To what extent was the rise to dominance of company law in the nineteenth and early twentieth centuries the inevitable consequence of technological advance?

During this period of history, Britain experienced what came to be known as the 'second industrial revolution' – a period of major industrialization with changes to British industry as a whole, and further to this, a change in the idea of the 'company' or firm. Hand in hand with this were technological advances, which it has been said spurred on this major change to life in Britain. Industry was expanding not least because of the growing importance of other industries such as the motor trade, metals and electrical engineering, but whilst this was a major cause of the growth in industry, was it in fact the reason for the triumph of company law in the early twentieth century? In this essay I intend to explore technological advance in this period, how much of an effect it had on company law as such, and to look further at other features of this age which could have affected the rise of company law.

By 1914, company law had overtaken the Joint Stock Company and the law of partnership as the most dominant form of industrial organization in Britain. As mentioned previously, this is often attributed to the increase in technological advances and the changes this made to industrial Britain. There was 'a relative decline of agriculture compared with other sectors such as industry'[1], and new industries were growing steadily throughout the nineteenth century, for example metals, mining and chemical trades. This was largely due to advances made in these fields, and with increased output came a rise in employment, most notably in the new industries of electrical engineering, and the motor trade. '*M*echanized mass production was spreading throughout the manufacturing industry' [2], and 'big business' was dominating Britain in one way or another, be it the larger scale production, or the large scale business organization. However, technological advance was not necessarily the main reason for this increase. The First Census of Production in 1907 showed the strength of old industries such as textiles, coal and iron and their supremacy in the areas of employment, production and exports. In fact, Britain tended to lag in the export trade in the newer industries, the ones making advances, whereas it was the cotton industry, which exported 84% of its output[3] that really held control in overseas trading.

Despite the older industries dominating over the newer advances, the 'mass production' which was allowed through technological development meant changes to industrial Britain – and not on its production or output. *M*any structural changes started to take place within the organization of industries. This advancing technology needed greater resources and capital for its development

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[1] AE Musson – The Growth of British Industry (1978), page 241
[2] AE Musson – The Growth of British Industry (1978), page 246
[3] AE Musson – The Growth of British Industry (1978), page 243

– for machinery, factory space and materials, and this in turn led to great changes to business. In the early period of this revolution, 'there was no sudden technological transformation'[4], and the capital needed was low – there were very few fixed assets required at this time, and business was still often financed by borrowing from family or friends or taking out loans and mortgages. However, steadily throughout the 1800's, the need for capital started to increase and with this came the rise of the Joint Stock Company.

The Joint Stock Company was not unknown at this time – it was dominant in fields where a large amount of capital was required, and was seen largely in the areas of railways, banking and insurance. It has often been said that the reason for its small impact in the early past of the century was the Bubble Act of 1720 which effectively prohibited Joint Stocks – one could get parliamentary consent, but it was costly, and consent was rarely given to the industrial sectors. Further to this was the view that Joint Stock Companies were largely 'viewed as bastions of monopoly power'[5], and this certainly didn't help their development. However, as noted above, there was little need at this time for the Joint Stock Company – Britain did not need them to finance their revolution.[6] So what was it that caused them to rise to the fore in the latter parts of the century? 'Business grew larger not only by increasing the number and size of their works, but also by taking over or merging with other firms'[7] - amalgamation became hugely popular and widespread in business, and it was fundamentally this which caused the rise of the Joint Stock Company.

Mergers were popular at this time because of increasing competition in industrial areas of production. M A Hutton commented that mergers were there to 'eliminate severe short term price competition'[8], and by amalgamating with other businesses in the same industry, one can effectively cut out large areas of the competition. These mergers started early as syndicates or trusts, whereby producers could come to agreements on price and production, whilst retaining the rest of the control of their business for themselves. This in turn led to large scale amalgamations, most famously the Salt Union and the Bleachers Association which involved over 50 firms each. Competition was widespread in industrial areas due to the massive over-production at this time – as technology developed, more was produced and it increased further until 'it becomes easy for production to overtake demand'[9]. This over-production was a major characteristic of The Great Depression 1873-96 and during this period, very large Joint Stock

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[4] Paddy Ireland – The Rise of the Joint Stock Company (unpub 1981), page 3
[5] Paddy Ireland – The Rise of the Joint Stock Company (unpub 1981), page 1
[6] Paddy Ireland – The Rise of the Joint Stock Company (unpub 1981), page 2
[7] AE Musson – The Growth of British Industry (1978), page 247
[8] MA Hutton – Some Features of the Early Merger Movements in British Manufacturing Industry, page 4
[9] JS Jeans – Trusts, Pools and Corners (1894), page 3

Companies became dominant. Therefore, a major underlying reason for the increase in Joint Stock Companies is in fact The Great Depression. However how far was the depression a product of the technological advances of the time?

In the mid 1880's, the limited liability company, or rather the company legal form was still overshadowed by the partnership, or rather these joint stock companies. There are various reasons for this, not least the limiting legislation of the time and because the merger boom at this time was encouraging larger partnership companies – not individual enterprise. Nevertheless, things began to change again in the mid nineteenth century to facilitate a rise of private companies, which led to the dominance of company law as a whole. At this time, the company legal form was intended purely for the use of joint stock companies, but legislation from 1844 onwards began to change this. The legislation was created largely due to the rise of the joint stock company and the effects of its unincorporated status.

The Companies Act of 1844 was the first major piece of legislation of its kind, and was intended only for economic joint stock companies. The 1844 act sought to eliminate the problems of fraud and exploitation that awaited unincorporated companies because of their association with the law of partnership. It required all joint stock companies to incorporate and had a system of registration and publicity. It was made abundantly clear that this act was not for the use of private companies – only for firms with transferable shares and associations of 25 or more people. The Limited Liability Bill in 1855 did little more to change this – in fact at this time incorporation with limited liability was confined to joint stock companies only because it was restricted, like the 1844 act, to associations of 25 or more people[10].

However, within one year a change came about which, despite the original views of the legislators, made a significant contribution to the rise of company law and private companies. The 1856 Joint Stock Companies Act extended the sphere of the company legal form with an important change – only associations of 7 people were now needed to incorporate. The legislators did not intend to open up incorporation to private companies – this is obvious not least, by the title of the act – The Joint Stock Companies Act. However, with the number of persons required set at only seven, a private company, by selling shares to family, friends or in fact even servants as was common at the time, could easily now become incorporated. Many had begun to notice the wide scope of the act, most notably by barrister Edward Cox who argued

[10] Paddy Ireland – 'The Rise of the Limited Liability Company', 12 International Journal of Sociology of Law (1984), page 242

that the company legal form could be used by anyone.[11] Whatever the views of either proponent or critic to the act, it had 'precipitated a dramatic change in the legal organizational forms of British industry'[12]

In spite of this, the effect of these acts during the period of 1856-62 was minor. The number of limited companies was small, and there were some who were describing the acts as a 'dead letter'[13]. However, during the latter part of the century, the number if limited companies began to pick up and dramatic increases were made right up to 1914. If this was not due to the acts themselves, what could it be attributed to? Firstly, the rise of the joint stock company had a large impact on the company legal form itself, and the rise had indeed been 'meteoric' (see above). However, in 1914, joint stock companies were far outstripped by the company legal form. This is chiefly to do with the escalation of the private company, who were in fact unincorporated and had a limited number of member, no public funds and restricted shares – in fact the complete opposite of the joint stock company. The rise was slow and shaky with joint stock companies far superior, but in 1877 a man called Palmer wrote a book on private companies which essentially challenged the view that only joint stock companies could form a company, arguing that anyone could indeed form a company. This had a significant impact to private companies.

However, as with joint stock companies, it was The Great Depression that truly facilitated the vast increase of private companies at this time. The Great Depression was a time of falling profitability, falling prices, protectionism abroad and over-production, and being in an unlimited liability partnership at this time seemed risky. Many people began to incorporate to 'avoid the dangers of the barbaric law of partnership'[14], which could lead to losses and bankruptcy. This, along with Palmer's book took the possibility of incorporation to those who had not yet realized it. Perhaps the final drive was the situation which arose with the Cit of Glasgow Bank with was an unlimited liability company which failed quite spectacularly in 1878. The idea of the 'private company could perhaps now be seen as 'finally alive' in a business sense – however it was in a legal sense that perhaps things now needed a final modification.
Despite the increase of incorporated, private companies, this use of the acts did go against the letter of the law, and this issue was laid out in the courts during the case of <u>Salomon v Salomon</u>

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[11] Paddy Ireland – 'The Rise of the Limited Liability Company', 12 International Journal of Sociology of Law (1984), page 243
[12] Paddy Ireland – 'The Rise of the Limited Liability Company', 12 International Journal of Sociology of Law (1984), page 244
[13] Paddy Ireland – 'The Rise of the Limited Liability Company', 12 International Journal of Sociology of Law (1984), page 244
[14] Paddy Ireland – 'The Rise of the Limited Liability Company', 12 International Journal of Sociology of Law (1984), page 247

and Co Ltd[15]. There were two major threats to the rise of the private company – those that thought limited liability lay only with joint stock companies, and company frauds. The case of Salomon addressed these issues. Aron Salomon, in 1982 decided to convert his business of leather and boot making into a limited manufacturer with a nominal capital of £40,000. this was split into 40,000 shares of which he gave one each to his 4 sons, wife and daughter and 20,000 shares to himself (no one else was ever intended to have any shares). The company agreed to pay £39,000 for his business, and in part payment he took £10,000 worth of debentures. The company however, fell on bad times and Salomon was forced to borrow £5,000 from Broderip and gave him the £10,000 worth of debentures as security for it. The company then defaulted on the payments folded, and there were not enough assets to pay the creditor, Broderick, back.

In the court, the judge argued that in fact the other 6 shareholders were merely nominees, and that Salomon wanted to take the profits without any risk of debts – there wasn't an allegation of fraud, but it was noted that Salomon was bound to indemnify his company as it was merely an agent of himself. The impact this would have on small private companies and sole traders was huge, and there was much discussion and speculation as to what the outcome should be. The Davey Committee, which reported in June 1895, was considering whether these companies should come under the sphere of the 1862 Companies Act. Although it was shown that many of these companies use dummies to get under the requirement of 7 persons, the Davey Committee stated that private companies could come under the act, as there was no reason why numbers under seven should necessarily become instantly liable. This was not reflected in the Court of Appeals decision on the Salomon case, and the original decision was upheld. Private companies could still be liable.

However, in 1896 the House of Lords finally reversed the controversial decision. They stated that the act required 7 members holding at least one share each to become incorporated, and that nowhere in the act did it mention that they must be 'beneficially' interested. This was an important decision in the growth of the private company and the company legal form. It had essentially allowed under no uncertain terms private and sole traders to incorporate under the act, and after this decision, numbers of private companies increased rapidly, so much so that in 1914 private companies had far overtaken joint stock companies, thus meaning the law of company had in essence scored a triumph over the law of partnership.

This issue of technological advance it seems has not been the most influential or important cause of the rise of company law, and neither, in my opinion, was the dominance of company law an

[15] [1897] AC 22

'inevitable consequence' of technological advance. The merger boom, the rise of the joint stock company, The Great Depression, private companies, the legislation of the mid 1800's and finally the Salomon case were all partially responsible for the rise of company law, and the company legal form. In fact, one can trace these events chronologically and see a pattern arising through the period of development of ideas, companies and the law. All of these factors are interrelated, the joint stock companies with the private companies, the depression with the mergers and it is important to notice that technological advance stands at one end, and company law at the other. Although not the only, nor the inevitable consequence, technological advance can perhaps be seen as the catalyst – without it there may have been no over-production, mergers and depression, but that said without out the other intervening factors there would have perhaps have been no company law. '*B*y the end of this period, nearly half the occupied population was in industry' [16], and this is an important indication of how influential technology and development had become with regards to it preparatory role in company law.

[16] AE Musson – The Growth of *B*ritish Industry (1978), page 241

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