THE LEGAL HISTORY OF JOINT-STOCK COMPANIES

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The history of joint-stock companies is part of the story of the birth of modern capitalism, but it is also the story of a legal institute which was to be important for developing society from farming to industrial production. A few essential principles of company law in development will be summarised from the present author's "The Legal History of Joint-Stock Companies" ("Aktieselskabernes Retshistorie", 1991). While not a textbook dealing with every relevant dogmatic aspect of company law, the book does deal with some of the more important problems. In this article light will be thrown upon the growth of this special type of legal organization and its reception in commercial and public life, and examples given of its interplay with the system of private law which came to flourish in the late 19th and early 20th centuries.

The problems chosen include the questions of establishing an enterprise in the legal form of a joint-stock company, and of how limited liability developed. In the 18th and early 19th centuries joint-stock companies in France and England were looked upon as economically dangerous and politically undesirable, because many people had lost much money in uncertain projects. In Denmark some people saw participation in a company of shareholdes as a preparatory "school for democracy". But bad management, unfair competition, fraudulent dealing in shares and speculation on the one hand and damage to persons or goods from the growing enterprises on the other, were to become some of the sadder chapters of Danish company history.

1. Promotion of Joint-Stock Companies

In most European countries around 1700 a special act of incorporation was required for establishing a legal person and obtaining special privileges such as the right to limited liability. Bad experience of joint-stock companies in England had led to the Bubble Act of 1720. Private companies without incorporation were seen as partnerships with personal liability, which were long the normal and preferred company form. Where limited liability *was* accepted, it was not quite clear what was

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ies or the like, a privilege, charter or concession was still necessary. But apart from such special needs the only condition for the running of a business was subsequent public registration. A new system of registration, which secured more public insight into individual firms and companies and their responsibility, was introduced in 1862. Publicity concerning ownership was necessary. Creditors and contracting parties had to be able to know whether the enterprise was owned by an individual or by a legal person.

Late 18th-century European jurisprudence had seen company law as part of public law as far as the charter or statutes were concerned and as part of private law as far as byelaws or conventions were concerned, since these represented private-law aspects concerning contracting, property, labour and responsibility. It is therefore logical that the more specific problems of limited liability in some legal systems were the result of the interpretation of byelaws.

2. *Convention and privilegium of the "Raadvaddam" Ironworks 1769*

Rather than analysing the full technical and legal contents of a convention and privilegium, some of the legal problems relating to the responsibility of an 18th-century enterprise, will be presented to illustrate the problems discussed later in the article.

The Raadvaddam Ironworks convention consisted of 18 articles concerning the following matters: 1) the election of directors; 2) directors' duty to supervise the work of the enterprise; 3) the raising of loans with shareholders' consent and the division of responsibility for these loans; 4) the duty of every shareholder to buy at least two shares at 250 *rigsdaler* each and the wording on the individual shares issued; 5) the guaranteeing of the shareholders' monopoly as ironmasters; 6) the limitation of creditors' possibilities of seeking security in the company's buildings, goods or material; 7) remuneration for employees etc.; 8) directors' accountability; 9) the purchase by the directors of raw materials etc. and the prohibition of the import of goods and implements from abroad by the directors; 10) the directors' responsibility for loans raised without the agreement of the shareholders; 11) the power to appoint master-craftsmen and apprentices; 12) responsiblitity for the day-to-day running of the works; 13) the quality of the goods produced; 14) the distribution of dividends; 15) the regulations governing general meetings; 16) the establishment of a sickness benefit scheme for works employees; 17) the principle of decision by majority vote at general meet-

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ings and the limitation of the shareholders' voting right to one vote regardless of number of shares held; and 18) the principle that all lawful decisions of a general meeting would be binding on both existing and future stockholders.

The *privilegium* contained 7 articles, covering the following matters: 1) the maintenance of the guild privileges of master-craftsmen seeking employment at the works; 2) the maintenance of the guild rights of journeymen similarly; 3) the equality in standing with other apprentices, after completion of the qualifying test piece, of apprentices who were trained at the factory; 4) the sole and exclusive right of the works to produce hardware; 5) the sole and exclusive right of the shareholders to import and trade in hardware and the prohibition of the import of hardware by others for resale, though not for their own use; 6) the right of military personnel employed at the works to receive an advance on their wages; and 7) exemption of the company's directors from public duties.

This brief summary of the contents of the two documents shows that the convention concerned the running of the company and its legal position both internally and externally, while the *privilegium* related particularly to the conferment of monopoly rights and the maintenance of guild privileges and other rights and immunities.

Responsibility for joint debts. Article 3 of the convention stipulated that for the company's proper debts, that is to say for loans raised in order to pay the purchase price for the works or raw materials, each individual shareholder was liable in proportion to his holding. It was added that if a shareholder became insolvent, his share of the debt would be divided among the other shareholders, once again in proportion to their holdings and that any obligation undertaken by the company on the basis of joint and several liability "should nonetheless be understood in the sense outlined above", that is to say as *pro rata* liability.

Each shareholder who held proper stock in the company was also responsible for the company's share capital in proportion to the amount he held and would "participate *pro rata* in this or subsequently accruing capital" (cf. article 4 of the convention, which reproduced the wording on each share certificate).

The prevalent legal view concerning the liability of shareholders for the company's joint debt was not entirely clear. The only legislation relating to company law was the regulations in chapter III of an ordinance dated 16 April 1681, which stated that all formal associations established for a certain period of time required written agreement and registration with the municipal authorities. Once this had been done, objections to the association's contract could not be raised and it could not be set aside

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by a subsequent verbal agreement between its members but only by written changes to its rules which were then registered in the same way. The ordinance did not affect the great companies that had received a royal *oktroj* or *privilegium.*

The ordinance only regulated the question of the validity of the association's contract and not individual practical problems of law such as liability. Legal theory in the second half of the eighteenth century reflected this lack of clarity, and Professor L. Nørregaard wrote on the subject of contracts establishing a company in general that "our laws do not mention at any point companies". He would therefore seek the answer in "the nature of the company contract and any analogy provided in our laws", that is to say that the law in this field had to be deduced on the basis of general methods of interpretation. Nørregaard distingished betweeen public, that is to say privileged, companies and private, that is to say unprivileged, companies. He maintained that in both cases the contract, convention or agreement which the shareholders had signed constituted the main basis for their rights and duties. However, a private contract of this kind could not be binding on outsiders, for example creditors, "unless either the convention was confirmed by the ruler and given the force of law" or the outsiders in question voluntairly entered into agreements "whose validity or lack of validity depended on whether or not the shareholders had legally informed them of the convention". It is unclear whether Nørregaard thought the convention had demonstrably to have been brought to the the creditors' attention or whether it was sufficient that they had had an opportunity to acquaint themselves with it when it had been made generally known to the public. However, his work on civil law, *Forelæsninger over den danske og norske privatret,* vol. 3 (Copenhagen, 1787), pp. 107 ff., gives the impression that he thought that creditors would only be bound, in the case of a convention not confirmed by the sovereign, if it could be proved that it had been brought to their attention, since he writes (page 110) "... and the same convention has been brought to the attention of those persons with whom the shareholders have concluded an agreement".

The convention relating to the Raadvaddam Works fulfilled the condition of being confirmed by the crown and it had also been made public, since it was printed by the royal court printer. Hence it had undoubtedly achieved the force of law and was therefore binding on the company's creditors, whether or not they had in actual fact become aware of its contents.

With regard to the question of liability Nørregaard maintained that, since a company was a legal person, liability must normally be regarded

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as a shared and unlimited liability for all shareholders "unless the company's convention states otherwise, and the same convention has been brought to the attention of those persons with whom the shareholders have concluded an agreement".

In this connection, Nørregaard did not explicitly mention the relevance of royal confirmation and its legal consequences for liability but, as we have seen, it must be assumed in view of his fundamental attitude that he believed that a convention confirmed by the crown could also change the principle of shared and unlimited liability for all shareholders.

The Raadvaddam convention clearly established a *pro rata* liability for the company's shareholders, but the terms of article 3 concerning the sharing of the liability of an insolvent shareholder among the solvent shareholders seems to show that the idea behind the convention was that each individual would be personally liable within the limits of his share in the enterprise. There was no question of limited liability in the modern sense, with liability restricted to the company's property and with no personal personal liability. Instead, the legal form chosen by the company is reminiscent of the jointly-owned shipping companies of the time, with personal and *pro rata* liability combined with freedom to sell one's stock. The disadvantage which the convention imposed on the shareholders' joint creditors was that liability was limited to being *pro rata* instead of being shared and unlimited, as was the normal practice. However, the individual shareholder's liability remained personal within the limits of the proportion of his total stock.

The Raadvaddam shareholders had proposed in article 6 of the convention that private creditors of the individual shareholders should not be able to pursue their claim by seizing the buildings, goods or materials of the works and would have to be content with the rest of the shareholder's property. This proposal was confirmed by the crown but with a further provision, namely that the private creditor of a shareholder could prevent the payment of dividends to him or seize his shares and the money that could be raised by selling them at public auction.

It was not therefore envisaged that a debtor would be able to withhold from his creditors that part of his fortune which was derived from his share of the company's profits. However, the company was to be protected from claims which originated in individual shareholders' private obligations. The problem which the individual creditor faced was therefore that he could not pursue any claim against the company's property but only against any profits which his debtor might obtain, or against

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such value as his shares might command when sold at public auction, though the creditor would then run the risk that the price for the shares might fall.

3. The Basic Fund and Limited Liability

In Roman Law a joint stock or common fund "acram communem" was accepted for associations, with a sort of manager who had the duty or right to work for the community, D 3-4, 1 pr.

The medieval Nordic word "felag" meant joint ownership of a fortune with ideal shares. The word "vederlag" or "bolag" related in the same way to a common fund or pool. In medieval commercial law such a fund normally was to be divided equally by profit and loss. The idea of such a basic fund, which consisted of investments and real property, was also part of the very early commercial companies of the 17th century, e.g. the Danish Asiatic Company.

The fundamental question is, when a *basic fund* alone might be supposed to be responsible for the obligations of a company. Historically there seem at different stages to have been several solutions, for example, where the interested parties were personally responsible with all their fortune, jointly and severally; or where personal liability was subsidiary, depending on the liability of the fund, or where the shareholder's responsibility was limited to a *pro rata* liability or to the amount of the share in the basic fund alone.

The Danish Asiatic Company Convention of 1732 mentioned a continuing fund. In the 1798 Convention it was decided that the basic fund toghether with all other Company property should alone be liable for the Company's debts.

In nineteenth-century jurisprudence the interest in "anonymous societies" with a fixed fund was growing. The great jurist A.S. Ørsted (1778–1860) considered that a person entering a contract with a society must take the consequences if he had reason to believe that this legal or moral peson was not trustworthy. As early as in 1818 Ørsted deemed that the capital of a society could be responsible for its debt. Against this background it is not surprising that the Danish Supreme Court in 1827 was satisfied with the agreement or memorandum of association as a sufficient basis for authorizing the sole and only responsibility of the fund and not that of the shareholders in person. The concept of a legal person was hereby changed, to become identical with an autonomous legal subject instead of being just another expression for a "responsible soci-

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ety'' with joint and several responsibility for each person.

Personal liability appears historically to have predominated in commercial relations. But whether this personal liability was of the "pro rata" or of the "in solidum" quality is less clear. The old solidarity, joint and several liability, known from very old sources concerning family responsibility, was a special executive form concerning family member's crimes or damages. The new solidarity which turned up in thirteenth-century Italian towns was intended for protection against fraudulent action in trade and business, e.g. flight, or the transfer of a whole fortune to a sort of company in order to evade creditors.

Pro rata liability seemed to have been preferred in the normal surety contracts of the 16th century, if solidarity was not explicitly declared. In joint-owned shipping firms, the *pro rata* principle was dominant concerning maritime law.

In the "Commenda", or partnership association, we also find the idea of a common fund as liable. In the early companies the "enterpriser" would be personally liable while the liability of the stock owners would be limited to their part of the fund. This mixed company form probably long competed in the 18th century with the joint stock company which normally asserted joint and several personal liability for the stock owners, or if limited liability was decided, then it would be as a *pro rata* liability.

Possible limitations of personal liability in great commercial companies were authorized in their charters or royally-confirmed conventions. When royal confirmation was no longer needed for the conventions of the Danish Asiatic Company in the late eighteenth-century, it was free to decide such limitations itself, without permission. The Asiatic Company then decided to restrict shareholders' liability to a *pro rata* form.

Several years had passed before the specific *limited liability* found general acceptance, and by then the Asiatic Company no longer existed. However, this early freedom for the great Asiatic Company must be seen as an important precursor of byelaws or conventions in private companies without public duties. In daily life as well as in theory though, it was difficult to understand the difference between limited liability and pro rata liability. With growing practice and the issuing or transfer of bearer shares, however, the concept of anonymity was understood and became an important part of the theory of company law when discussing the reasons for a liability limited to the common fund.

Another problem of this period seems to have been that jurisprudence and practice understood the concept of *private* company law as if it only comprised the rules which regulated internal company relations, while

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the rules regulating external relations were looked upon as primarily part of *public law*. Trade and creditor relations were consequently not understood as joint company questions but as problems concerning the single partners or shareholders alone. The situation lasted until it was accepted that private company law regulated both internal and external relations.

The present author has tried to trace the reason for the Supreme Court change of 1827. It might have been that one of the attorneys, Poul Sporon, had sufficient courage and knowledge to try to convince both the High Court and the Supreme Court. Sporon was a very clever lawyer and son-in-law to a professor of jurisprudence, Bagger Brorson. Sporon did in fact introduce the special vocabulary about depositing assets or funds in the case.

The judge who voted first in the Supreme Court stressed that the composition of the society was irrelevant. The persons were not mentioned by name, they were in fact unknown or anonymous. We meet the terminology known from the French "sociétés anonymes". All the other judges followed the first in their opinions.

Germany in the early nineteenth century followed the "concession principle" with chartering as a prior necessity. Hamburg and Bremen, however, accepted that the agreement and deed of establishment constituted a free contract which only should be registered subsequently. From the byelaws of the Hamburger "Assekuranz Kompanie" we know that limited liability might be authorized in special "limit proxies" from the shareholders to the management.

A similar understanding of the extent of the proxy seems to be expressed in the premises of the Danish Supreme Court decision of 1827, where it was said that a managing director lacked the mandate to impose personal libility upon shareholders without their consent: only the capital of the society could be compulsorily held liable for debt. In older practice from the late eighteenth century the argument had been similar, but on another level: a director could not as agent impose joint and several liability upon shareholders without their consent, but only *pro rata* liability.

The 1827 decision opened the door for the modern European joint-stock company in Denmark. It was not the legislator, but jurisprudence and some great entrepreneurs who started to work out the principles and rules for the fixed fund, limited liability and the transfer of bearer shares.

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4. *The Joint-stock Company, Society and Legislation*

The joint-stock companies of the early nineteenth century provoked optimism, rashness, folly, swindle, humbug and crisis followed by sorrow and social distress. The lack of business morality was in the long run to bring about more legislation, though this consequence came very late to Denmark.

In the late nineteenth century the joint-stock company became more popular. Although normally identified with capitalism, it was also chosen by workers for many of their production cooperatives, since they could more easily afford the limited liability than the personal and *in-solidum* responsibility of the normal cooperative associations.

The growing industrialization of the 1870s created a real promotion of companies. Many initiatives were taken by the magnate C.F. Tietgen (1829–1901) who with a base in the "Private Bank" as a typical "crédit mobilier" bank quickly established more than 15 enterprises. A young lawyer, Niels Lassen, showed in a newspaper article how dangerous freedom of contract as a holy principle could be if combined with secrecy and if public registration did not reflect whether the registered capital was in fact paid up.

Discussion in the newspaper and among lawyers and economists and the demand for publicity saw the century out. In fact the criticism did not differ completely from Karl Marx' strictures, even if they did have a different political view.

At the beginning of the twentieth century the growing demand for legislation was inspired by several alarming bank failures. A prominent professor of law, Carl Torp (1855–1929), addressed the Juridical Society of Copenhagen in 1908 on the question of legislation for joint-stock companies. He described with irony how this question was taken seriously each time society was shakened by economic scandals, because all had connection with stock and shares swindles. But soon all was forgotten and then no one demanded legislation. In Torp's opinion the greatest opposition to stock-and-share-swindle legislation was from banking and stockbrokers and from some of the more suspect attorneys. They all believed that legislation would hamper commercial life.

The right to establish joint-stock companies with however tiny share capital and shares was, Torp claimed, seen as holy and inviolable. He was worried that it was possible to establish such small and weak companies without personal responsibility or security safeguards. The first bill on joint-stock companies finally passed in 1917, but it was not able to stop

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all the abuses and fraudulent conversions. With the second Joint-stock Company Act of 1930, a better regulation was created and the Act survived the Second World War.

5. *Enterprises, Damages and Competition*

It seems to be a general principle in practice concerning the law of damages that technological and economic development will contribute to the acknowledgement of claims for damages in areas where earlier generations would not have dared to propound them. This development can be defined as a sort of slow juridification of a responsibility which earlier was based upon ethical norms alone. This scheme also seems to have been noticable in the field of great industrial enterprises. For external damages incurred by dangerous enterprises it was rather difficult in Denmark to institute a strict liability; but at least liability for fault was accepted by the courts.

Since late medieval merchant law, the courts and commercial customs for each place and time have marked out the borders of honest customs and usage and developed the principle of honest business morals. This principle was not incorporated in the first Competition Act of 1912, but is found in the 1937 Act. It was the great managers of the joint-stock companies who most persistently argued against the idea of competition legislation, while small and medium-sized trade and industrial concerns wanted an act to better protect their interests. The early history of company law was, as shown, closely connected with monopolies and all kinds of privilege, which interfered with growing commercial wishes for free competition and fairness. By the early twentieth century, freedom of competition was looked upon as a right, which must yield only to a risk of serious breach of legal and moral principles.

Before 1849 the State had used general regulations, single privileges and the granting of sole and exclusive rights increasingly to break down the old corporational crafts and trade system with its narrow barriers to further technological and economic progress.

The word "monopolies" in legal history is often prefixed "prejudicial or detrimental" because the monopolizing of trade or production could only happen through misuse or exploitation of the market and the consumers, with the sole purpose of obtaining unfair prices. In canon law the principle of "justum pretium" or just price was in late medieval legal theory developed to become an ethical standard for the protection of consumers against unfair prices.

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"Justum pretium" presupposed the possibility of the formation of a free market price and free competition as a contrast to the "legal price" fixed or decided by public authorities. "Free market prices" very early became the foundation for great enterprises, either as joint stock companies or one-man firms, while "legal prices" or controlled prices regulated small-town trade and handicrafts, which were often organized as guilds and corporations. Inside and between such corporations, competition was regulated in detail and the idea of free competition was totally unacceptable.

The nineteenth and early twentieth centuries saw a growing tendency of smaller enterprises to concentrate by merging or by forming cartels with the clear purpose of obtaining market dominance and restricting the trade of possible rivals. Great trustifications and multinational concerns became common. For all these organizations the joint-stock company form was preferable.

Legislation against price agreements was adopted in 1929 and 1937. It had little effect until the end of the Second World War, because it was suspended and replaced by crisis legislation during the German occupation (1940–45).

6. *Joint-stock Companies in Crisis*

A sadder chapter of the history of joint-stock companies is the great risk of going bankrupt. Wishes for speedy and high profit without much personal effort and as far as possible without personal liability were the force driving the development when limited liability was accepted in the nineteenth century. The absence of regulations and restrictions long seemed to make joint-stock companies most lucrative. Earlier the intention of forming of joint-stock companies had probably been to divide the risk and the responsibility, but also the profit.

Few cases concerning the bankruptcy of companies reached the Supreme Court in the first half of the nineteenth century. Most cases were decided by voluntary composition with the creditors or a composition scheme in bankruptcy decided by the bankruptcy court with no appeal. Eighteenth- and nineteenth-century theory in a way contributed to the uncertainty about responsibility, because the discussion long concentrated on individual "in solidum" versus "pro rata" liability instead of tackling the problem as a question of legal rights and duties for the company as a legal person.

The first bankruptcy act, 1858, was not very clear in this respect, but

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the second, 1872, which remained the legal basis of bankruptcy law for the next hundred years, did regulate special trade and business relations. The famous case already mentioned in which the Supreme Court in 1827 accepted limited liability was also important as a historical example of the interrelation between bankruptcy law and company law.

The case concerned the bankruptcy of a sugar enterprise which had been brought in the probate commission under the High Court. The probate case was just closing, when at the last meeting a representative of a sea insurance company claimed payment for a bill of exchange, which had not been notified to the probate commission. He asserted a right to sue both the issues and all the participants. The probate commission disregarded the claim.

The management of the insurance company then sued the director of the former sugar enterprise and the participants, which were sugar refineries. The High Court and later the Supreme Court allowed the claim of the summonsed participants partly because the basic invested fund alone was seen as responsible for the debt of the enterprise, not the participants personally, partly because the enterprise had already been cleared lawfully in the probate commission with no notification from the insurance company. It was pointed out in the premises that the insurance company already knew that it was dealing with a legal person when the contract was entered into. It should have investigated whether the basic fund of the sugar enterprise was sufficient and whether the board itself would offer a guarantee that the debt would be paid.

The board would have no authorization to pledge the basic fund without the consent of the participants. Both courts also indicated that the bill of exchange had not named the individual participants when the debt was incurred, and the insurance company had not even tried to prove their identity.

As many as 163 joint-stock companies were established between 1872 and 1884, and 72 old enterprises first established as one-person firms were converted into joint-stock companies. In 1884, 31 of these joint stock companies were either wound up or had gone bankrupt.

In the same period in Copenhagen, with a population of 261,000 in 1880 and of 606,000 in 1916, 79 bankruptcies were registered by the Maritime and Commercial Court.

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7. *Conclusion*

In 1917 the first Joint-stock Company Act was passed. It was to create more publicity and transparency and place the responsibility for the accomplishment of this purpose upon director and board. Limited liability was now codified. In 1930 an improved Act made the requirements regarding the necessary capital more rigorous. Also more information about the agreement, byelaws, names and annual accounts was required to be registered in the special register of companies. A limitation to 10 % for the company as to treasury stock was decided, and the share capital had to exceed 10,000 Danish Crowns.

In this way the joint-stock company finally became a more reliable factor in society and commercial life.

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