Comment on Professor Watson's presentation: The Significant Origins of the Modern Company

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The history of the company, the English East India Company and the 18th century

We are fortunate to have had the benefit of Professor Watson's presentation which draws in part on her book, *The Making of the Modern Company*.[1] I will touch upon both Professor Watson's presentation and her book in my comments.

Professor Watson's presentation today addresses the themes of the first part of her book, which is, in effect, a history of English company law. Professor Watson there advances the thesis that the "modern company" first emerged in the middle of the seventeenth century as a vehicle for raising long term capital. She treats the first "modern company" as the English East India Company and the Bank of England.

In her presentation today, Professor Watson refers to the development from the chartered corporation, through the concept of a "persona ficta" or artificial legal person, through joint stock companies (in Professor Watson's phrase, "joint stock funds"), to the history of the English East India Company. In her book, Professor Watson similarly addresses (in Chapter 1) the development of contractual joint stock companies in the 16th century and points to the development of the concept of a "persona ficta" in England in that century. Professor Watson then turns to the history of the English East India Company and characterises that company as having "acquired all they key features that made it the world's first modern company." In her book, Professor Watson similarly emphasises the extent to which at least the English East India Company had the features now associated with companies, namely:

> "The rights of suing and being sued, of having a common seal, to enter into transactions as a corporation, of dealing with lands and making bylaws; the benefit of perpetual succession; and, importantly, the fact that the English East India company was a "persona ficta or artificial legal person"."[2]

Professor Watson undertakes (In Chapters 3 – 5 or her book) an extended analysis of the history of the English East India Company, tracing developments in financing in the first half of the 17th century, governance disputes within the company, and subsequent issues arising from private trade by company associates in competition with the company. She also emphasises the importance of the development of double-entry bookkeeping in the middle of the sixteenth century, which allowed the capital of shareholders to be kept separate from those shareholders for accounting purposes. She emphasises the significance of this matter, in developing her concept

[1] Hart Publishing, 2022. For reviews, see TD Peters, Book Review, (2022) 38 *AJCL* 150; J Hardman, "The Making of Corporate Legal Concession Theory" (2024) *Oxford J Legal Studies* 181.
[2] Watson, *The Making of the Modern Company*, p 1.

of "the Corporate Fund".[3] She also refers (In Chapter 6 of her book) to the "emerging obligations of governing bodies of corporations" and she here points to a possible link between an oath which directors of early bodies swore on taking up office and directors' duties. There is perhaps an open question whether that is a matter of parallel developments rather than a sequential development.

Professor Watson then addresses (in Chapter 7 of her book) the liability of shareholders to third party creditors, focusing on the position in the 16th and 17th centuries, and then (in Chapter 8) to the development of the deed of settlement companies in the 18th century, after the *Bubble Act* of 1720[4] made corporate charters for business more difficult to obtain. I note, in passing, that there is an ongoing debate as to whether the *Bubble Act* was introduced to address the risk of an overheated market arising from the failure of the South Sea Company, or in an attempt to entrench the South Sea Company's monopoly and restrain the activities of its competitors.

Professor Watson characterises the deed of settlement company as a variation of the contractual joint stock company and summarises its limitations as follows:

> "The deed of settlement company form could not provide investing shareholders with comprehensive protection from liability to third parties. The deed of settlement company could contractually limit the liability of subscribing shareholders to the deed of settlement company itself. As common law did not recognise the trust that held the capital, however, shareholders were not protected from claims by third parties. Shareholders and the companies themselves struggled to use the Courts, Chancery in particular, where they were tolerated more than sanctioned. The deed of settlement company was not a legal person, so it could not sue, or be sued, as a juridical person. Nor could shareholders readily litigate against the company."[5]

She notes, however, the potential significance of the deed of settlement company for the understanding of the modern company in English law, observing that:

> "The deed of settlement form … also widely litigated, leaving a legacy in the case law that informed the understanding in the 19th century of the companies incorporated pursuant to general incorporation statutes."[6]

The 19th century

In her presentation today, Professor Watson deals briefly with the general incorporation statutes in the 19th century, which she addresses more fully in her book. She there reviews (in Chapter 9) the general incorporation statutes which developed in England in the mid-19th century. She notes that the case law had begun to distinguish between a corporation which was established by statute, often for a large scale infrastructure project such as a canal and railroad, and its shareholders prior to the development of general incorporation statutes.[7] She also

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[3] Watson p 3.
[4] The full title of the *Bubble Act* described it as "An Act to Restrain the Extravagant and Unwarrantable Practice of Raising Money by Voluntary Subscriptions for Carrying on Projects Dangerous to the Trade and Subjects of this Kingdom."
[5] Watson p 125.
[6] Watson p 127.
[7] *Bligh v Brent* (1837) 2 Y&C Ex 268 at 295; Watson, p 132.

contrasts the element of the "modern company, and particularly companies of larger size, in the United States and Germany with a slower development of larger companies in England.

Professor Watson commences her analysis with the *Joint Stock Companies Act* 1844 (7 and 8 Vict C110) which she characterises as "restrictive rather than facilitative".[8] That Act required that a partnership of more than 25 members, insurance companies and insuring friendly societies, and partnerships with shares that were transferable without the consent of co-partners register with the Board of Trade, which did not undertake a merits assessment of the application for registration. The process of registration involved two stages. At the first stage, a company filed a prospectus and obtained provisional registration, which allowed it to raise capital, on giving specified details (ss 4, 21). The company could proceed to the second stage, completing registration, after a deed of settlement was signed by shareholders and submitted (ss 7, 21). There was an obvious risk that companies would not proceed to final registration after capital had already been raised and about three-quarters of companies registered at the first stage did not proceed to complete registration between 1844 and 1855.[9]

Professor Watson also addresses the *Limited Liability Act* 1855 (18 and 19 Vict C133)[10] which amended the 1844 Act to limit the liability of a shareholder to the amount of any unpaid portion of the nominal value of its shares[11]. The *Limited Liability Act* also required that enterprises publicly file an annual balance sheet, and Dr McQueen has observed that that requirement was challenging where financial reporting processes were undeveloped, both in principle and in practice, and the Act was not suitable for the incorporation of small enterprises.[12]

Professor Watson then contrasts the 1844 Act with the *Joint Stock Companies Act* 1856 (19 and 20 Vict C47) and the *Companies Act* 1862 (25 and 26 Vict C89) which she characterises as "facilitative rather than restrictive"[13] and notes that:

> "Statutory limited liability of shareholders to the company and to third parties dealing with the company became the default position for companies from 1856."[14]

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[8] Watson, p 128.

[9] McQueen, *A Social History of Company Law: Great Britain and the Australian Colonies 1854– 1920*, p 50; S Watson, "How the company became an entity: a new understanding of corporate law" (2015) *JBL* 120 at 124. I have here and below drawn on my paper for the Francis Forbes Society for Australian Legal History, Introduction to Australian Legal History Tutorials, Development of Corporations law, 26 October 2016.

[10] Watson pp 130, 133-134, 144, 178, 185.

[11] That limitation was subject to requirements that the documents lodged on the company's provisional registration state that the company proposed to limit its liability; that the nominal value of the company's shares be at least £10 each; that the word "limited" be included in the company's name and stated in all public documents; that the deed of settlement state that the company be formed with limited liability; and that it be signed by at least 25 shareholders, who held 75% of the capital of which 20% had to be paid up. See M Wibisono, "Corporations" in JT Gleeson et al (eds), *Historical Foundations of Australian Law - Volume II,* 2013, 403; W R Cornish and G de N Clark, *Law and Society in England 1750-1950*, 1989, 256; J Taylor, *Boardroom Scandal: The Criminalisation of Company Fraud in Nineteenth-Century Britain*, 2013, 101.

[12] McQueen, *A Social History of Company Law*, p 141.

[13] Watson p 130.

[14] Watson p 131.

She deals more briefly with the 1856 Act and rightly pays greater attention to the *Companies Act* 1862 which took a form closer to modern companies legislation,[15] and also provided for winding up by the court and for voluntary liquidation. She rightly recognises the significance of developments in the United States in influencing introduction of limited liability in the *Companies Act* 1862, and those developments may have also created a degree of economic pressure for the recognition of limited liability.[16] In a familiar sequence of law reform and recurrent corporate failure, Overend, Gurney & Co Ltd, a financial firm, failed not long after the passage of the 1862 Act. I could not find a reference to that failure in the index to Professor Watson's book but that index tells us something about the history of company law, with references to the "Panic of 1837" (p 176), the "Panic of 1847" (p 176) and the "Panic of 1866" (p 146, 173, 178-9). One could, of course, add to that list.

Professor Watson notes, as other commentators have also noted, a relatively slow adoption of corporate form in England in the second half of the 19th century.[17] She observes that, following the passage of the 1862 Act:

> "Manufacturing companies did not follow the fundraising patterns that the infrastructure canal and railroad statutory corporations had followed in the period before general incorporation."[18]

Professor Watson identifies a possible explanation, namely that business could source loan capital from a well-developed banking sector without the need for investment capital from the public or the need to offer limited liability to shareholding investors. She notes that, until 1885, the use of incorporation was primarily driven, in larger enterprises, by increases in the amount of fixed capital needed.[19] She also points, in an interesting analysis, to a relatively slow shift of management control from shareholders to the board of English companies in the late 19th century.[20]

Salomon* and *Sequana

Appropriately, Professor Watson offers an extended discussion of *Salomon v Salomon & Co Ltd* [1897] AC 222 *("Salomon")* in her book.[21] That decision is, of course, generally treated as confirming the principle that a company is a separate legal entity, distinct from its shareholders, with rights and liabilities distinct from those shareholders. That decision is also treated as confirming that a company may properly be established where it is controlled and owned, as matter of economic reality, by one person.[22] It has provoked equally strong approval and disapproval among commentators, when it was decided and subsequently.

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[15] Cornish and Clark, *Law and Society in England 1750-1950*, p 257.
[16] Watson, p 133.
[17] Watson, p 171.
[18] Watson, p 172.
[19] Watson, p 173.
[20] Watson, pp 188ff.
[21] Watson, pp 138-143, 154-156.
[22] For comment upon *Salomon* in its legal and historical context , see G Rubin, "Aron Salomon and His Circle" in J Adams (ed), *Essays for Clive Schmittoff*, 1983; N James, "Separate Legal Personality: Legal Reality and Metaphor" (1993) 5 *Bond LR* 217; R McQueen, "Life without Salomon*"* (1999) 27 *Fed L Rev* 181; S Ville, "Judging Salomon: Corporate Personality and the Growth of British

In her presentation today, Professor Watson also refers to *BTI 2014 LLC v Sequana SA* [2024] AC 211; [2023] 2 All ER 303; (2022) UKSC 25 and quotes Lord Briggs' observation that:

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

That case deals with the question, well known in Australian and New Zealand law, of directors' duty to take into account creditors interests in the region of insolvency. That duty has been recognised in Australia and New Zealand, at least since the Court of Appeal's decision in *Nicholson v Permakraft (NZ) Ltd (in liq)* [1985] 1 NZLR 242 and the Australian case law holds that directors owe a duty to the company to take into account the interests of creditors, where there is a real and not remote risk of insolvency and the transaction will adversely affect creditor's interests.[23] In *Sequana*, the Supreme Court characterised that duty in familiar terms as an element of the director's duty to act in the company's interests, and noted but did not follow the Australian case law as to when it arose. The Court there held that directors were required to consider the interests of a company's creditors when insolvency was imminent and that the interests of creditors became paramount when it was inevitable that the company would face liquidation (per Lord Reid P at [50], Lord Briggs and Lord Kitchin at [171]-[176]; Lord Hodge DP at [222]-[227]). There result may not depend on any wider question as to the application of *Salomon*.

For completeness, Professor Watson also undertakes an interesting review of accounting and financial development in Chapter 10 of her book, including the development of double-entry bookkeeping, the floating charge and the relationship between company law and partnership law.

I should make two further comments as to Professor Watson's historical analysis in the first part of her book. First, that analysis has value for its own sake, and one can and should have an interest in that history without necessarily seeking to draw any "lessons" for the present from knowledge of the past. Second, Professor Watson is also plainly conscious of modern debates as to the scope of corporate law and links her historical analysis with those developments, as I will note below.

Professor Watson's discussion of the nature of the modern company

The second part of Professor Watson's presentation today overlaps with the second part of her book, headed "Consequences of the Modern Company", which draws out aspects of the company's modern character, partly in a comparative perspective, and also addresses particular themes. Professor Watson there recognises the difference between, for example, a "property conception" and a "social entity conception" of the

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Capitalism in a Comparative Perspective" (1999) 27 *Fed L Rev* 203; Lipton, "The Mythology of Salomon's Case and the Law dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective" (2014) 40 *Monash University LR* 452.

[23] *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557 at [162]; *Termite Resources NL (in liq) v Meadows* (2019) 370 ALR 191 at [202]; *Cassimatis v Australian Securities and Investments Commission* (2020) 275 FCR 533 at [453].

company.[24] She also recognises characterisations of the modern company as contractually based, which she notes developed in the mid-19th century, although they have also been a significant focus of recent American commentary influenced by law and economics thinking.[25] In the opening chapter of her book, Professor Watson recognises the link between her historical analysis and her review of contemporary issues, observing that the "modern company" is "an amalgam of key features drawn from antecedent forms" and:

> "The modern company is neither wholly the private property of current shareholders, nor is it just a social entity."[26]

Professor Watson here expressly "draw[s] on the historical analysis to highlight insights that bear significantly on contemporary debates over the nature, role and governance of modern companies".[27] She here deals with the concept of the company from a current perspective, addressing her concept of the "Corporate Fund" and the question of corporate legal personality; the relationship between the differing concepts of a company, a firm and organisation; questions of corporate governance, and important current issues as to sustainability.

She summarises the position, as developed through her historical analysis and a reference to several theories of the corporation as follows:

> "The key features identified in the preceding chapters are a Corporate Fund seeded by capital contributed by shareholders, but separated from those shareholders for accounting purposes through a double-entry bookkeeping. The Corporate Fund is also separate for legal purposes, as it is held by a *persona ficta* or artificial legal person that is a separate legal entity from its shareholders. The modern company can exist in perpetuity, making size and scale possible over time."

Professor Watson recognises the significance given to the concept of "entity shielding" in recent American literature, including the several editions of *The Anatomy of Corporate Law*. She addresses the question "[i]s the company an entity?",[28] although her analysis here is somewhat more abstract than her historical analysis; for example, her observation that:

> "Legally the company is a *persona ficta* or artificial legal person that exists in the abstract. The fiction may be our shared belief and acceptance that the company exists, meaning we interact with the company as a real thing that extends beyond the law as a mere legal fiction."

Professor Watson also addresses the "real entity" theory as a possible conception of the "modern company" and here addresses concepts of the company as a firm, an organisation, an entity and an accounting entity. Again, this analysis has a degree of abstraction, although it plainly reflects a significant focus in the current academic literature.

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[24] Watson p 4.
[25] Watson p 6.
[26] Watson p 9.
[27] Watson p 9.
[28] Watson, p 209.

Professor Watson then returns to more concrete questions of corporate governance, including the relationship between directors and shareholders; she rightly addresses Berle and Means' analysis in *The Modern Corporation and Private Property* at some length[29]; and she touches upon modern debates as to shareholder primacy and the relationship between the corporation, its directors and other stakeholder interests. She then turns (in Chapter 16) to contemporary issues in respect of the modern corporation, touching upon recent developments in New Zealand, including the development of legal personality for significant mountains and rivers and issues as to sustainability and the responsibilities of the modern corporation.

Conclusion

I should conclude with the observation that there seems to me to be something for everyone in Professor Watson's work. There is an interesting and extended exercise in legal history; she also addresses several current issues as to the role of the corporation, including the ongoing debate as to shareholder primacy; and, for those who have a taste for it, she ventures into some of the deeper waters of legal philosophy. Returning to where I began, we are fortunate to have had her presentation today, and I commend her book to you for a more extended analysis of these issues.

[29] Watson, pp 249-251.