complaining, but receiving all benefits and having no burdens, and that after that he may challenge transactions like those before us when he awakes?"[132]

The passage also reveals his lack of comprehension of the nature of this increasingly typical shareholder. He was a passive rentier: he was not, as St Leonards would have it, "a

partner" who "cannot abstain from taking any part in the transactions of the company", being " bound to inquire" as to the particulars of company transactions.[133] On the basis of his own view of the responsibilities of shareholders Lord St. Leonards was willing to recognise acquiescence by the mere passage of time.

Lord Chelmsford, on the other hand, was aware of the threat to shareholders posed by St Leonards' suggestion, given their lack of general business competence:

> "...it can hardly be said that acquiescence by a dispersed body of shareholders in the illegal acts of directors can be presumed, because they might have discovered that the acts were in excess of the of the powers conferred by the deed of settlement. I cannot think that in such a case it is sufficient to show that the shareholders, by the examination of the books of the company, might have made themselves acquainted with the unauthorized acts of the directors; for such an examination would, in most cases, be to many of them impracticable or useless; but knowledge of these acts ought to be brought home to them, either expressly or by necessary implication, before any presumption of acquiescence in them can be fairly raised" [134]

Lord Chelmsford's statement is paradoxical to the extent that it recognised the externality and lack of competence of the

majority of company members, yet allowed for the possibility of their exercising that incompetence in such a way as to bind themselves to its consequence.

VII. The 1862 Companies Act.

The 1862 Act has to be seen in the light of the failure of the common law to provide appropriate protection for the investment form represented by the company share.

Whereas previous legislation had been silent as to the powers of members to alter the constitution of their company, section 12 of the 1862 Companies Act[135] expressly provided that no alteration was to be made by any company in the conditions contained in its memorandum of association, other than in regard to the company's name, or its capital structure. Such a provision put the objects of the company, which were required to be included in the memorandum, beyond the control of the members. In recognition of the externality, passivity and lack of competence of typical money-capitalist shareholders the statute curtailed their prospective, and potentially ruinous, role as industrial-capitalists and active partners.

The judiciary did not immediately perceive the underlying reason for the change, and although Kinnersley J adopted a literal reading of the section 12 in Hutton v Scarborough Cliff Hotel Co. Ltd [136], for the most part they failed to give full effect to the change in perception apparent in the

1862 legislation by continuing to view, and treat, the registered company as simply a form of partnership.[137] It was not until the House of Lords decision in The Ashbury Railway Carriage and Iron Company Ltd. v Riche[138] that the true nature of the joint-stock company, and the typical investor in it, was finally recognised by the courts. The leading judgement in that case delivered by Lord Chancellor Cairns begins with a classic statement that deserves to be quoted fully:

> "My Lords, the history and progress of the action out of which the present appeal arises is not, I must say, creditable to our legal proceedings. There was not in the case any fact in dispute; and the only questions which arose were questions of law, or questions, perhaps, as to the proper inferences to be drawn from the facts as to which there was no dispute. The action, however, was commenced as long ago as the month of May 1868. The litigation appears to have been active and continuing, and yet seven years have been consumed, and the result of all, up to the present time, is this, that in the Court of Exchequer, two of the three judges were of the opinion that the plaintiff should have judgement; and when the case came before the Exchequer Chamber, it was heard before six judges, three of whom were of the opinion that

the plaintiff was entitled to judgement, the other three thinking that the defendant was entitled to judgement. The result, therefore, was that the judgement of the Court of Exchequer was affirmed. My Lords, but for this difference of opinion among the learned Judges, I should have said that the only questions of law that arise in the case, the questions which appear to me to be sufficient altogether to dispose of the case, were of an extremely simple character."[139]

From a modern perspective what Lord Cairns stated in regard to the simple nature of the legal problem involved in Ashbury v Riche is true; but such concurrence is achieved only at the expense of ignoring the legal process that preceded that particular judgement. It would be mistaken to impute legal incompetence, or obtuseness to the judges who reached conclusions opposed to the unanimous opinion of the House of Lords. The truth is that the whole area of what is now recognised as Company Law was in a state of flux and formation, and it was only the decision of the House of Lords in Ashbury v Riche that crystalised the concept of ultra vires in the form in which it was later to be understood and applied. Indeed the clearly authoritative tone of the House od Lords' decision can be seen as a consequence of the previous uncertainty, in that the law as it was to be applied thereafter had to be stated clearly and categorically in

order to completely extirpate alternative interpretations. That the question of law involved in Ashbury v Riche now looks so simple demonstrates the success of that process of deracination.

Support for the above contention is provided by an examination of the various judgments involved in the protracted litigation.

In the Court of Exchequer all three judges adopted the then prevailing legal perception of the registered joint-stock company as a partnership[140], and ultra vires as a matter of directors' authority rather than a matter of the company's capacity.[141] On the basis of agency law the shareholders retained the right to ratify any transactions entered into by their agents, the directors, outwith the scope of their normal authority as stated in the company's constitutional documents.[142] Surprisingly, however, although the company was registered under the 1862 Companies Act, there was no reference to section 12 of that Act[143]. Consideration of that section had to wait till the case came on appeal before the Court of Exchequer Chamber; and it divided that court evenly as to its effects.

In the opinion of Blackburn J., with whom two others agreed, section 12 prevented the company from changing its objects, but it did not prevent shareholders from unanimously ratifying particular ultra vires contracts. His reasoning was that at common law corporations had the full capacity of

natural persons[144], and upon registration companies became corporations. Whilst it was possible for the legislature to restrict the ambit of corporate activity, as it had done in respect of statutory companies, that was not the effect of section 12, which was not couched in sufficiently positive terms to override common law rights and powers.
Thus shareholders in registered companies were generally protected from the consequences of their directors entering into ultra vires contracts, but they retained the right to benefit from a particular contract, by unanimously adopting it, if they considered it to be in their interests.
This apparently gave shareholders the benefit of both worlds; general protection and the opportunity for particular profit if they so chose. Given the money-capitalist nature of investors in joint-stock companies, however, it is extremely unlikely that they would possess the ability to take such decisions. And with the possibility of ratification through acquiescence the effect of Blackburn's apparently tempting offer would increase shareholders responsibility to third parties for the actions of their directors. This may well have been the motivation behind Blackburn's judgement.[145] It is somewhat ironic, however, that he resorted to the common law of corporations in order to attain the end, which had previously been achieved by treating registered companies as simply extended partnerships.

A contrary opinion was stated by Archibald J., with whom two others also agreed. According to this view section 12 was sufficient to rebut the prima facie presumption of general authority of a corporation at common law. In effect the capacity of a registered company was unchangeably fixed and restrained by the terms of the memorandum, and any contracts beyond the scope of incorporation were incapable of ratification.[146]

The House of Lords, with the emphasis of unanimity, endorsed the view expressed by Archibald J. In so doing they reasserted the traditional common-law attitude towards the joint-stock company. The registered company was a body of people to which particular legal privileges had been extended; but extended only on condition. Whereas previously, however, the privilege emphasised had been the right to act as a body corporate, subject to the condition that it could not claim limited liability; the privilege now emphasised was limited liability, and the condition, the operation of ultra vires doctrine apparently in order to safeguard the interests of third parties.[147]

It has been suggested, in spite of the statements of the various Law Lords in Ashbury v Riche, that there is no connection between the ultra vires doctrine and limited liability[148], and although such an assertion may go too far, it has to be admitted that the link between limited liability and ultra vires is a tenuous, or at least an indirect, one

indirect, one given that third parties have no locus standi to forestall ultra vires contracts. Perhaps the explanation, as opposed to the legal justification, of the doctrine is to located elsewhere.

Both of the views which had contended in the Exchequer Chamber had revealed a consciousness of the importance of the transferability of shares. And although both demonstrated a concern for the possible effect that the sanctioning of otherwise ultra vires transaction might have on future shareholders, such concern weighed heavier in the opinion represented by Archibald J's judgement.[149]

Whereas Blackburn had concentrated on the rights of third party creditors and **existing** shareholders; Archibald J. and particularly Cairns L.C. in the House of Lords emphasised the need to protect creditors and **future** shareholders. A passage from Lord Cairn's judgement demonstrates this point:

> "The provisions under which that system of limiting liability was inaugurated, were provisions not merely, perhaps I might say not mainly, for the benefit of shareholders for the time being in the company, but were enactments intended also to provide for the interests of two other very important bodies; in the first place those who might become shareholders in succession to the persons who were shareholders for the time being,

and more particularly those who might be creditors of companies of this kind."[150]

The consequence of this reasoning was, not so much the protection of the shareholder, either present or prospective, but the protection of the share as a form of property, and the stability of the investment system as a whole. This need to protect the share as an important new form of property required that the powers of the members be curtailed. The potential of the company to benefit from fortuitous transactions was to be restricted, but in so doing the court simply recognised the true money-capitalist nature of the typical shareholder. The shareholders' rights as putative industrial-capitalists were withdrawn in recognition of their true role as mere money-capitalists. As a consequence they would benefit from the increased stability of the investment system as a whole, upon which the security, and the eventual liquidity of their particular investment depended.

The House of Lords decision Ashbury v Riche stated the ultra vires principle in stark terms: a registered company was a corporation only for those particular and fixed purposes stated in the objects clause of its memorandum of association, and it could lawfully undertake no action beyond the ambit of that stated authority. Such a clear statement was sufficient to bring to an end the controversy relating to the basis of the doctrine, and the express/implied prohibition theory could no longer be sustained. That the

reasoning in Ashbury applied to statutory companies as well as registered companies was recognised in Baroness Wenlock v River Dee Company.[151]

IX. Subsequent Developments.

The foregoing has shown how the development of the doctrine of ultra vires can be understood as the product of a desire on the part of both legislature and judiciary, acting in recognition of the money-capitalist nature of the typical investor in joint-stock companies, to provide protection for the investment system as a whole. It is ironic, however, that by the time ultra vires was fully developed, understood, and applied by the judiciary, it was no longer appropriate and merely acted as a constraint on the successful operation of joint-stock companies.

By the last quarter of the 19th century the investment system was well established and no longer required such protection as ultra vires could provide, but more importantly the emphasis had moved from protecting the investment mechanism as a whole, to ensuring the flow of income upon which its continued success depended.[152] Restricting companies within the powers and purposes stated in their memorandums contradicted this latter process.

In the light of Ashbury v Riche it was apparent that companies should register with objects as wide as possible, but this did not help the cause of those companies "which had

incorporated at a time when it was not the practice to enumerate in great detail the objects with which the company had been established." Such companies "were often seriously hampered in their business by the absence of any power to extend or alter the objects clause in the memorandum."[153] One particular manifestation of the potentially inhibitory effect of ultra vires was the extent to which it prevented companies from either taking over other companies, or alternatively amalgamating with them.[154] If the objects clauses of the companies concerned did not specifically allow for the procedure then it could not be undertaken.

The Companies (Memorandum of Association) Act 1890[155] permitted companies to alter their objects clauses to achieve any one or more of five stated grounds. It made no provision, however, for alterations to permit either the disposal of a company's undertaking, or to permit it to enter into an amalgamation. And those were precisely the powers that companies required under the prevailing economic circumstances. Such powers of alteration were not expressly provided until the Companies Act of 1928[156], section 2 of which contained the explanatory statement that:

> "For removing doubts it is hereby declared that a company has power under section 9 of the principal Act (i.e. the Companies Act 1908) to alter the provisions of its memorandum by including amongst its objects the power to sell or dispose of the

whole undertaking of the company and a power to amalgamate with any other company or body of persons"

The doubts mentioned in the above passage refer to a difference of approach between the Scottish and English courts in regard to the precise operation of the legislation. This difference is highlighted in two cases. In re Marshall Sons and Co. Ltd.[157] the Court of Chancery sanctioned an alteration to a company's objects clause permitting it to sell or dispose of its undertaking. In re Aberdeen Steam Navigation Co. Ltd.[158] the Court of Session held that an alteration should not be confirmed so far as it purported to confer the power to sell or dispose of a company's undertaking.

These decisions are contradictory, irreconcilable, and ironically to be found together in column 78 of Butterworth's Yearly Digest for 1919.

The two cases are simply the culmination of a divergence of approach that had been evident for some time. The Scottish courts had adopted a restrictive interpretation of the 1890 Act and had refused to countenance any alteration that could not be fitted under one of the five heads provided therein; no matter how commercially expedient or reasonable the proposed alteration might appear.[159] The English Court of Chancery on the other hand evidencing no sign of the legal formalism that had confused the development of ultra vires,

adopted a more liberal approach to the exigencies of commerce.[160] In so doing they exceeded their statutory authority, but <u>their</u> ultra vires action was sanctioned by the Companies Act of 1928.

The granting to companies of the power to alter their objects clause was only one way in which the ultra vires doctrine was undermined[161], and most lawyers would have agreed that the doctrine was ineffective and in deep disrepute long before its reformation by the Companies Act 1989.[162]

The effective reduction of the doctrine to an internal matter, by that Act, however, does not reduce the importance of a theoretically informed understanding of the history of the doctrine, both in itself, and for the illumination it sheds the history of company law in general, and in no way undermines the approach of the preceding work.

Chapter Six: Endnotes.

1.Palmer's Company Law, 22nd Ed. vol.1 p 1042.
See also T.B. Napier, A Century of Law Reform, pp.395-396.

2.(1613) 10 Co. Rep. 30 b.

3.Sir F. Pollock, Has the Common Law Received the Fiction Theory of Corporations, L.Q.R. 1911, vol 27,pp 219-235 at p.229.

4.The process started with Blackstone, Commentaries, vol.1 p 475. From the point of view of this thesis, however, it is of interest to note that the later statements of the unrestricted capacity of corporations at common law were made in an endeavour to limit the operation of the ultra vires doctrine. Noted examples of such are: Parke L. J. in S. Yorks Rlwy & River Dun Co. v the Great Northern Rlwy. Co.; and Blackburn L.J. in Ashbury Rlwy Carriage etc. v Riche. The law relating to corporations at common law, as stated in those cases, was accepted in Wenlock v River Dee Co. These cases considered in detail infra.

5.P.T. Carden, Limitations on the Powers of Common Law Corporations, Law Quarterly Review,1910, vol. 24,pp 320-330; accepted by Holdsworth vol.9 pp. 57-62.
Both Carden and Holdsworth cite the Islington case, Dyer,fol. 100. as authority for their criticism.

6.Carden Ibid. p. 329; Holdsworth Ibid. p.61.

7.Holdsworth Ibid. p.62.

8.Brice, the Law Relating to Ultra Vires, 1st Ed. pp.32-33. This suggestion conflicts with his repeated statements that ultra vires emerged as a response to the particular problems associated with statutory companies in the 19th century. See infra.

9.Holdsworth Ibid. vol.8 p.215.
S.18 of the Bubble Act specifically declared to be illegal acting under any charter for purposes other than those expressed in it.

10.See Scott Joint Stock Companies, vol.1. pp.425-427 for the circumstances surrounding these actions.

11.See Brice, Law Relating to Ultra Vires, (1st Ed.) p. 27.

12.1 C.P. Cooper 501.

13.(1846) 10 Beav. 1.

14.Ibid. p. 9.

15.Ibid. p. 14.

16.Ibid. p.18.

17.4 MY & CR 116.

18.1 MY. & K. 145, p.162.

19.Ibid. p. 14.

20.Ibid p. 15.

21.12 Beav. 339. This case is interesting in that not only does counsel for the plaintiff cite the partnership authority Const v Harris (1824) Turn. & R 496; but the headnote of the report misstates the ratio of the case in terns of partnership principles rather than in terms of the new Company law concept of ultra vires as Langdale actually stated it.

22. 12 Beav. 125.

23. 1 Mac & G. 481.

24.2 Mac & G. 389.

25.13 Beav. 1.

26. e.g. Salomons v Laing, note 10 supra at p. 353.

27. 11 C. B. 775.

28.Ibid. p. 811.

29.op. cit.

30.18 Q.B. 618.

31.10 Hare 51.

32.L.R. 9 EX. 55.

33.Ibid p. 89.

34.East Anglian Rlwy. Co. v Eastern Counties Rlwy. Co.; Macgregor v Dover & Deal Rlwy. Co. supra. These cases were cited by Parke as instances where the companies in question had entered into "engagements clearly beyond their powers". p. 85.

35.This approach developed by V. C. Kindersley and Blackburn B. is considered in detail infra.

36.4 El. & Bl. 397.

37.Ibid. p.416.

38.Ibid. p, 443 & 448.

39.Ibid p. 432-433.

40. 4 El. & Bl. 798.

41.L.R. 5 H. L. C. 331.

42.Ibid. p. 348.

43.1 De. G. Mac. & G. 737.

44.Note 32 supra.

45.Note 36 supra.

46.Ibid. p. 373.

47.(1857) 5 H.L. C. 114.

48.It is not suggested that such share owning would have led to any impropriety, it is merely pointed out as evidence of the importance and widespread nature of railway companies as a source of investment amongst the non industrial capitalist class.

49.Supra.

50. Given this conflict, and the repeated emphasis Cranworth placed on the fact that the time for implementation of the contracts in question had not yet arrived, this decision is clearly obiter, but it provided authority for the prohibition concept which Backburn J. was later to cite in Taylor v Chichester & Midhurst Rly. Co. Considered in detail infra.

51.1 Dr. & Sm. 154.

52.(1865) 35 L. J. (Ch) 156.

53.As will be seen infra this is precisely the approach adopted by the judiciary in regard to Registered companies.

54.L. R. 2 Ex. 356.

55.Ibid p. 378.

56.For Blackburn this type of ultra vires was an internal matter. Equity would protect the individual by maintaining his right to object to any non-authorised transaction, but the important point is that the individual was free not to object and thus to permit the company to enter into previously unauthorised transactions.

57.Ibid 379.

58.Ibid. p. 381.

59.Supra.

60.The majority opinion delivered by Montague-Smith, although expressed in terms of implied prohibition, stated that what was not authorised was prohibited, by implication. Thus in effect express authority was required to permit a statutory company to contract.

61.(1870) A. C. 4 p. 628

62.Considered infra.

63.(1880) 5 App. Cas. 473

64.(1885) 10 App. Cas. 354.

65.See Ch.2 supra.

66. See for example R v Dodd, 9 East 516; McIntyre v Connell, 1 Sim (NS) 225; re The Vale of Neath & South Wales Brewery Joint Stock Company, ex parte Morgan 1 Mac & G. 225; re German Mining Co. ex parte Chippendale 4 De G. M. & G.41. For contemporary comment see Taylor G., A practical Treatise on the Act for the Registration, Regulation, and Incorporation of Joint Stock Companies, 1847, at page 5; and Gow N. A Practical Treatise on the Law of Partnership. London 1830. See also Carr C. T. The General Principles of the Law of Corporations, p.p. 106/107.
Unincorporated companies which had received the right to sue and be sued in the name of a particular officer were treated no differently; Smith v Goldsworthy, infra.

67. Natusch v Irvine 2 Coop T. Cott. 358. at p. 371; ex parte Chippendale, supra, at p.41.

68.ex parte Morgan, supra, at p. 241.

69.At a superficial level both of these problems arose merely from the sheer size of joint-stock companies, but essentially they are a consequence of the nature of the members interest in the company.

70.ex parte Chippendale, supra, at p. 52.

71. e.g.Burmester v Norris 6 Exch. 796 at p.802.

72.ex parte Morgan, supra, at page 235.

73.3M.& S 488.

74.ibid p.492.

75.2 Coop. T. Cott. 358.

76.At p.370.

77.Foss v Harbottle (1843) 2 Hare 461 provided for the supremacy of the majority in matters relating to the internal management of the company. The question was whether such alterations to the company's business could be considered as a matter of internal management.

78.Clauses 17 & 29. See Smith v Goldsworthy, infra, at p. 433

79.4 Q.B. 430.

80. Although early practice was for the general court of the company to rely on such provisions to alter the Deed of Settlement, Dubois cites the proceedings of the Equitable Assurance Society as supporting the fact that, towards the close of the eighteenth century, companies were being advised to behave with more circumspection, and "the individual member's privileges seemed much greater." Dubois. The English Business Company. pp. 305-307. In this instance legal regulation, when it came to be stated, accorded with contemporary business practice.

81.ex parte Morgan p. 240.

82.in re Cameron's Coalbrook Steam Coal and Swansea and Loughor Railway Company, ex parte Bennett 24 L.J.(NS) 130.

83. Smith v Goldsworthy p.467.

84.The Vale of Neath and South Wales Brewery Joint Stock Company, Walters' case 3 De G & SM 149

85.This suggestion is implicit in Walters' case and is also supported by Davies v Hawkins at p.492, and Natusch v Irvine at p.371.

86.See ex parte Bennett at p.134.

87.C.T. Carr p.106
It is perhaps more accurate to state that the quasi corporation had established itself prior to 7 & 8 Vict c 110, which merely recognised it in order to regulate it more effectively. B.C. Hunt (p.29) would apparently endorse this latter approach.

88.As early as 1823, in Davis v Fisk (Times Oct.11 1838), Lord Eldon had used the term quasi-incorporation to refer to companies which had taken been granted the right of suing and being sued in the name of an officer. The difference is that although such companies had been granted some of the privileges of a body corporate without being incorporated, companies which registered under the 1844 Act were incorporated, but denied the full privileges of incorporation.

89.Salmon v Hamborough Co. (1671) 1 Ch. Cas 204.

90.7 & 8 Vict. c.110 S.56.
Under the 1855 Act, 18 & 19 Vict c.133, creditors could still sue shareholders personally to the extent to which their shares remained unpaid ,with the prior approval of the court. The right to sue shareholders personally was removed by S.61 of the 1856 Act, 19 & 20 Vict. c.89. Thereafter the shareholder was liable to contribute to the assets of the company to the extent of any amount unpaid on his shares.

91.7 & 8 Vict. c.110 S.7

92.S.25.

93.Ch.2 supra.

94.Both cases reported together in 1848 2 Ex. 711, and L.J. vol. 17 Ex. 252. The two reports contain important differences and have to be taken together.

95.ibid at pp. 716/717.

96.7 & 8 Vict. c 110. S.7.

97.Ibid. p.717.

98.1848 2 Ex. 711 at p. 716.

99. See report in Law Journal L.J. Vol 17 Ex. 252 at p.255.

100.Supra.

101. ibid. at p. 255.

102. For a considerable time the courts referred to companies as they rather than it. The company was not considered as being completely separate from its constituent members. The shareholders together formed the company, and, in essence, it remained the members merged; although they were granted the privilege of corporate form for the particular purpose of suing and being sued. On the point of changing use of language in relation to companies see "The Conceptual Foundations of Company Law" in J.L.S. 1987; and Ch.7 infra.

103.8 C.B. 670.

104.re the Sea Fire and Life Assurance Company. 3 De G. M. & G. Lord Chancellor Cranworth's judgement, pp.471-484, considers the authorities in this particular area in some detail.

105.VI H.L.C. 401.

106.Lord St Leonards, whose opposition to ultra vires in relation to statutory companies has already been mentioned, was instrumental in this development. See Taylor v Hughes 2 Jones & Lat 24; and Bargate v Shortbridge V H.L.C. 297 in which Lord Cranworth accepted St. Leonards' view somewhat against his own opinion.

107.This particular development should not be confused with the rule relating to the supremacy of the majority as stated in Foss v Harbottle for the latter merely referred to matters relating to the internal management of the company within its agreed objects. For a consideration of the difference between the effect of ultra vires actions and the rule relating to majority control see Gregory v Patchett 1864 33 Beavan 595 at p.606.

108.Bargate v Shortbridge V.H.L.C.297 at p. 318. This case involved a banking company formed under 7 Geo.4, c.46, but similar reasoning can be applied by analogy to ordinary registered companies. Further support for the proposition is provided at p. 328.

109.W. Horrwitz, Company Law Reform and the Ultra Vires Doctrine, 62 L.Q.R.66 at p.67.

110.Spackman v Evans 3 H.L. 171 cannot be taken as authority for such a contention as Horrwitz suggests, as it was not the issue under consideration.

111. G.Hornsey, Alterations to the "Constitution" of Companies, pp.265/266, and p.269.

112.As authority he cited (p.269) re Phoenix Life Assurance Co. 31 L.J. Ch. 749; and although the headnote of the case supports his contention, the case itself does not. The question of informality is clearly left open at p. 751.

113.Hornsey distinguished (p.266) between a ratification, ex post facto, of an act ultra vires the directors which left their powers unchanged for the future, and a permanent extension of their powers for the future. The former could be achieved informally; but the latter process required a new Deed of Settlement. It is suggested that such a nice legalistic distinction, although it appears appropriate in the light of later developments , would not have recommended itself to contemporary judicial opinion.

114.Any alteration to the articles required a special resolution. 19 & 20 Vict. c. 47, section 33.

115.Supra.

116.e.g. Australian Auxiliary Steam Clipper Company Ltd. v Mounsey 4 K.& J. 33; Bryon v The Metropolitan Saloon Omnibus Company, Ltd. 3 De G. & J. 123; Hutton v The Scarborough Cliff Hotel Company Ltd. 2 Dr. & Sm. 514.

117.eg.in The Australian Auxiliary etc. v Mounsey at p. 740; but more clearly in the Bryon case at p.128.

118.(1860) 8 H.L.C. 712.

119. Lord Campbell at p. 717;, and Lord Cranworth at p. 719.

120.It was still understood as a matter of directors authority rather than capacity of the company. Lord Kingsdown's judgement at p. 720.

121.The New Law and Practice of Joint Stock Companies,1857. p.lxiii-lxiv.

122.See supra.

123.In regard to cases considered previously see Ridley v Plymouth etc. at p. 255; Smith v the Hull Glass Co. at p. 678. Re Phoenix Life Assurance Co. at p.751 pointedly leaves the question of the effect of acquiescence open, but see also re Magdalena Steam Navigation Co.(1860) Johns 690 at pp. 694-695.

124. Gregory v Patchett supra at p. 602.

125.Spackman v Evans; Evans v Smallcombe; Holdsworth v Evans. All (1868) L.R.3 H.L. 171 et seq.
These cases involved a company registered under the 1844 Act. As stated in the Deed of Settlement, the only method by which shareholders could withdraw from the company was by transfer of their shares to some other persons approved by the directors. In addition the directors were provided with powers to forfeit shares for non-payment of calls. When the company got into difficulties a general meeting of the company agreed to a scheme implementing the forfeiture mechanism to allow members to withdraw from the company on the payment of an agreed sum. The directors permitted some shareholders to withdraw on different terms to those previously agreed. The question on winding up was whether it was correct to place these members names on the list of contributories.

126.supra.

127.Lord Romilly dissenting.

128.It was held in fact not to have been ratified by acquiescence. Lord St. Leonards, not surprisingly, dissenting.

129.Hornsey op cit. p.267.

130.This distinction did not emerge until after Ashbury v Riche.(1875) L.R. 7 H.L. 653 Considered in detail infra. Hornsey makes the mistake of reading Spackman v Evans mediated by Ashbury v Riche.

131.Lord Romilly's minority judgement most closely approaches the contemporary understanding of the ultra vires doctrine. It is not surprising, therefore, that Hornsey concentrates on it, but Romilly's linguistic confusion leads him to mis-state it at page 267.
In any case if the matter was simply a matter of a breach of directors authority, as now understood, why did ratification require unanimity?

132.ibid. at pp.221-222.

133.In order of quotation: Ibid at pp. 222, 208 & 202.

134.Ibid at p. 234.
It was commonplace for the judges to describe ultra vires transactions as illegal. For a consideration of the relationship of legality, and ultra vires, see Horrwitz ibid. at pp. 73-74.

135.25 & 26 Vict. c.89

136.Supra at pp. 523/524.

137.The Agriculturalists Cattle Assurance Company cases, considered supra, were decided after the 1862 Act but exhibit no concept of the company as anything other than a partnership. See also The Phosphate of Lime Company Ltd v Green.(1871) L.R. 7 C.P. 43.

138.(1875) L.R. 7 H.L. 653.

139.ibid. pp.663-664.

140.Channell B. distinguished the registered company from the statutory company. Only the latter had its capacity restricted by ultra vires. see p. 227.

141.Riche v The Ashbury etc. Co. (1874) L.R. 9 Ex. 225 at pp. 229; 234; 244.
Baron Martin at p.245 stated that the law on the subject was "clear and well established". Baron Channell had agreed at p. 227.

142.ibid. pp.227 & 229; 244.
Bramwell B.'s dissenting judgement at p. 239 did not deny the possibility of ratification in theory, he simply did not find it in fact.

143.Even more surprisingly all three judges seem to the admit the possibility of the company altering its objects by a special resolution in line with a provision in its articles. Pp. 229; 235; 244. Such a possibility was later considered and declared void in view of S.12 in Dent's case, re The Anglo-Moravian Hungarian Junction Rlwy. Co., L.R. 8 Ch. Ap. 771.

144.The case of Sutton's Hospital 10 Co. 1.

145. He certainly was opposed to ultra vires as his judgement in Taylor v Chichester & Midhurst Rlwy. Co. (supra) certainly shows.

146.ibid. pp. 288 , 292,& 293.
The implication which Archibald apparently accepted was that companies registered prior to the 1862 Act did have such power. See pp. 289-290.
He was also uncertain as to whether the members could be made liable in their personal capacity pp. 291/292. This possibility is reminiscent of Cox's suggestion, considered supra) in relation to the 1856 Act, but as the 1862 Act made partnerships of more than 20 illegal any ultra vires contract could not be enforced against the company as partnership.

147.L.R.7.H.L. at pp.: 668-670; 678; 685-686; 691; 693-694. Paradoxically this assertion of the pre-eminence of legal formalism over economic form, by placing the objects of the company beyond the control of the members, merely served to emphasise the distinction between the shareholders and the company, and thus to confirm the perception of the company as a separate personality from its members. See further ch.7 infra.

148.Horrwitz op. cit. p.69. The justification for the statement is that ultra vires applied, and applies, equally to unlimited companies as to limited ones.

149.Blackburn J., pp. 270-271.
Archilbald J., pp.291-292.

150.L.R.7. H.L. 667.

151.(1875)10 App. Cas. 354. Ironically it was Lord Blackburn who rejected an argument to the contrary. pp.360-361. It was the starkness of the decision that necessitated the subsequent amelioration provided in Att. Gen. v The Great Eastern Railway Company. (1880) 5 App. Cas. 473.

152.It has been suggested previously that the change in the dividend law that took place at this time reflected this change in perception.

153.Eve J. in re Jewish Colonial Trust [1908] 2 Ch. 287.

154. The motivation for undertaking such procedures could be the outcome of success or, paradoxically, a lack of success: Either a desire to swallow the capital of defeated competitors, or to displace competition by uniting previous competitors within monopoly organisations. Given the conditions prevailing during the Great Slump of the last quarter of the 19th century amalgamation was much utilised as the most effective method of monopolising markets. See L. Hannah, The Rise of the Corporate Economy; and Ch.3 supra.

155.53 &54 Vict. c. 62.

156.18&19 Geo.5 c. 17.

157.(1919) W.N. 207.

158.(1919) S.C. 464.

159.Other cases where the Scottish courts adopted such an approach are: Glasgow Tramways and Omnibus Co. Ltd. v Magistrates of Glasgow.(1891) 18 R. 675; re Young's Paraffin

and Mineral Oil Lighting Co. Ltd. (1894) 21 R. 384; re John Walker and Sons Ltd. (1914) S.C. 280; re McFarlane Strang and Company Ltd. (1915)S.C. 196; re Union Bank of Scotland (1917)2 S.L.T. 155; re the North of Scotland and Orkney and Shetland Navigation Co. Ltd (1920) S.C. 33; re Tayside Floorcloth Co.Ltd. (1923) S.C. 590.

160.Other cases where the English court adopted this approach are:re Westminster Brewery Co. Ltd. (1911) 105 L.T.R. 946;re Provident Clerks' and General Guarantee Association Ltd.(cited op. cit.); and re Anglo American Telegraph Co. Ltd. (1911) 105 L.T.R. 947.

161.An examination of the various ways in which the doctrine has been progressively undermined, together with a consideration of the modern situation has been provided in the report prepared by Professor D.D. Prentice for the Department of Trade and Industry in 1987, entitled the Reform of the Ultra Vires Rule: a Consukltative Document.
His recommendation was that the ultra vires doctrine be scrapped and companies should have the capacity to do any act whatsoever. Professor Prentice's report, although not enacted in full, did form the basis for the alteraion of the ultra vires doctrine by the Companies Act 1989.

162.The changing attitude of the judiciary prior to the 1989 Act can be seen in the Court of Appeal's judgement in Rolled Steel Products (Holdings) Ltd. v British Steel Corporation. [1985] 2W.L.R.908, which effectively limited the scope of the doctrine.

Chapter Seven: The Doctrine of Separate Corporate Personality.[1]

I. Introduction.

The essential contention of this thesis has been that the joint-stock company, as an organisational form of capital, and Company law, as the means of regulating that capital form, can be properly understood only on the basis of an analysis of the distinct forms assumed by capital over time. More specifically, it has been suggested that the emergence and development of the share as a distinct property form in the nature of fictitious money-capital offers an explanatory insight into the historical process which saw the formulation of the doctrines and rules which together constitute the distinct legal corpus Company Law as it is now understood. One such doctrine, that of corporate personality, is of central importance within the overall structure of Company Law. The purport of the doctrine of corporate personality is that once incorporated, a company constitutes "a permanent body quite distinct from its members"[2]
Palmer's Company Law provides the following, more detailed, exposition of this generally accepted view:

> "A corporation is not like a partnership or family, a mere collection or aggregation of individuals. In the eyes of the law it is a **person** distinct from its members or shareholders, a metaphysical entity

or a fiction of law, with legal but no physical existence."[3]

Although the precise nature of corporate existence is a matter of jurisprudential debate[4], it is not disputed that the doctrine of corporate, or separate, personality is one of the cornerstones of modern company law.[5] According to L.C.B. Gower:

> "Since the Salomon case[6] the complete separation of the company and its members has never been doubted."[7]

This complete separation of company and members is generally assumed to be the immediate consequence of the process of incorporation, but an examination of cases and texts prior to the last quarter of the nineteenth century reveals such a conclusion to be fallacious in its simplistic acceptance of the generality of what are in reality specifically contemporary perceptions. It is suggested that prior to the last quarter of the nineteenth century the consequence of incorporation was not such complete separation as is consonant with the contemporary conception of corporate existence. It is not denied that incorporation gave rise to a corporate entity, the incorporated company; but this entity was not as completely separate from the members who constituted it as modern theory would have it. On the contrary, contemporary sources support the conclusion that up until the last quarter of the nineteenth century incorporated

joint-stock companies were consistently identified with their members. The incorporated company was not understood as a distinct person apart from its constituent members, but as a distinct person composed of the totality of those members.[8] Thus in 1793 a corporation was defined as:

> "...a collection of many individuals united into one body..."[9]

and in 1843 members of an incorporated company were described as being:

> "...united so as to be but one person in law..."[10]

That the judiciary also shared the view which saw companies as the legal embodiment of the shareholders as a unified group can be seen from the fact that in cases concerning such companies they were consistently referred to by the personal pronoun "they", whereas contemporary practice would insist on the use of the pronoun "it".[11] The previous practice led one American commentator to the conclusion that:

> "The English have never been strong on corporation grammar - legislators, pleaders and judges have persistently called a corporation "they"."[12]

Such a comment is as misconceived as it is patronising. The difference is not merely grammatical, for behind the so called weak grammar of former practice lies a completely different conception of the corporation from the fully fetishised approach of the contemporary writer. The pronoun "they" was used, and appropriately so, for the reason that

the company was not as yet fully reified in legal thought. It had not as yet been cleansed of the people who were its members but was conceived of as actually being constituted by those people.

Such condescension as is apparent in the preceding quotation typifies the predominant approach of modern company lawyers. When faced with the problematic evidence of history, which reveals that incorporation did not always have the same consequences as it has today, they have dismissed it by impugning either the competence or intelligence of earlier lawyers. In such a way they are able to accommodate what appear as previous anomalies without questioning their own preconceptions which uncritically accept the conventional view of the complete separation of company from members. A particularly striking example of this writing of history backwards is apparent in the statement of one leading textbook in regard to the Joint Stock Companies Act of 1844 that:

> "The deed of settlement company , when registered, was invested with the qualities and incidents of corporations, although the full effect of this was not recognised until later in the nineteenth century."[13]

To criticise earlier lawyers for a failure to understand the true nature and effect of corporate personality, as it is understood in contemporary legal thought, is to impose an

anachronistic interpretative framework on legal history. The truth of the matter is that the learning of earlier lawyers was not inadequate it was simply different.[14]

The nineteenth century witnessed the development of the share as an essentially money-capital form, and the legal recognition of the money-capitalist nature of the typical shareholder. As a consequence, as shareholders ceased to perform the functions of industrial-capitalists, so at the legal level, existing legal concepts were altered and new ones developed specifically to accommodate and facilitate such a change. As regards legal personality it became inappropriate to conceive of the company as the members merged and functioning collectively to operate a common fund of industrial-capital. The company became seen, in terms more appropriate to a money-capital form, as connoting an absence of shareholders, reflecting the absence of the members from the sphere of production, and their location in the sphere of the circulation of revenues. As a consequence the company became reified and was seen as existing in its own right without reference to its money-capitalist members. Thus corporate personality became understood as involving an entity apart from its members rather than as body constituted by those members.

The remainder of the present chapter will demonstrate how the externality of the typical shareholder to the process of production, itself a function of the money-capitalist nature

of the shareholder, gave rise to a number of legal principles which together generated a more complete notion of separateness of company and members from that which prevailed previously.

II. The Transferability of the Share, Fictitious Capital and Separate Personality.

The preceding chapters of this thesis have emphasised transferability as an essential attribute of the share, together with the related existence of a market specialising in the transfer of titles to revenue. It is the coalescence of those two factors which permits the share to function as a money-capital form.[15]

With the existence of only a limited market in shares, the potential to realise investment exists but remains problematic, depending as it must on the seller finding suitable interested parties to purchase his shares. During this intermediate stage of development the share, whilst representing a title to a revenue from the enterprise carried out by a company, is so directly linked to the performance of concrete capital that it cannot as yet fully constitute a property right on its own account, and continues to represent an interest in that concrete capital.[16]

Under such circumstances it is not appropriate to consider shareholders as being completely separate from the concerns in which they hold shares.[17]

It is only when the property interest of shareholders is recognised to be in the nature of fictitious capital that the legal concept of the share can be said to be fully assimilated within the general concept of money-capital. Such assimilation, which emerged with the advent of the fully developed share market, brought with it a concurrent intensification of the perception of the shareholders as distinct from the company.[18]

The consequence of the process by which the share assumes the characteristics of an abstract money-capital form of property in its own right, distinct from the company's concrete industrial-capital, is that the shareholder's dependence upon and interest in the performance of concrete capital is mediated through the share and its performance in the stock exchange. The shift in the focus of shareholder attention from the concrete industrial-capital to the structure of fictitious money-capital has the effect of strengthening the impression of the separateness of shareholders from the company. The shareholder owns and is interested in fictitious capital, which represents the exchange value of his investment as a source of income, which in turn is determined within the sphere of the circulation of revenues: the company, in the form of corporation, is interested in, and owns, the concrete industrial-capital, whose sphere of operation is the process of production.[19]

This notion of separation of company from shareholders is further compounded by the fact that the exchange of shares means that company membership is continually in a state of flux, which tends to increase the appearance of the company itself as the focus of continuity apart from the fluctuating membership.

An examination of the historical evolution of the joint-stock company form confirms the validity of the above schema. It was the lack of a developed market in shares that ensured that the seventeenth-century joint-stock company, in spite of the transferability of its shares, was not:

> "in the full modern sense of the term, a public company..."

and tended to be:

> "more in the nature of extended partnerships."[20]

The semi-private of nature of joint-stock companies at this time was reflected in the fact that although the London Stock Exchange expanded in the course of the seventeenth century, dealing in company shares played no significant part in the growth of its business which consisted essentially in dealing in Government debt.[21]

The public funds continued to constitute the exclusive area of stock exchange activity into the early decades of the nineteenth century. As Gayer, Rostow and Schwartz concluded:

> "Although prices of shares were given in the authorized list of quotations by 1811, there was

> really no widespread interest in them as an outlet for savings until the decade of the 20's, Such shares as there were on the market at the outset probably had no special attraction either for investors or for speculators. For the investor, most of the shares then available had neither the advantage of security offered by consols nor a compensating differential in yield for the greater risk element..."[22]

Even the boom of 1825 had no more than a temporary effect, and thus as late as the 1830's the London Stock Exchange continued to function almost exclusively on the basis of government stock.[23]

It was only with the coming of the railway that matters changed. The construction of a railway line necessarily involved the centralisation of extremely large amounts of capital. The mechanism of centralisation was the incorporated joint-stock company constituted on the basis of limited liability and freely transferable shares.

The fact is that the railways could not have been constructed without the existence of the stock exchange which, by providing an active market in railway shares, provided money-capitalist shareholders with the potential to liquidate their investments as and when they desired. Equally, however, the effect of the railway boom on the stock exchange was dramatic. The number of shares available for trading was

greatly increased, as was the number of individuals willing to trade in them. Transactions in railway shares were:

> "on a larger scale and more widespread than previous Exchange operations",

involving an:

> "extraordinary volume of transactions by previous standards".[24]

Nor were the effects of the boom in railway shares restricted to London for with the emergence of the provincial stock exchanges it produced:

> "for the first time, a large-scale participation in investment and speculation outside London".[25]

The effect of this expansion in share dealing was qualitative as well as quantitative. Shares became commodities in their own right, commanding exchange-value in the own market. In the significant phrase of B.R. Mitchell:

> "...a class of property had been, if not created, then vastly expanded."[26]

That new class of property was the share as fictitious capital.

In addition, and perhaps of more long term significance, the increased interest in railway securities encouraged the emergence of a wider share holding[27], the outcome of which was the emergence of a body of shareholders more interested in dividend return and the value of their shares than in the day to day operation of their company.

By the 1860's there had emerged, according to M.M. Postan:

> "A single national market for long term investment...functioning almost as smoothly as that for short term,... indeed a single market for capital, ruled and dominated by the rate of interest."

Those active in this market were a

> "new class of pure investors, the people who had learned to put their money into profitable use, and to decide that use by the sole criterion of interest, and whose expectation of income were very largely a matter of yields and quotations."[28]

This new rentier class with its interest primarily in the share market was correspondingly distanced from the day to day operation of industrial-capital within the process of production. As has been suggested, the consequence of this alienation of shareholder form industrial-capital, the withdrawal of members to the sphere of the circulation of revenues was the reification of the company, as represented in the contemporary doctrine of separate corporate personality.

III. Limited Liability and Separate Personality.

An example of the teleological approach to the history of Company Law, criticised previously, can be seen in respect of the liability of the members of an incorporated company for the debts of the company.

In 1891 in Elve v Boyton Lindley L.J. expressed the view that:

> "It was not in the power of the Crown so to incorporate...persons so as to make them liable to any extent to the debts of the corporation."[29]

Accepting this statement of the position of corporations at common law, professor Gower drew the generally accepted contemporary conclusion that:

> "It follows from the fact that a corporation is a separate person that its members are not as such liable for its debts.[30]

An examination of the manner in which the law operated in earlier times, however, reveals such a conclusion to be less than fully accurate.

There is no question that the concept of corporate personality is an ancient one, occurring as it does in the Roman Civil Law. There are doubts, however, and contending opinions, as to whether or not members of corporate bodies were personally responsible for corporate debts under the civil law.[31] Such doubts carry over in regard to members' responsibility for debts when the corporate form began to be used for commercial purposes in England in the course of the seventeenth century.

As Dubois stated:

> "There is Year Book authority to show that the classical dictum of Ulpian respecting the liability

> of the **universitas** was known to English judges in the fifteenth century. There is no indication that the idea was developed or applied when business began to use the joint stock and to acquire corporate status. Certainly as far as the law reports of the seventeenth century are concerned, there is little to show that the lawyers were more than slightly bemused by the idea. The evidence at the beginning of the eighteenth century itself demonstrates only somewhat equivocally the existence of a nexus between the corporation and restricted liability."[32]

It is not doubted that from the date of its earliest use by trading enterprises the corporation was seen as constituting a distinct legal person apart from the individuals who were its members. A consequence of this separation of company and members was that the corporate assets were not subject to claims against members in their individual capacities.[33] There is, however, less certainty as regards the responsibility of the members for corporate debts. The separation of corporation and members meant that the members were not directly responsible for the debts of the corporation[34], but conflict of opinion exists as to the extent to which members could be made responsible to the corporation for the means of paying its debts.

Scott was of the opinion that shareholders would have been responsible for the debts of their incorporated companies unless they were recipients of some express exemption.[35] Williston, although more cautious than Scott, hazarded the opinion that "so far as the evidence went", it pointed to the conclusion that, just as in Roman law:

> "if the corporation became insolvent the persons constituting it were obliged to contribute their personal fortunes".[36]

Warren on the other hand, in line with the present understanding of corporate personality, was of the opinion that shareholders in incorporated companies were not liable, simply as members for the company's debts[37]; a view with which Horrwitz concurred.[38]

Holdsworth, whilst drawing attention to the fact that the actual effect of incorporation was only settled in favour of shareholders not being liable for corporate debts at the end of the seventeenth century[39], failed to state expressly the conclusion that is implicit in his work; that until that time the members of a corporation would have been liable to make good its debts. Such a conflict of views merely continues earlier differences noted in contemporary accounts of legal opinion.[40]

The reason for this disparity of opinion as to the effect of corporate personality on membership liability arises from the fact that the situation was complicated by the power which

companies generally had to make leviations, or calls, on their members in order to provide additional capital as required.

Where there was an express limitation on the amount that could be raised, no call could be made beyond that limit. Occasionally charters included express limitations on the call-making power which would effectively limit the amount that could be raised. But where there existed neither express limitation on total capital nor express call making power it appears that the members were liable to any calls made.[41]

If members owed an obligation to their corporation such as to render them responsible to supply additional capital, then although there would exist no liability to outsiders at law, Equity might intervene to ensure that the obligation was met in order to pay corporate debts. In this indirect manner the members might have unlimited liability for the debts of the company even although it was incorporated.

In 1688 in Edmund v Brown & Tillard[42] it was held that the members of the incorporated Company of Woodmongers were not liable in their personal capacity for the debts of the company after it had been dissolved. As the company no longer existed it could not oblige the former members to make any contribution to its debts.

In 1670, however, in Salmon v the Hamborough Company[43] the House of Lords ordered that leviations be made upon every

member of the defendant company sufficient to pay the debt owed by the company to the plaintiff.

Salmon's case does not necessarily vitiate the technical separation of the corporation from its members; the shareholders have an obligation to the corporation not to its creditors.[44] But the fact that the members were responsible for the debts of the corporation ensured that, in practice, there could be not be that complete separation of members from company as is connoted by the modern conception of corporate personality.

In addition to the foregoing there is considerable negative evidence for the claim that incorporation did not necessarily or usually involve limited liability in the seventeenth and early eighteenth centuries. According to Williston:

> "...there is no case decided before the present [nineteenth] century which is inconsistent with the theory that members of a corporation [were] thus liable."[45]

Equally, given the stridency of its tone and its all-encompassing condemnation of joint-stock companies, it is at least surprising that the Bubble Act did not make any reference to limited liability.

But perhaps even more convincing is the point made by Davies that the earliest trading companies:

> "...did not behave, in relations with their

creditors, in such a way as to suggest that they were conscious of limited liability."[46]

The suggestion that members of the earliest trading corporations did not have limited liability is further supported by Dubois' findings that in the applications for incorporation, limited liability did not figure as an important attribute for the would-be corporations.[47]

As the original trading corporations were not really money-capital forms[48] they did not require limited liability. It was only as the joint-stock company developed as mechanism for the investment of true money-capital that the need for limited liability emerged; such a need being a reflection and a consequence of the lack of involvement which the money-capitalist shareholder had in the day to day running of the enterprise in which he invested.

The earliest comprehensive recognition of limited liability as the motive for seeking incorporation occurred as late as 1768 in regard to the Warmley Company.[49] It is only in the course of the last four decades of the eighteenth century, and with the realisation that where companies had no right to make leviations the members had no liability for corporate debts, that the importance of limited liability as a motive for incorporation increased.[50]

The foregoing has demonstrated that until the latter part of the seventeenth century the prevailing concept of corporate personality did not necessarily involve limited liability and

certainly did not automatically provide for such. By the nineteenth century, however, it had become settled that members bore no liability for the debts of their corporation. Thus during the debate on the repeal of the Bubble Act in 1825 the Attorney General, Sir John Copley, stated that:

> "Under the charters as they were commonly granted, the persons incorporated were not individually liable for any debts of the company, but only so far as the corporate property extended. This circumstance caused considerable reluctance on the part of those whose duty is was to advise the Crown to grant charters."[51]

In order to overcome that reluctance it was proposed that the Crown be granted the power to grant charters of incorporation whilst retaining the liability of the individual members.[52] Thus the quasi-corporation made its first appearance in statute, to be granted wider recognition under the Joint Stock Companies Act of 1844.[53]

This latter Act was introduced to overcome the various deficiencies which resulted from the application of Partnership Law to joint-stock companies, but without the provision of the full privileges of the corporate form.[54] Deed of settlement companies, and companies registered under the early companies Acts, although inchoate money-capital forms, were not fully developed as such. Initially such companies were perceived and treated at law as merely

extended partnerships, as forms of industrial-capital organisation; and as such they were denied the benefit of limited liability. Section 66 of the 1844 Act provided that, in the case of a creditor being unable to gain satisfaction out of a company's assets, execution might be taken out against any shareholder of the company. Thus although liability might be secondary, it was direct as well as unlimited. Such treatment assumed, if it did not dictate, that the individual shareholder was in the position of being able personally to safeguard his interests, at least to the extent of taking an active interest in his company, if not actively participating in its operation.[55]

When in 1855 the Joint Stock Companies Act introduced limited liability, it retained the possibility of direct action against shareholders to the extent that their shares were unpaid.[56] The provision for limited liability, introduced the idea of a particular fund to which creditors should look for the satisfaction of their debts, rather than to the shareholders of the company[57], but there could be no complete separation of the company from the members so long as the latter retained direct responsibility to creditors. Nor could the shareholders totally divest themselves of their responsibilities to the company so long as their shares remained unpaid; especially when they remained unpaid to the large extent that was typical of most early registered companies.[58]

The first of these impediments was removed in the 1856 Joint Stock Companies Act, which provided the company creditor with no remedy other than the winding up of the company, upon which shareholders were liable to contribute, up to the amount outstanding, on their shares in the payment of the company's debts.[59] Thus for the first time in relation to registered companies the company itself was interposed between the shareholder and the creditors of the company. The shareholder owed a liability to the company, and the company owed a liability to the creditor; the shareholder was no longer directly responsible to the company's creditors. Such an arrangement could not but enhance the idea of the company existing in its own right apart from the shareholders.

An indication of the practical effect which this change had on the conceptualisation of the joint-stock company is suggested in the subtle, but significant, difference in the wording the Companies Acts of 1856 and 1862. Whereas the earlier Act provided that "seven or more persons...may...form <u>themselves into</u> an incorporated company; the latter Act omitted the words underlined above.[60] The effect was that the personal involvement of the subscribers to the memorandum in regard to the operation of their company was signally reduced: they no longer <u>constituted</u> the company but <u>created</u> it; the company was no longer a group entity but a thing apart from the group.[61]

As regards liability for amounts unpaid on the nominal value of issued shares, as early as 1857, E.W. Cox had recommended that shares should be fully paid up.[62] His advice was not taken for some considerable time, however, although the fact of shares being fully paid up increased their transferability and improved their efficacy as money-capital forms.[63]
The foregoing has shown how limited liability, although not an essential attribute of corporate personality, does enhance the idea of separation of company and members that such a concept recognises and signifies, for without limited liability there can be no possibility of the "complete separation" of the member from the company.

IV. Ownership, Control and Separate Personality.

It is accepted from a number of theoretical perspectives that the emergence and development of the joint-stock company has caused, as well as merely facilitated, a corresponding development of capitalist property relations.[64] Whereas Berle and Means[65] claimed to discover within the corporate form, a disassociation between legal ownership of capital in the hands of shareholders, and the effective control of such capital which rested with managers, Marxists have tended to utilise a more complex categorisation of ownership, and have questioned the validity of the conclusion drawn by Berle and Means.

Accepting Bettelheim's terminology[66], it is possible to distinguish three levels of property: possession; economic ownership; and legal ownership. The first of these refers to the ability to operate the means of production, and is the level of ownership enjoyed by the management of a joint-stock company. Economic ownership is synonymous with effective control and is the power actually to determine how the means of production are to be used and to appropriate the product of that use. While legal ownership is merely the nominal right to control and benefit from the operation of the means of production.

All three levels of property rights were embodied in the person of the archetypal industrial-capitalist entrepreneur, operating on the basis of his own capital. Legal ownership of capital was combined with control over its operation; and the right to appropriate revenue from ownership was combined with, and depended upon, the power and the need to perform the functions of capital.

With the emergence of the joint-stock company, the capitalist was relieved of the need to perform the functions of capital, which task could be left to paid functionaries, whilst the capitalist continued to claim interest as the reward for the mere ownership of capital.[67] For as long, however, as the general meeting retained ultimate control over the management of the company, the shareholders retained, at least in theory, effective economic possession of the company's

capital. Such a situation represented the separation of ownership and day to day management, rather than a separation of ownership and control.[68]

However, with the development of the share as a distinct money-capitalist form of property the company's concrete capital, almost by default, became the exclusive property of the corporation.[69]

The fact that the corporation itself was confirmed as the legal owner of its assets meant that the struggle for effective control of those assets became a matter of controlling the strategic decisions of the corporation. The question of which individual or group was able to control corporate strategy became all important in determining who had effective economic ownership of the company's capital.[70]

Marxist commentators have concluded that the wide dispersion of shareholding, and the split between large and small shareholders has permitted the concentration of effective control in the hands of the former, with a resultant disassociation between legal ownership and economic ownership.[71] The general accuracy of that contention is not questioned but it is suggested that it does not adequately represent the situation with specific regard to the distinction between the types of property right enjoyed by various shareholders. The distinction between those who exercise control in relation to companies and other shareholders is not simply a matter of the size of holding

but is essentially a matter which relates to the manner in which shares are held. The large-scale shareholder who actively controls a company does so as an industrial-capitalist; whereas the typical shareholder remains external to the process of production. This represents not so much a separation of economic from legal ownership, for neither owns the capital of the company, but the distinction between those who operate as industrial-capitalists and those who operate as money-capitalists; between those who operate concrete-capital in the process of production, and those who merely have a claim against the product of that operation.

Whether a company is effectively controlled by a particular shareholder or group of shareholders, or is under the control of its management can only be determined empirically, by actually examining how the company's strategic decisions are arrived at, as Scott points out.[72] In either case the mechanism of effective control of the company is control of the board of directors, which has replaced the shareholders in general meeting as the locus of ultimate power in respect of the day to day operation of the company.

It is now intended to examine the process whereby the general meeting lost control over the day to day management of their company to the directors, and the confirmatory effect this had on the contemporary doctrine of separate corporate personality.

Article 70 of Table A of the 1985 Companies Act provides that the business of a company shall be managed by directors who are empowered to exercise all of its powers, not otherwise restricted by the Act, the memorandum, or the articles of the company, subject "to any directions given by special resolution." Although it cannot invalidate previous actions of directors, such a provision permits the possibility, at least in theory, of the general meeting actively participating in the day to day running of their company, through the issuing of instructions to directors.

It has been suggested that article 70 represents "a sensible compromise" by permitting a sufficiently large body of motivated shareholders to interfere on a particular issue whilst leaving general management in the hands of the directors.[73] Such a view, however, fails to take into consideration not only the practical difficulties faced by shareholders in the face of the directors' control of the proxy machinery and flow of information, but also the fact that shareholders, as money-capitalists, typically remain external to the operation of their company's business. Although it offers the formal possibility of shareholder power, the substantive effect of article 70 is to recognise the superiority of the board of directors over the general meeting in relation to powers of management.

In any event article 70 simply states the law as it operated previously, and its purpose is to clarify the meaning of the

previously operative article, article 80 of Table A of the 1948 Companies Act, and to render the previously obscure wording of that article more immediately consonant with the law as it had come to be interpreted by the courts. That the wording of the previous article was perceived to be obscure, and to require clarification, was a consequence of the significant change that the law relating the powers of directors vis a vis the general meeting had been subjected to in the course of the late nineteenth and twentieth centuries, reflecting a shift in the locus of power towards the former group.

As has been stated previously, the earliest legal conception of the incorporated joint-stock company was of the members merged so as to constitute and function as a group of industrial-capitalists, and corporate form was understood as merely an organisational convenience necessary to overcome the inadequacies of the partnership form. The corollary of this conceptualisation of the company as the members, was that the members, as a group operating through the mechanism of the general meeting, were seen as the company. This understanding is encapsulated in the judgement of Wigram V.C. in Foss v Harbottle, in which, in construing the company's Act of incorporation which provided for the directors to have control over the day to day operation of the business, he stated that:

> "The result of these clauses is that the directors are made the governing body, subject to the superior control of the proprietors assembled in general meeting...the proprietors so assembled have power...to control the action of the directors..."[74]

The subordinate relationship of the directors to the general meeting was in no way diminished by the introduction of the Joint Stock Companies Act of 1844, the design of which, according to J.L. Ryan, was:

> "to incorporate the shareholders into a company, to vest some personal rights in individual corporators, to enable them if they wished to provide for the administrative machinery respecting the running of the concern to be invested in directors, <u>and to give the company or entity powers such as they were to the general body of corporators</u>."[75]

Nor was any alteration in the relationship introduced in regard to statutory companies by section 90 of the Company Clauses Consolidation Act of 1845, which provided that the directors were

> "...subject also to the control and regulation of any general meeting, especially convened for the purpose.."

In the absence of any requirement for a special resolution such power of the general meeting must have been operative through an ordinary resolution.[76]

This last provision provided the model for article 46 of Table B of the 1856 Joint Stock Companies Act, and was substantially re-enacted as Article 55 of Table A of the 1862 Companies Act, which provided that:

> "The business of the company shall be managed by the directors who...may exercise all such powers of the company as are not by the foregoing Act or by these articles, required to be exercised by the company in general meeting, subject nevertheless to any **regulations** of these articles, to the provisions of the foregoing Act, and to such regulations, being not inconsistent with the aforesaid **regulations** or provisions, as may be prescribed by the company in general meeting..."

Given the history and derivation of this article, it is suggested that at the time of drafting this article the word regulation had two distinct meanings: firstly, it meant any particular one of the company's articles of association; and secondly it meant an ordinary resolution of the general meeting of the company.[77] Thus in the above, where the word regulation appears in bold print it is used in the first meaning whereas where it is underlined it bears its second meaning. The consequence of this interpretation would be that

the directors would have full rights of management subject; firstly to the Act of Parliament, secondly to the articles as they stood, and thirdly to a resolution of the general meeting which was not inconsistent with either the Act or the existing articles. In order to alter or countermand any powers granted to the directors by the articles, a special resolution would be required to alter those articles, but where there was no specific grant of power to the directors they were subject to the direction of the general meeting.[78] It could not be argued that article 55 itself gave full management powers to the directors as it has to be read as a whole, thus the powers granted by the article were subject to the limitation that they could be overridden by the general meeting.[79]

The substance of article 55 was re-enacted lineally through the intervening Acts until article 80 of Table A of the 1948 Act introduced a major alteration. Article 80 provided that:

> "The business of the company shall be managed by the directors who...may exercise all such powers of the company as are not by the Act or by these regulations, required to be exercised by the company in general meeting, subject nevertheless to any of these regulations, to the provisions of the Act, and to such regulations, being not inconsistent with the aforesaid regulations or

provisions, as may be prescribed by the company in general meeting...[80]

In this provision there is no mention of articles and the implied distinction between regulation meaning articles and regulation meaning resolution, which existed in the 1862 wording, is no longer as immediately apparent. All distinctions are subsumed within, and obscured by, the one word, "regulations". Although the exact meaning of article 80 "has been surrounded in controversy", it is generally accepted that the use of "regulations" refers solely to the articles of association.[81] If, however, the third use of the word "regulations" relates to the articles of association, then the latter part of the provision is either meaningless or redundant.[82]

There has been considerable uncertainty and conflict of opinion relating to the extent to which residual power continued to reside with the general meeting prior to the clear statement of article 70 of the present Table A.[83] That throughout most of the nineteenth century the general meeting was understood to be the company, and that the directors were subject to the control of that body is revealed clearly in the Court of Appeal decision delivered in 1883 in Isle of Wight Rlwy. v Tahourdin, in which Cotton L.J. expressed the view that:

"It is very strong thing indeed to prevent shareholders from holding a meeting of the company,

when such a meeting is the only way in which they can interfere, if the majority of them think that the course taken by the directors, is not for the benefit of the company."

and later:

"The adjourned special meeting [has] undoubtedly a power to direct and control the board in the management of the affairs of the company..."[84]

It is apparent , however, that by the first decade of the twentieth century the Court of Appeal had changed its conception of the power relationship between directors and the general meeting. Automatic Self-Cleaning Filter Syndicate Co. v Cunninghame[85] related to a company incorporated under the Companies Act 1862 but having its own specific articles of incorporation, one of which, no.96., vested the management of the business in the directors subject nevertheless:

"...to the provisions of the statutes and of these presents, and to such regulations, not being inconsistent with these presents, as may from time to time be made by extraordinary resolution..."

while article 97. expressly granted the directors the powers:

"to sell, lease, abandon or otherwise deal with, any property, rights, or privileges to which the company may be entitled, on such terms as they may think fit."

The Court, distinguishing the Isle of Wight case on the grounds of the specific wording of section 90 of the Companies Clauses Act of 1845, held that it was not competent for a simple majority to interfere with the management of the company by ordering the directors to sell the company's assets.

Gower suggests that the effect of the decision was that unless and until their powers were curtailed by an extra-ordinary resolution or an alteration of the articles the directors were free to ignore resolutions of the general meeting on matters of management.[86]

However, as article 97 expressly provided the directors with powers, any attempt to usurp them, even by means of an extraordinary resolution, would have been invalid under article 96, as being inconsistent with the articles. The powers of the directors in regard to the disposal of company property would then only have been open to interference by an alteration of the articles.[87]

In any event it can be seen that the decision of the Court of Appeal in this case did not question the possibility of the general meeting controlling the directors through the mechanism of ordinary resolutions if the articles so provided. It merely stated that under the contractual terms represented by the particular articles of the company in question, the simple majority had no power to interfere, and the court would not read such powers into the articles.

The most that can be claimed for the Cunninghame case is that it represented a recognition on the part of the judiciary that shareholders were not necessarily competent to control the management of their companies. A more critical assessment of their competence is reflected in the later Court of Appeal decision in Gramophone and Typewriter Ltd. v Stanley in which it was stated that where articles placed powers in the hands of directors, the shareholders, even by a majority at a general meeting, could not interfere in the operation of those powers.[88]

That the decision in Automatic Self-Cleaning Filter Syndicate Co. v Cunninghame represented a novel approach to the distribution of power within companies was recognised with disapprobation by Neville J. in Marshall's Valve Gear Company Ltd. v Manning, Wardle & Co. Ltd in which he distinguished the former case and restated the superiority of the general meeting.[89]

Almost immediately, however, the House of Lords re-asserted the change in perspective in Quin & Axtens Ltd. v Salmon.[90] The effective ratio of this case only extended as far as deciding that an ordinary resolution could not bind the directors where it was inconsistent with the express provisions of the articles, and therefore did not necessarily conflict with the earlier authorities such as Isle of Wight Rlwy. v Tahourdin or Marshall's Valve Gear Co. v Manning, Wardle & Co. In the course of his judgement, however, Lord

Loreburn stated that in his opinion the word "regulation" as used throughout article 75 of the company's articles of association, which provided the directors with general management powers, meant articles.[91] The effect of such an interpretation was to deny to the general meeting the power to control the acts of the directors through the means of ordinary resolutions, and to restrict their potential for interference to altering the articles for the future.

It is generally accepted, in the light of the wording of article 80 of the 1948 Act, that Lord Loreburn's interpretation lacked conviction.[92] In the light of the actual wording of the article in question, which was in the form of the provided by the 1862 Companies Act, it was simply not coherent.[93]

In Shaw & Sons (Salford) Ltd. v Shaw[94], in which the company's articles expressly empowered directors to perform particular actions as well as providing an article similarly worded to article 55 of the 1862 Act, Greer L.J., in the Court of Appeal, held that the only way in which the general body of shareholders could interfere with the exercise of powers granted to the directors by the articles, was by either altering the articles or refusing to re-elect the directors. Greer L.J. even went so far as to suggest the applicability of such restrictions in respect of powers not specifically delegated to directors.[95]

This latter point was supported and justified by Lord Clauson, in Scott v Scott[96]. In the course of his judgement his lordship revealed that he was fully aware that this particular aspect of company law had altered over time. As he expressed the matter:

> "...it must be borne in mind that the professional view as to the control of the company in general meeting over the actions of the directors has, over a period of years, undoubtedly varied..." [97]

Nonetheless by 1942 the position had sufficiently crystallised for Lord Clauson to declare that the members in general meeting had no right to intervene in the management of a company where the articles had placed the power of management in the hands of the directors. As regards powers which were expressly granted to directors by the articles there was nothing problematic or contrary to the earlier authorities, which he declined to examine, in Lord Clauson's statement. He was prepared to extend his reasoning, however, to cover articles which adopted the wording set out in the model articles of the various Companies Acts in respect of providing general powers of management to directors. The company in question had such an article: number 71.
Lord Clauson attacked the powers of the general meeting in two ways. Firstly he denied that the limitation applied to the general management powers of the directors.[98] And secondly he applied a disingenuously specious argument to the

effect that as article 71 was one of the articles of the company, then any resolution which attempted to instruct the directors as to how they should perform their management duties was necessarily inconsistent with the articles.[99] Under such circumstances the only avenue open to the shareholders was the indirect one of altering the articles. It can be seen, therefore, that prior to the Companies Act 1948 the judiciary had not only accepted, but had actually been instrumental in promoting the superiority of company directors over the general meeting in regard to the management of the company's business affairs. It is suggested that the reformulation of what was to become article 80 of Table A of that Act was a recognition of the fact that the conclusion reached by the judiciary, and the reasoning used to justify it, had not been compatible with the wording of the previous model articles, and represented an endeavour at post hoc justification of the process of judicial creativity. That the attempt was not a success is evident from the continued controversy in relation to the precise meaning of article 80 and the more fundamental question of the power relationship of shareholders and directors, which was only fully resolved by the new provision contained in the 1985 model article 70.

That such a change occurred is widely recognised but the reason for it remains obscure. And such controversy as existed, stemmed from a failure to place the power

relationship between the general meeting and the board of directors, and hence the various interpretations of article 80 in their proper historical and economic context.

Thus Ryan, whilst fully recognising the role played by the judiciary in the process mapped out above, is highly critical of such judicial creativity, characterising it as a contravention of parliamentary intention.[100]

Similarly, although Goldberg and Sullivan accurately chart the process whereby the law was changed, they refuse to acknowledge the legal validity of the alteration in approach, and fail to recognise the reason for it. Thus Goldberg's declamation, in tones approaching legalistic ecstacy, that:

> "...the old faith is still the true faith...the residuary powers of the company do reside in the general meeting of the shareholders acting by ordinary resolution..."[101]

is matched by Sullivan's fond hope that:

> "...when an appellate court does resolve this issue it will find that under article 80 shareholders in general meeting by passing ordinary resolutions can give controlling directions to the board in matters of management."[102]

These commentators fail even to consider the reason why, to use Ryan's terminology, the courts demonstrated a propensity to find a self-denying ordinance on the part of the general meeting within the articles. In fact ultimate control was

placed with the directors for the reason that the shareholders were neither competent, nor sufficiently interested, to exercise such control. The money-capitalist nature of the typical shareholder precluded active participation in the management of his company, which was left under the control of the directors, operating as specialist capitalist functionaries. The law recognised this shift in the locus of power, and with such recognition came a consequential withdrawal from shareholders of powers more pertinent to industrial-capitalists, and a confirmation of those powers in the hands of the directors.
As a consequence of this change it became increasingly inappropriate to consider the shareholders collectively as the company, even in general meeting. They could no longer determine its actions, even in theory, by the exercise of their joint will through an ordinary resolution, and in practice the company was completely beyond their immediate control. Nor was it appropriate to conceive of the directors as the agents of the shareholders, when the former were not necessarily bound to follow the instructions of the latter.

V. Ultra Vires and Separate Personality.

Even before the power to intervene in the exercise of management powers had been withdrawn from the company in general meeting the development of the doctrine of ultra vires, which also has been shown previously to have been a

response to the money-capitalist nature of the joint-stock company form,[103] had operated in a similar manner to re-enforce the notion of corporate personality as connoting a complete separation of shareholders from the incorporated company. Whilst ultra vires was understood as a matter of directors' authority rather than as corporate capacity and shareholders retained the ability to authorise or ratify ultra vires contracts, the company could really only be understood as the members merged, its sphere of activity depending on the decisions of its constituent members. Even when ultra vires was conceived of in terms of the company's capacity there could be no complete separation of company from members so long as the latter retained the right to ratify ultra vires contracts.

By limiting the capacity of the company to what was stated in the objects clause of its memorandum of association, and by refusing to recognise the power of shareholders to ratify contracts made outside that limited ambit of authority, the ultra vires doctrine, as set out in Ashbury Ry Carriage & Iron Co. v Riche, effectively placed the constitution of a company beyond the control of its members.[104] And to the extent that the constitution of the company was beyond the control of its members so the company appeared to have an existence independent of, and consequentially apart from, those members.

The effect of the ultra vires doctrine was, therefore, that the company tended to take on an existence apart from the shareholders, but of equal importance in the process of reification undergone by the company form was the fact that the shareholders, as a group, could have no existence apart from the company.

Under the 1856 Joint Stock Companies Act, it was not unlawful for partnerships of more than twenty persons to trade, but such organisations could not receive the benefit of limited liability unless they registered as companies under that Act. As a consequence of this provision E.W. Cox, in 1857, formulated the contemporary understanding of the manner in which ultra vires operated thus:

> "Companies are incorporated only for particular purposes...If they travel out of these purposes into others for which they are not incorporated, they lose pro tanto the benefit of incorporation, and consequently the privilege of limited liability which is attached to it...For all such the ordinary liabilities of a partnership will attach to the managers certainly, and probably the shareholders."[105]

It can be seen from the foregoing that Cox accepted the prevailing conception of the company as representing a body of individuals which under the Act was incorporated for particular and limited purposes. However, even if a company

could not pursue ultra vires business in its corporate capacity, it could still do so as an unincorporated partnership. The possibility of such action could only emphasise the legal perception of the corporation as being merely an organisational device, adopted by its constituent members, but as yet not essentially distinct from those members.

Section 4 of the Companies Act 1862 altered the situation, by making it unlawful for the formation of any business organisation consisting of more than twenty persons other than by registration under that Act. As a consequence the company representing the shareholders as a collective group, if as was almost certainly the case, it consisted of more than twenty members, was forbidden from carrying on any business other than in its incorporated form.[106] The effect was that the company as a collection of individuals only had an existence as the corporation.

VI. <u>Salomon v Salomon & Co.: the One-man Company and Separate Personality.</u>

The Salomon case[107] is generally cited as finally establishing the doctrine of separate corporate personality.[108]

As Ireland has shown, however, the Salomon case:

> "merely confirmed the extension of separate

personality to incorporated partnerships and individual proprietorships."

and

"the real significance of the case was that it interpreted the policy of the Company Acts so as to sanction an individual trading with limited liability..."[109]

In making its categorical statement as to the nature of separate personality the House of Lords not only confirmed the extent to which the doctrine of separate personality had already developed in regard to economic joint-stock companies, but did much to enhance it by emphasising its consequences. The extension of corporate status to non joint-stock companies, together with the recognition of the corporation as distinct from the controlling shareholders, could not but strengthen the impression of separate personality in relation to true joint-stock companies: if a one-man company constituted a separate legal person from its controlling shareholder, then, a fortiori, the incorporated joint-stock company, with its large and fluctuating membership, must constitute a separate legal person in law.[110]

VII. Conclusion.

The foregoing has demonstrated that the "complete separation" of shareholders from their company was not the automatic

outcome of the legal process of incorporation, as contemporary orthodoxy would have it; but was a consequence of the various processes whereby the joint-stock company emerged as a fully developed money-capital form of organising the process of production, and the share assumed the attributes of fictitious capital.

In so doing it has conformed to the general purpose of this thesis, which has been to demonstrate the way in the historical development of one particular form of property, the share, together with its ideological attributes and trappings, can be explained adequately, only in relation to the changing forms of capital over time.

In pursuing this goal attention has tended to be concentrated on specifically intra-class conflicts amongst capitalists in relation to the distribution of surplus-value, or the right to exercise the functions of capital. It must be borne in mind, however, that the share and the joint-stock company are capitalist forms.[111] And in relation to those forms there are fundamental inter-class struggles relating to the actual generation of surplus-value, or the specific manner in which capital is operated within the process of production, which this thesis has not addressed in detail.

Moreover the historical process through which the share and the joint-stock company became objects in their own right is but one aspect of the reification of social relations which characterises the development of the capitalist mode of

production. In the course of this development, the twin processes of concentration and centralisation of capital, which processes are greatly accelerated by the emergence of the joint-stock company, exert a centripetal force on previously discrete fragments of total social capital. In the process, capital increasingly asserts itself as a social power whose imperatives are internalised within its universe and sanctified as the abstract laws of political economy. Thus within advanced capitalism, class relations cease to be a matter of direct personal exploitation, but appear as the consequence of the application of impersonal, universal, and hence neutral, economic laws; and the corporation, although the locus for the appropriation of unpaid surplus-value, appears driven not by the desire to exploit its workforce but by the imperatives of the competitive capitalist system. Still, at the heart of this universal alienation lies the specific alienated condition of labour within the capitalist mode of production. The separation of labour from the means of production is the prerequisite for the operation of the capitalism, for only as a consequence of such primitive accumulation, is labour-power required to assume the form of a commodity, to be bought and sold at its value as any other commodity, in order to gain access to those means of production. It is this commodification of living labour, and its alienation from its own productive activity, which is the

basis for the reification and mystification of all social relations within the capitalist mode of production.

> "wage-labour,...labour alienated from itself,...stands confronted by the wealth it has created as alien wealth, by its own productive power as the productive power of its product, by its enrichment as its own impoverishment and by its social power as the power of society."[112]

With regard to the share as a money-capital form, it has to be asserted that the mere ownership of money does not make a person a capitalist, nor does money function as capital outside the historically specific conditions of the capitalist mode of production. Within those conditions, however, money appears not only pregnant but self-fructifying.

The emergence of money-capital, apparently possessed of this ability to increase as a mere consequence of its existence without reference to the process of production, served to increase the fetishistic power of capital and compound the alienation experienced by labour.

> "Just as growth is characteristic of trees so money-bearing is characteristic of capital in this, its pure form as money [capital]. The incomprehensible superficial form we encounter and which therefore has constituted the starting-point of our analysis is found again as the result of the

> process in which the form of capital is gradually more and more alienated and rendered independent of its inner substance."[113]

The share, as a form of money-capital, also possesses the apparent capacity for self-expansion; but again this appearance was only achieved by disconnecting capital revenue from the social relations which generated it. In relation to the share, the legal process served to further mystify the underlying social relationships by reifing titles to revenue and constituting them as autonomous forms of self-expanding property. It is this attribute, together with the role it has in the mobilisation and centralisation of total social capital, that led Marx to conclude that, in the form of the share:

> "capital had worked itself up to its final form, in which it is posited, not only in itself, in its substance, but is posited also in its form as social power and product."[114]

The intention of this thesis has been to consider that historical process and its consequences at the level of legal thought and practice.

Chapter Seven: Endnotes.

1.This chapter includes an expansion of much of the material in "The Conceptual Foundations of Modern Company Law, P.Ireland, I.Grigg-Spall, and D.Kelly, 14 Journal of Law and Society, 1987.

2.W. Holdsworth, History of English Law, vol.8. p.205. This picks up the assertion of Lord Macnaghten, in Salomon v Salomon & Co., infra at p.51, that an incorporated company was "at law a different person altogether from the subscribers to the memorandum of association."

3.Ibid. p.149

4.The debate tends to revolve round the question whether the nature of juristic personality partakes of a legal fiction conceded by the State, a view clearly adopted by Palmer's, or reflects an underlying reality which the State merely recognises. M. Wolff summarises the debate in; On The Nature of Legal Persons, 216 Law Quarterly Review,1938.

5.According to Palmer's Company Law the distinction between corporation and its members is a fundamental or cardinal one, and one which "lies at the root of many of the most perplexing questions that beset company law."(22nd ed. p.163)

6.Salomon v Salomon & Co. [1897] A.C. 22. Considered infra.

7.Modern Company Law, 3rd ed., p.71. Emphasis added.

8.This would tend to support the arguments of those, such as Maitland who following Gierke, saw the company as a real entity in its own right apart from and irrespective of the recognition by the State.

9.S. Kyd, On Corporations,vol.1 p.3.
In his treatise on ultra vires, p.1-2, Brice suggested that Kyd's statement was "...fairly accurate...but sufficient stress is not laid upon that which is the real characteristic in the eye of the law, viz. its existence separate and distinct from the individual or individuals composing it." This is a clear example of the tendency to write history backwards that is considered infra.

10.J.W. Smith, Mercantile Law, 3rd ed. p.81.

11.For examples see Ireland et al, ibid. pp.150-51.

12.E.H. Warren, Safeguarding the Creditors of Corporations, 36 Harvard Law Review, 1923. No.5, p.510, footnote 1.

13.J.H. Farrar, Company Law, 1st ed., p.17. Emphasis added. See also at pp.80,126, and particularly 135.
C.H. Fifoot's chapter on corporate personality in, Judges Jury in the Reign of Victoria demonstrates a truly startlingly teleological approach to legal history.
Even Gower writes, ibid. p.68 that "it was not until Salomon v Salomon & Co. at the end of the nineteenth century that [the implications of corporate personality] were fully grasped even by the courts."

14.Some writers have emphasised the distinction between the modern business corporation and its precursor. For example Williston, The History of the LAw of Business Corporations before 1800 p.204, in comparing the two forms commented that: "...as to the points which belong exclusively to the conception of the business corporation, the law has been formed very largely since 1800. And not only had a body of new law to be thus formed, but old doctrines laid down by early judges s true of all corporations, though in reality suited only to the kinds of corporations then existing, had to be discarded or adapted to changed conditions."
And Dubois, in The English Business Company After the Bubble Act, p.93, pointed out that: "In many respects, points of corporation law which became dominant in the nineteenth century had their origins in the period under discussion [1720-1800]."

15.Without the facility to transfer their interests, shareholders would remain tied to the means of production; their investment being, for the long term, locked into the concrete embodiments of industrial-capital operated by their company. Such a situation would be inimical to the money-capitalist status of the typical shareholder whose essential requirement is liquidity of investment. See ch.1 supra.

16.See ch.3 supra for a consideration of the changing nature of the share.

17.As long as the members were still understood as having a proprietorial interest in the industrial-capital operated by the company, they retained, at least theoretically, the role and functions of industrial-capitalists. See infra.

18.C.A. Cooke's, Corporation Trust and Company, fails to notice the distinction between fictitious share capital and industrial capital. His analysis concluded with the emergence of a capital fund against which outsiders claimed as the ultimate development in company law.

19.See Short v Treasury Commissioners [1948] A.C. 534.

20.K.G. Davies, Joint-Stock Investment in the Later Seventeenth Century, pp.283-284; and W.R. Scott, The Constitution and Finance of English and Irish Joint Stock Companies to 1720, vol.1 pp.45-46.
E.Morgan and W.A.Thomas, The Stock Exchange, pp. 14,21, support Davies' opinion as to the primitive nature of the share market, stating that it was at that time "haphazard and unorganized", being conducted "usually by private negotiation".
Amongst the reasons militating against the existence of a general market in shares were the small number of such companies which tended to issue only a small number of shares of large denomination, together with the restrictions on entry into membership and the subsequent transfer of shares. See Davies and Scott, ibid.; and ch.2 supra.

21.Morgan and Thomas, ibid., p.43.

22.A.D.Gayer, W.W.Rostow,and A.J. Schwartz, The Growth and Fluctuation of the British Economy 1790-1850, p.376.

23.M.C.Reed, Railways in the Victorian Economy,p.163.

24.Gayer, Rostow, and Schwartz, ibid.409.p.

25.M.C.Reed, ibid.p.183.

26.B.R.Mitchell, The Coming of the Railway and U.K. Economic Growth, 24 Journal of Economic History p.331.

27.There are numerous contemporary descriptions of the mania for speculation that gripped the nation during the period of the second railway mania. The following from the Glasgow Citizen newspaper was quoted in the Economist,III of 1845: "Needy clerks, poor tradesmen's apprentices, discarded serving-men, and bankrupts- all have entered the ranks of the great monied interest. Persons to whom Goldsmith's village preacher [is] a Croesus, bravely pledge themselves in black and white...It is no longer the sun or the frost which makes man hot or cold. The temperature of the blood is regulated by the stock market barometer. It is warmed by the excitement of gain, or chilled by the mortification of loss."
For a fuller quotation see B.C.Hunt,The Development of the Business Corporation in England 1800-1867,p.106-107.

28.M.M. Postan, p.76-77.

29.[1891] 1 Ch.501 at p.507.

30.L.C.B. Gower, ibid. p.71.
A similar, but much earlier, statement to the same effect was included in Brice's 1874 book on Ultra Vires in which he

stated, at p.6 that: "The corporation as a distinct and separate entity being alone recognised in all legal matters affecting itself, it follows that the corporate property and funds are alone are liable for the corporate transactions, and that no responsibility for the same can be attached to any member of the corporation merely as such...the old common law...in no case recognised the individual apart from the corporation"
Such a statement is not surprising as it is at precisely this time through the application of such principles as ultra vires that the strict notion of separate personality was being generated.(See chapter 6 supra and infra.)

31.Whereas Williston, The History of the Law of Business Corporations Before 1800, p.229, cites Ayliff and Savigny to the effect that members were liable; Warren, Safeguarding the Creditors of Corporations, p.518, cites Pound's claim that Ayliff's contention was wrong and that members were not responsible.

32.Ibid.p.94.

33.Such an attribute was highly prized, and was one the benefits commonly cited as being sought in applications for charters of incorporation. See C.T. Carr, Select Charters of Trading Corporations p. xvii-xviii. Holdsworth, vol.8 p.203 cites Carr's evidence but does not sufficiently emphasise that it was not authority for the conclusion that shareholders were not responsible for corporate debts. If anything Hodsworth implies the opposite.

34.In Y.B. 19 Hy.VI 80 in a case concerning the incorporated Society of Lombards it was held that distraint against individual members for a debt against the Society amounted to trespass. "For where a corporation is impleaded they ought not to distrain any private person."

35. He was of the opinion that the Act 13 & 14 Car III, c.24 provided a form of limited liability to shareholders in East India, African and Fishery Companies. Joint Stock Companies to 1720, p.270. A better view, however, is that the Act was essentially procedural. It did not refer to liability, merely providing that shareholders in the named companies should not to be treated as traders, and hence were not to be subjected to the operation of the normal bankruptcy procedure. Support for this interpretation is found in Warren, ibid p. 518; Holdsworth, Laws of England vol.8 p.205; and K.G. Davies, Joint-Stock Company Investment in the Later Seventeenth Century p.282.
Scott's confusion is understandable, however, for as Dubois, ibid. p 98, pointed out there is evidence that, at the end of the eighteenth century, even the people petitioning for incorporation were confusing the privilege of being exempt

from the bankruptcy laws with the question of the extent of liability. The point remains, however, that Scott clearly thought that without such a provision the shareholders would not have had limited liability.

36.Williston, ibid p.229.

37.Warren, ibid. p.518.

38.W. Horrwitz, The Historical Development of Company Law, 62 L.Q.R. 1946 p.375.

39.Ibid. vol.8 pp.203-205.

40.The records of the Virginia Company of London, Kingsbury,ii, pp.165-66 shed some interesting light on this matter. At a Company Court 1622 Sir Edwin Sandys delivered the opinion of lawyers whose advice had been sought that: it was "...cleare by lawe that only the goods of the Corporation are layable to the debts thereof..." On the other hand a member, a Mr.Wrote, cited contrary legal opinion to the effect that:"...each Member of the Companie was bound to make good [company debts] out of his own private estate..."

41.Dubois, ibid.pp.93-103.

42.(1668)1 Lev. 237.

43.(1671)1 Ch.Cas.204, also 6 Vin. Abr.310.

44.See Warren, ibid p.519.

45.Ibid p.231.

46.K.G. Davies, ibid, p.282.
As he points out debts, for which shareholders having limited liability would not have been responsible, caused the ruin of a number of incorporated companies.

47.Op cit.

48.See chapter 2 supra.

49.Dubois,ibid p.95.
"...the conception of limited liability...although it made its appearance in seventeenth century joint stock activity was of slight importance." Ibid p.93.

50. Holdsworth, ibid p. 204.
In addition charters of incorporation increasingly began to expressly provide for limited liability, see Dubois, ibid pp.96-97.

51.Hansard XIII, 1019.

52.6 Geo.IV c.91.

53.7&8 Vict. c.110.
See chapter 2 supra for a consideration of the history of the various companies Acts.

54.See ch. 2 supra.

55.There was never any question of the clearly money-capitalist shareholders in the railway companies not being granted limited liability. As ch. 2 supra has shown it was the realisation that shareholders in registered companies were of the same nature as those in the statutory companies that led to the extension of limited liability to them.

56.18&19 Vict, c.133. s.8. The shareholder was required to gain the prior approval of the Court before instituting any actions against a shareholder.

57.See ch.6. supra.

58.For a consideration of this point see P.L. Cottrell, Industrial Finance 1830-1914, ch.4.

59.19&20 Vict. c.47. s.61.
See re Overend, Gurney & Co., Grissel's case, (1866) 1 Ch. App.528; and Oakes v Turquand (1867) L.R. 2H.L.325, for judicial consideration of the changes introduced by this provision.

60.Joint Stock Companies Act 1856, s.3; and Companies Act 1862, 25&26 Vict. c.89, s.6.
Section 1 of the Companies Act 1985 continues the formulation of the 1862 provision.

61.The effect of the alteration in the legislative wording must not be exaggerated. It was not until later in the century that the interpretation of the wording suggested here accurately reflected the manner in which the Courts perceived and treated joint-stock companies. See infra in regard to the ultra vires and the powers of general meetings.

62.E.W. Cox, The New Law and Practice of Joint Stock Companies, p.XXI.

63.See ch.3. supra.

64.For a consideration of these see J. Scott, Corporations, Classes and Capitalism, ch.2.

65.A.A. Berle & G.C. Means; The Modern Corporation and Private Property, passim.

66.Economic Calculation and Forms of Property, passim.

67.Marx, Capital, vol.3, ch.27; and ch.1 supra.

68.In practice shareholders did not exercise such economic control. The point is, however, that the law did not, as yet, recognise or accommodate this fact. The legal ownership of collective industrial-capital was held not by the corporation as a legal person completely separate from its members but by the corporation as a distinct entity representing the company, i.e. the members, as a whole.

69.The corporation, therefore, holds the legal title to the means of production which it operates, but the shareholders are still usually seen as retaining nominal ownership of the corporation; which proprietary interest provides them with the right receive a revenue. Palmer's Company Law, 22nd ed.p.332, endeavors, somewhat confusedly, to explain the legal position thus: "A share in a company is the expression of a proprietary relationship: the shareholder is the proportionate owner of the company but he does not own the company's assets which belong to the company as a separate and independent legal entity."
If this means that, as providers, the shareholders actually own the capital that is operated by the company then not only does it ignore fact of the legal personality of the corporation but it fails wholly to take account of the phenomenon of fictitious capital.
Alternatively, if it means that although the corporation has legal ownership of capital the shareholders retain economic ownership, it is equally mistaken. The withdrawal of ultimate control from the general meeting removed from shareholders even the potential of exercising the rights of economic possession. See infra.

70.Cutler et al, Marx's Capital and Capitalism Today, vol.1, chs.10-12, and Hirst on his own account in, On Law and Ideology, pp.131-136. have continued to maintain that effective possession of capital and the functions of economic calculation are combined in the form of the corporate enterprise. The latter connoting a collective social actor operating within the structural legal device of the corporation. Such a claim, however, is doubly misconceived. Firstly, it fails to take account of the fact, considered infra., that shareholders have had their powers of effective control reduced if not totally removed by the courts. Secondly, it fails to consider the more general fact that not every constituent member of the collective actor that is the corporation is equally competent or capable of participating

in the determination of corporate action. In other words it ignores the fact that the money-capitalist nature of the majority of shareholders ensures that they remain external, not only to the process of production, but also to the decision making process which determines the manner in which the concrete capital at the disposal of the company is operated. Shareholders typically neither own nor control the capital of their company. The corporation may well be the locus of economic decisions but that begs the question as to who exactly it is who takes those decisions.

71.E.g. see Bettelheim, op cit; De Vroey, The Separation of Ownership and Control in Large Corporations; Poulantzas, Classes in Contemporary Capitalism.

72.J.Scott, ibid.p.34.

73.Farrrar's Company Law, p.297.

74.(1843) 2Hare 461. at pp. 492-495.
See also Ch.6. supra.

75.J.L. Ryan, The Functions and Responsibilities of Directors Considered Historically With Special Reference to Equity, 1968, Ph.D., University College, London. Ch.12, p.430, emphasis added.
At p.427 Ryan supports his conclusion by pointing out that the Act referred to company rights being exercised by "they, i.e. the shareholders", but undercuts the effect of the point by stating that,"Corporate identity as a complicated concept was not fully appreciated."

76.8&9 Vict.c.16. S.90.

77.Ryan, ibid p.436-37, agrees that there were two meanings of regulation but differs in his interpretation of the first of those. In his view the two meanings were:
i) regulation amounting to a <u>special resolution</u> leading to an alteration of the articles;
ii)regulations equated to an <u>ordinary resolution</u> of the general meeting.
It is suggested that the first of these meanings is incorrect and does not follow from or fit with the actual wording of the article. The manner in which the word "regulation" appears for a third time, which Ryan does not consider, provides a context within which the meanings proposed here appears mutually supportive.

78.This interpretation of the article fits with the conception of ultra vires then prevailing. As was suggested in chapter 6 supra, ultra vires was initially understood as a matter of directors' authority rather than as a matter of

corporate capacity. Outsiders had constructive knowledge of any limit on the authority of the directors contained in the constitutional documents of the company and could not hold the company liable for a transaction in excess of that limit. The company, however, as whole retained the power to unanimously sanction or ratify ultra vires transactions and where either process had occurred the company was liable on the transaction.

79.See the reasoning of Lord Clauson in Scott v Scott infra. That the word "regulations" included the meaning "articles" is expressly demonstrated by the interpretation clause of the 1908 Companies Act which provided that "articles" meant the articles of association of a company, including the "regulations" in Table B of the 1856 Act or Table A of the 1862 Act. Such a provision does not directly support the claim that regulation also meant resolution, but the need for the express statement suggests that there was, at least some confusion as to its precise meaning. Companies Consolidation Act 8 Edw. 7 c.69,s.285.
See Ryan, ibid. pp.437-38.

80.Companies Act 11&12 Geo. VI, c.54, sch.1, art 80.

81.Farrar, ibid. p.297.

82.This is not lost on the authors of the leading text books. As Gower, ibid. p.131 stated: "The final words of article 80 seem to have been deprived of any meaning." Although he suggested that: "Possibly "regulations when it first appears, means the existing articles and, when used in the final phrase, means any new articles adopted by special resolution. Pennington, on the other hand, states that: "The power to prescribe regulations seems to be the vestigial remains of the power to make bye-laws which used to be reserved to the members by the deeds of settlement of companies formed at common law. Such bye-laws were usually procedural, and it is probable that regulations made by general meetings, too, must be confined to procedural matters, so that the members might, for example, prescribe when and how board meetings shall be held, but not what shall be done at them."(ibid. at p.651.)

83.See Goldberg (1970) 33 M.L.R. 177;Sullivan (1977) 93 L.Q.R.569; Mackenzie(1983) 4 Co. Law 99.

84.(1883)25Ch. D. 320, at p.329 and at p.331-2.
See also Lindley L.J. at p.334, and Fry L.J. at p.335 for confirmation of Cotton's approach.
The company in question was formed under the Companies Clauses Act 1845, and although Ryan, ibid.p.135, claimed that the court was called upon to adjudicate on the meaning of

article 90 of that Act, at no place in the report does it appear that article loomed large in the reasoning of the Court, who apparently decided the case on general principles.

85.[1906] 2Ch.34.

86.Ibid.p.130-31.
Gower, in a footnote 38 p.130, suggests that Lindley L.J. was involved in the case. In fact Cozens-Hardy L.J. merely cites his book on Partnership Law.

87.G.D. Goldberg, ibid. p.179, fails to note that article 96 required an extraordinary resolution for any interference, and could not therefore the same as article 80 of the 1948 Table A.

88.[1908] 2K.B.89.
As this was essentially a tax case any comment on the relationship between the directors and shareholders is necessarily obiter, but it nonetheless demonstrates the change in the judiciary's perception of that relationship. This change is particularly evident in the case of Buckley L.J., who, in his Book Companies Acts, 7th ed. p.530, dated 1897, stated categorically that: "The company in general meeting have no doubt power to direct and control the board in the management of the affairs of the company." In the Gramophone etc case, at p.98, this approach had been altered such that: "even the numerical majority at a general meeting cannot impose its will upon the directors when the articles have confided to them the control of the company's affairs." Subsequent editions of his book adopted and extended this latter approach. Thus by the 12th edition, at p.859, he stated that articles in the form of article 55 of the 1862 Companies Act did "not enable the shareholders by resolutions passed at a general meeting without altering the articles, to give directions to the directors as to how the company's affairs are to be managed..." This statement in turn was expressly approved by Greer L.J. in Shaw v Shaw [1935] 2 K.B.113 at p. 134.

89.[1909] 1Ch.267 at pp.272 273.

90.[1909]A.C. 442.

91.At p.444.
His reasoning appears to have been that because in the first article the word "regulation" clearly meant "article" it had to have that meaning throughout the remaining articles.

92.Gower, ibid.,p.131.

93.See supra. It is surprising that in the debate concerning the extent of the general meeting's residual powers, neither side has considered the fact that the 1948 Act substantially altered the previous wording of the article.

94.[1935] 2K.B.113.

95.At p.134.
Neither Slesser nor Roche L.J.J. decided on this particular point.

96.[1943] 1 All.E.R. 582.

97.Ibid. p.585.

98.Both Goldberg, ibid.p.182; and Sullivan, ibid.p.577, demonstrate the fallacious nature of this contention.

99."One of the aforesaid regulations or provisions is this provision about the business of the company being managed by the directors, and I find the greatest difficulty in seeing how any resolution of the company in general meeting, controlling the directors in the management of the business, can possibly be justified under the terms of the article." (p.585.) As Sullivan, ibid p.577, suggested the effect of this argument was that any such article was "...irredeemably at odds with itself: any attempt to invoke the limitation the regulation places on the directors is irreconcilable with making them the repository of management powers."

100.Ibid. pp.426-441 passim. At p. 440

101.Ibid p.183.

102.Ibid. p.578.

103.See ch.6 supra.

104.This effect was strengthened by the fact that the 1862 Act gave shareholders no power to alter the objects clause. Such power was only being granted by the Companies (Memorandum of Association) Act 1890.

105.E.W. Cox, The New Law and Practice of Joint Stock Companies, 1857, pp xxv-xxvi.

106.See Padstow Total Loss and Collision Assurance Association (1882) 20 Ch.D.137; Jennings v Hammond (1882) 9Q.B.D.225; and Shaw v Benson(1883) 11 Q.B.D. 563.

107.[1897] A.C. 22; also at first instance, sub nom Broderip v Salomon [1895] 2Ch.323.

108.In the view of Professor Gower:
"...corporate personality became an attribute of the normal joint stock company only at a comparatively late stage in its development, and it was not until **Salomon v Salomon & Co.** at the end of the nineteenth century that its implications were fully grasped even by the courts...Since [when] the complete separation of the company and its members has never been doubted." ibid.pp.68,71.

109.P.W.Ireland, The Rise of the Limited Liability Company, 12 Int. Journal of the Sociology of Law, p.255.

110.It should be noted that neither Vaughan-Williams J. at first instance, nor the Court of Appeal, denied the separate personality of the company once it was registered, but they were mindful to prevent the legal form from being used for what they clearly considered to be an illegitimate purpose. It is interesting to note that these decisions, so criticised by the House of Lords, may be considered as early attempts at piercing the corporate veil.

111.In The Conceptual Foundations of Modern Company Law, supra. p.161, my co-authors and I commented on the failure of contextualist writers to recognise this fundamental fact to the effect that: "Contexualists fail to theorise the...reification of the company and externalisation of shareholders, and this leads them to the mistaken claim that the separation of ownership and control has fundamentally altered the nature of the joint-stock company. For the same reasons, claims that worker participation can democratise companies are misconceived."
The company form is not a neutral technocratic structure, it is the forum in which surplus-value is created through the exploitation of alienated labour. Just as Carchedi, Problems in Class Analysis, questions the neutrality of science and other forms of knowledge which are specifically the products of capitalist social relations, so the joint-stock company, as a specifically capitalist form of organising production, reflects and enshrines the power relations that characterise the capitalist mode of production. Even if labour were to control the company within which they worked they would still function as alienated labour.
Ian Grigg-Spall considered this situation and confirmed the above conclusion in an as yet unpublished conference paper: Worker Directors and the Joint Stock Company.

112.K.Marx, Theories of Surplus Value, vol.3p.259.

113.K.Marx, Theories of Surplus Value, vol.3 pp.466-67.
And later, at p.494, he writes:"Apart from expressing the capacity of money, commodities, etc., to expand their own value, interest insofar as it presents surplus-value as

natural fruit, is therefore merely a manifestation of the mystification of capital in its most extreme form..."

114.K.Marx, Grundrisse, p.530.

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