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A TALE OF UNINTENDED CONSEQUENCE: CORPORATE MEMBERSHIP IN EARLY UK COMPANY LAW

COLIN MACKIE*

ABSTRACT.

This article seeks to elucidate the historical basis in UK company law of the right for one company to be a member (i.e. shareholder) of another company and, through this position, benefit from limited liability. The contemporary relevance of this study lies in better understanding the original rationale behind conferring limited liability upon corporate members. Their own members may have already benefited from it. The protection afforded by this doctrine can, of course, be used strategically by a parent company to minimise losses arising from *its subsidiary's* activities. It is argued that the courts found corporate membership to be compatible with the Companies Act 1862 in the late 1860s to ensure that the companies in question bore legal responsibility for shares which they held or were held on their behalf. This prevented them from disclaiming liabilities associated with the shares by contending that their very ownership was, in fact, unlawful. Importantly, the courts neither acknowledged nor considered whether corporate members could or, indeed, should benefit from limited liability. Whilst *companies' legislation*, when read alongside this formative jurisprudence, would later be taken to confer limited liability upon corporate members, this was an unintended consequence of the early case-law and the 1862 Act itself.

KEYWORDS: limited liability, ultra vires, corporate member, corporate groups, corporate structure, separate legal personality

A. INTRODUCTION

For nearly a century, it has been common in the United Kingdom for enterprise to be conducted through a number of legally distinct companies, together comprising a single corporate group.¹ The complexity of the legal structures adopted by many enterprises has increased exponentially with time. From the early days of rudimentary parent-subsidary relationships, there may be many tiers of parent, subsidiary and sub-subsidary companies within a modern corporate group. Whilst genuine managerial and administrative efficiencies may be attained through the adoption of such structures,² their employment may be more contrived. In recent years, the convoluted and, at times, artificial manner in which some multinational enterprises operating within the UK are structured so as to reduce their liability for corporation tax has come under close scrutiny by the UK Government.³

Three basic legal preconditions were necessary for this business model to emerge and flourish: the right for one company to be a member (i.e. shareholder) of another company and, through this position, vote on the latter's affairs in general meeting; the separate legal personality of each company with the result that they were an entity distinct from their members and possessed with their own rights and liabilities; and the conferral of limited liability to the company's members with the consequence that their liability could be limited to any amount unpaid on their shares. Each component was made available to companies incorporated by registration under early UK companies' legislation and, in the case of limited liability, their members at different points between 1856 and 1867.

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¹ Corporate groups overtook the individual company as the most significant business model in the United Kingdom in the 1920s and 1930s: Tom Hadden, 'Inside Corporate Groups' (1984) 12 *Int'l J Soc L* 271, 271.

² Alfred Chandler Jr, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge: HUP reprinted, 2004) 31 and 73.

³ See e.g. House of Commons Committee of Public Accounts, *Tax Avoidance – Google* (HC 2013-14, 112-I)

<<http://www.publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/112/112.pdf>> accessed 14 June 2016.

The Joint Stock Companies Act 1856 would allow members of companies incorporated by registration under it to benefit from limited liability.⁴ However, not only was the Act silent as to the lawfulness of corporate membership,⁵ companies incorporated under it could not be considered to be 'completely separate' from their members.⁶ The first true companies Act, the Companies Act 1862, would provide the first legislative platform to enable the three components to be utilised collectively. Separate legal personality was conferred upon companies incorporated under it,⁷ and limited liability could be granted to their members if the incorporators so desired.⁸ The Act was, however, silent as to the

⁴ The general statutory conferral of limited liability first arrived in England in 1855 under the Limited Liability Act 1855 (the '1855 Act'). This Act did not apply to Scotland: 1855 Act, s 18. It permitted companies formed under The Joint Stock Companies Registration, Incorporation and Regulation Act 1844 (the '1844 Act') to confer limited liability upon their members provided that certain conditions were met: 1855 Act, s 1. Limited liability was later extended to the rest of the UK by the Joint Stock Companies Act 1856.

⁵ Certain discrete pieces of legislation relating to companies did, however, explicitly permit corporate membership: see text accompany nn 91-100.

⁶ "Section 3 of the 1856 Act stated that: "Seven or more persons...may...form themselves into an incorporated company", clearly indicating that the people were the company; that it was made up of them. Perceived as such, the incorporated company could hardly be 'completely separate' from its members.": Paddy Ireland, Ian Grigg-Spall and Dave Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14 *Journal of Law and Society* 1 149, 150 (original emphasis). Lipton makes a similar observation in respect of the 1856 Act: 'Incorporated joint stock companies were identified with their members as entities composed of those members merged into one legally distinguishable body.': Phillip Lipton, 'The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective' (2014) 40 *Mon LR* 2 452, 460.

⁷ 'Any Seven or more Persons...may...form an incorporated Company...': 1862 Act, s 6. For Ireland, Grigg-Spall and Kelly, 'While the 1856 Act clearly identified the company with its members, the 1862 Act suggested that it had an existence external to them. Seen as a thing made by, but not of, people, the incorporated company was depersonalised and thus 'completely separated' from its members.': Ireland, Grigg-Spall and Kelly (n 6) 150 (original emphasis). For Lipton, section 6 of the 1862 Act made clear that, '...the members, or incorporators, were forming a completely separate body, rather than something composed of themselves': Lipton (n 6) 460.

⁸ Section 6 of the 1862 Act stated that a company could be incorporated under the Act, '...with or without limited liability.' Section 7 stated that, 'The liability of the members of a company formed under this Act may, according to the Memorandum of Association, be limited either to the amount, if any, unpaid on the shares respectively held by them, or to such amount as the members may respectively undertake by the Memorandum of Association to contribute to the assets of the company in the event of its being wound up' (emphasis added).

lawfulness of corporate membership. The Court of Appeal in *In re Barned's Banking Company*⁹ would deem this to be compatible with the Act in 1867. It did so by finding that a limited company was a 'person' for the purposes of the Act and so capable of being a 'member' of another limited company if, and only if, this was authorised by its constitution. This approach was followed one year later in *In re Asiatic Banking Corporation*.¹⁰

Through enabling one company to be a member of another, the decisions in *Barned's* and *Asiatic Banking* would transform the way in which enterprise in the UK was conducted. Their impact was, however, amplified by two later developments. The first was the trend towards the small, fully paid up share, a movement not envisaged by the originators of limited liability.¹¹ These became common in the 1870s and 1880s, with the £1 share prevalent 'in almost every sphere of limited company enterprise' by the end of the century.¹² It was at this point that limited liability became truly effective in reducing the risk to which members were exposed by the company's insolvency. Prior to the emergence of this trend, large calls made in respect of unpaid portions of issued shares could, and often did, result in financial ruin for those involved even though they benefited from limited liability.¹³ The second development was the confirmation that a subsidiary possessed a legal personality separate to its parent. This was emphasised first by the High Court in the 1893 decision of *Bartholomay Brewing Company Ltd v Wyatt*¹⁴ in circumstances where a limited company incorporated in England held 99.93% of the shares in its American subsidiary.¹⁵ Four years

⁹ (1867) 3 Ch 105 (CA).

¹⁰ (1868-69) LR 4 Ch App 252 (also referred to as *The Royal Bank of India's Case*).

¹¹ J.B. Jefferys, 'The Denomination and Character of Shares, 1855-1885' (1946) 16 EHR 1 45, 55.

¹² *ibid* 45-46 and 54.

¹³ Ron Harris, 'The Private Origins of the Private Company: Britain 1862-1907' (2013) 33(2) OJLS 339, 358; Lipton (n 6) 461-462. See *infra* nn 77-81 and accompanying text.

¹⁴ [1893] 2 QB 499.

¹⁵ In *Bartholomay Brewing*, a limited company incorporated in England held 9,993 of the shares in an American company, with seven American-based trustees holding one qualifying share each. The question for the court was whether the English company carried out activities abroad for the purposes of income tax liability. The court found that the English company was not liable to pay income tax upon the portion of the profits retained in America. Wright J reasoned that, '...whatever control is

later, the House of Lords in *Salomon v Salomon Ltd*¹⁶ affirmed that separate legal personality would be accorded to a company upon its incorporation by registration, even where one member held virtually all of its shares.¹⁷ Whilst *Salomon* concerned a family-run business and was decided when corporate groups were relatively rare, its ratio was extended to parent-subsidary relationships from the early twentieth century.¹⁸ Thus, through piecemeal development, UK company law evolved so as to enable the creation of corporate structures capable of insulating each tier entirely from the debts and obligations of the lower tiers and, indeed, those of other group companies.

The separate legal personality of incorporated companies and the limited liability of their members have spawned an extensive body of literature. There has, however, been very little analysis of the origins in UK company law of the right for one company to be a member of another company. Writing over a century apart, Blumberg¹⁹ and Brice²⁰ did consider the significance of the decisions in *Barned's* and *Asiatic Banking* but they drew opposing conclusions on the authority for which the cases stood.²¹ Contradictions aside, neither Brice or Blumberg, nor any other commentator who has cited *Barned's* and *Asiatic*

exercised by the English company is exercised by it as the holder of practically all the shares in the American company...The business of a company is not carried on by its shareholders, but by the company through its directors...': *ibid* 516 (emphasis added).

¹⁶ [1897] AC 22.

¹⁷ *ibid* 30 and 43.

¹⁸ See e.g. *The Gramophone and Typewriter Ltd v Stanley* [1906] 2 KB 856; *Ebbw Vale Urban District Council v South Wales Traffic Area Licensing Authority* [1951] 2 KB 366; *Albacruz v Albazero (The Albazero)* [1977] AC 774; *In re Southard & Co Ltd* [1979] 1 WLR 1198; *Adams v Cape Industries plc* [1990] Ch 433 (CA); *Prest v Petrodel Resources Ltd* [2013] UKSC 34.

¹⁹ Phillip Blumberg, 'Limited Liability and Corporate Groups' (1986) 11 J Corp Law 573, 608-609.

²⁰ Seward Brice, *A Treatise on the Doctrine of Ultra Vires: being an investigation of the principles which limit the capacities, powers, and liabilities of corporations, and more especially of joint stock companies* (Stevens & Haynes 1874) 92-96.

²¹ For Brice, a company possessed an implied power to be a member of another company which did not need to be provided for expressly: *ibid* 93. In contrast, Blumberg asserted that silence in the memorandum of association, a core constitutional document of the company, meant that the purchase of another company's shares was ultra vires: Blumberg (n 19) 608.

Banking as authority for the lawfulness of corporate membership,²² has attempted to explain the legal factors that led the courts to construct the 1862 Act in a manner permissive of corporate membership. There has been even less consideration in the literature of the closely connected question as to whether an intended corollary of the right of corporate membership, as originally conceived, was the conferral of limited liability to corporate members. Blumberg is the exception here. He made the significant, yet undeveloped observation that this question had, largely,²³ been ignored by the English courts but did not attempt to explain this.²⁴ This article contributes to the literature in two ways: first, it elucidates the legal factors that shaped the emergence of a right of corporate membership; and, secondly, it considers whether the conferral of limited liability to corporate members was an intended consequence of this right.

The contemporary relevance of this study lies in better understanding both the historical legal basis and original rationale behind conferring limited liability upon corporate members. Their own members may, of course, have already benefited from it. The doctrine of limited liability has been treated as near inviolable in parent-subsidary relationships by the UK courts. In the absence of wording in a particular statute or contract permitting shareholders to be held liable for the company's debts, the courts have, typically, refused to hold a parent company liable for the debts of its subsidiary.²⁵ It seems likely that this position will be maintained even where a subsidiary has been used strategically to insulate the parent

²² Nathaniel Lindley and Samuel Dickinson, *A Treatise on the Law of Partnership: Including its Application to Companies* (Callaghan 1881) 86; Note, 'Ultra vires Purchase of Stock by Corporation' (1893) *The American Law Register and Review*, vol. 41, no. 11, (First Series), Volume 32 (Second Series, Volume 6) 1054; Henry Ballantine, *Ballantine's Manual of Corporation Law and Practice - A Treatise on the Principles of Corporation Law: Practical Directions on Organization Corporate* (Callaghan 1930) 221; Muzaffer Eroglu, *Multinational Enterprises and Tort Liabilities: An Interdisciplinary and Comparative Examination* (Edward Elgar 2008) 74-75; Lipton (n 6) 474.

²³ He cites *Re European Society Arbitration Acts* (1878) LR 8 Ch D 679 as the exception. See *infra*, Section D.

²⁴ Blumberg (n 19) 608.

²⁵ Cape (n 18) 536.

from liability.²⁶ One important implication of the court's approach is that it encourages entrepreneurial risk-taking.²⁷ In the absence of limited liability, decision-makers within an enterprise considering entering in to a new venture may be discouraged by the fear of placing the assets of the wider group at risk should it fail. By affirming the parent's unilaterally determined limitation on its liability (i.e. by limiting its liability to any unpaid share capital), the position of the court provides certainty and predictability.²⁸ These are highly regarded values in corporate planning and decision-making.

More controversially, the court's approach may be seen to foster moral hazard and encourage strategic corporate structuring.²⁹ Moral hazard arises from the fact that the parent obtains the financial rewards of the subsidiary's activities but is, beyond the loss of the latter's assets and any unpaid share capital, insulated from liability for the harmful consequences. This creates an incentive for it to utilise the voting rights available to it as a member to make profit maximising, yet socially undesirable decisions in respect of the subsidiary's activities.³⁰ There is also the motivation to structure the parent-subsidiary relationship so as to ensure that the parent is insulated from liability should the subsidiary's activities cause harm (e.g. environmental damage following an industrial accident) in the future. This would thwart the prospect of a successful claim or cost recovery by a legitimate claimant, public or private.

The provisions of the Companies Act 2006 which may be seen to confer limited liability upon a corporate member (e.g. the definition of 'member' in section 112)³¹ are

²⁶ The incorporation of a subsidiary by a parent to minimise any future exposure to financial liability arising from, for example, an environmental accident appears to be insufficient for veil piercing doctrine to be invoked by the UK courts: *Prest* (n 18) 20-21.

²⁷ Nina Mendelson, 'A Control-Based Approach to Shareholders Liability for Corporate Torts' (2002) 102 *Colum L Rev* 1203, 1218.

²⁸ Stephen Bainbridge, 'Abolishing veil piercing' (2000) *J Corp L* 26 479, 524.

²⁹ Frank Easterbrook and Daniel Fischel, 'Limited Liability and the Corporation' (1985) 52 *U Chi L Rev* 89, 104.

³⁰ Steven Shavell, 'Minimum Asset Requirements and Compulsory Liability Insurance as Solutions to the Judgment-Proof Problem' (2005) 36 *RAND Journal of Economics* 1 63, 63-64

³¹ See *infra* n 101 and accompanying text.

strikingly similar to those contained within the 1862 Act. Thus, there is value in analysing legal history and the emergence of doctrine within the context of that legislative framework. To be clear, the purpose of this paper is not to question the lawfulness of corporate membership but rather to inform contemporary debate as to whether the inviolability accorded by the courts to limited liability in the parent-subsidary relationship is justifiable.

It is the central claim of this article that the Court of Appeal in *Barned's* and *Asiatic Banking* found corporate membership to be compatible with the 1862 Act to ensure that the companies in question bore legal responsibility for shares which they held or were held on their behalf. This prevented them from disclaiming liabilities associated with the shares by contending that their very ownership was, in fact, unlawful. Whilst justice may have been achieved in both cases, the instrumental approach adopted by the courts resulted in their failure to consider the wider implications of their decisions. They neither acknowledged nor considered the fact that corporate members could, in addition to their own individual shareholders, be taken to benefit from limited liability. Nor did they recognise that they had laid the legal foundation from which corporate groups would emerge. Whilst companies' legislation, when read alongside *Barned's* and *Asiatic Banking*, would later be taken to justify limited liability being conferred upon corporate members, this was an unintended consequence of these early cases and, indeed, the 1862 Act itself. Unintended consequence is the overarching theme emerging from this article: decisions which enabled liability to be imposed upon the responsible persons would, with time, provide the jurisprudential basis for a parent company to shield itself from liability by undertaking a hazardous activity through a subsidiary.

This article is structured as follows. Section B will explain the legal factors that shaped the emergence of the right of corporate membership in the period 1850-80. Section C will evaluate the reasoning utilised in *Barned's* and *Asiatic Banking* to justify the treatment of limited companies as 'members' for the purposes of the 1862 Act. It will consider whether the conferral of limited liability to corporate members was an intended corollary of this.

Section D will examine the consideration given by the courts to whether limited liability would be conferred to corporate members. Section E will draw conclusions.

B. THE FORMATIVE JURISPRUDENCE

This section will explain the legal factors that shaped the emergence of the right of corporate membership in the period 1850-80. It will be seen that the right developed in two distinct stages. The first, observed between 1850-66, comprised tacit acceptance by the courts of the commercial practice of companies acquiring shares in other companies through the use of trustees. The second stage saw explicit acceptance by the courts of corporate membership under the 1862 Act, from 1867 onwards. A theme constant in the jurisprudence of both stages, however, was that the constitution of the company seeking to hold or acquire the shares of another company must have authorised the transaction. If not, it was ultra vires (i.e. beyond the company's powers) and invalid.

1. The Position Prior to *Barned's* and *Asiatic Banking*

Authoritative treatises by Grant in 1854³² and by Lindley in 1860³³ asserted that one corporation could be a member of another corporation. Lindley cited Grant as authority for his statement but Grant provided no authority to substantiate his own claim. The position was not, however, as clear as either suggested. In a leading 1874 treatise on the application of ultra vires doctrine to corporations and joint-stock companies, Brice observed that, '[t]ill

³² 'The members of corporations may be natural persons...or natural persons joined with a corporation or corporations aggregate or sole, so that corporation A. may be composed of other corporations, B., C, D., &c...; or the members may consist wholly of corporate persons, or of certain officers of a corporation...': James Grant, *A Practical Treatise on the Law of Corporations in General, as Well Aggregate as Sole* (T & J W Johnson 1854) [5].

³³ '[T]here seems to be no doubt that at common law one corporation may be a member of another': Nathaniel Lindley, *A Treatise on the Law of Partnership, including Its Application in Joint-stock and Other Companies* (William Maxwell 1860) 119 [78-9] (hereafter '*1860 Treatise*').

quite recently it was doubted whether one company could be a shareholder in another; indeed, the weight of authority was in the negative.³⁴

Two factors evidence truth in the claims of Grant and Lindley. First, legislation applying to both unincorporated companies and companies incorporated by private Act of Parliament did cater explicitly for the prospect of corporate bodies holding shares in other corporate bodies.³⁵ There was, however, legislation applicable to companies incorporated by registration, notably the 1855 and 1856 Acts, which did not. Secondly, it was common during the 1850s and 1860s for companies to hold and acquire shares indirectly through trustees.³⁶ Directors often held the shares on behalf of the company rather than the company taking the shares in its own name.³⁷ It may be inferred from the fact that the lawfulness or otherwise of this practice was not challenged by or before the courts, that is until *Barned's*, that the judiciary were tolerant of it. Nevertheless, the utilisation of trustees is significant for it gives strength to Brice's contention that the position was not settled until *Barned's*.

With the exception of charter companies,³⁸ the constitution of an incorporated³⁹ or unincorporated⁴⁰ company must have authorised the holding or acquisition of another

³⁴ Brice (n 20) 92-3 (emphasis added). The 1863 decision in *Great Western Railway Company v Metropolitan Railway Company* (1863) 32 LJ Ch 382 was cited as authority for this proposition but it does not support it. Great Western was empowered under its private Act of Parliament to take shares in Metropolitan and did so to the full extent of its powers. The shares were held by trustees for Great Western. The trustees were registered as the holders of the shares. Metropolitan later created new shares and a portion were offered to Great Western. Great Western later sought to enforce its right to these shares. At first instance, Wood VC held, inter alia, that Great Western had 'no power to take a single more share in this new undertaking...' and to do so was ultra vires: 385. On appeal, the Court of Appeal overruled the demurer contending that it was not the appropriate forum to determine whether Great Western could hold the shares. The matter was too complex to be dealt with by demurer. Thus, Great Western does not stand for the proposition that corporate membership was prohibited. In fact, the lawfulness of corporate membership per se was not challenged in any way. Rather, Great Western was merely prohibited from taking any further shares in Metropolitan owing to the constraints of its constitution.

³⁵ See infra n 91-100 and accompanying text.

³⁶ Brice (n 20) 95; see e.g. *The Great Western Railway Company v Rushout* (1852) 5 De G & Sm 290; 64 ER 1121.

³⁷ Brice (n 20) 95.

³⁸ It may be asserted somewhat tentatively, in the absence of contrary evidence, that charter companies did possess an implied power of corporate membership. They were deemed to have the rights and capacities of natural persons (Harry Rajak, 'The Foundations of the Doctrine of Ultra Vires' in Richard Plender (ed), *Legal History and Comparative Law, Essays in honour of*

company's shares. Thus, the power was neither general nor implied. Whilst an unincorporated company could, if necessary, amend its deed of settlement to authorise such a transaction, companies incorporated by private Act of Parliament could not. The latter could, however, apply to Parliament 'for any special law which he [thought] he [could] induce the Legislature to pass for his benefit.'⁴¹ The state could confer the power by letters patent⁴² or private Act. Whilst, in theory, the power could be granted by the state, it was a privilege conferred to a minority of applicants. Many faced great difficulty obtaining a charter or private Act.⁴³ Also, the conferral of letters patent was not widely utilised.⁴⁴

The restrictive conferral of corporate privileges stemmed in large part from the rules adopted by the state, acting through the Board of Trade, for determining applications.⁴⁵ Privileges, such as the power of corporate membership, would only be granted if a company's objects were of 'general public advantage'.⁴⁶ Circumstances, inter alia, satisfying this test was where the capital required was 'of so large an amount that no single partnership could be expected to support the expense, as in the case of Railways, Canals, Docks and

Albert Kiralfy (Frank Cass 1990) 220 citing *The Case of Sutton's Hospital* (1612) 10 Coke Reports 23a, 77 ER 960 as authority), who were, of course, entitled to hold and acquire shares.

³⁹ In respect of companies incorporated by private Act of Parliament, see *Colman v The Eastern Counties Railway Company* (1846) 10 Beavan 1, 15; 50 ER 481, 487; *Great Eastern Railway Company v Turner* (1872-73) LR 8 Ch App 149, 152. In respect of companies incorporated by registration under the 1862 Act, see *Barned's* (n 9) 112; *In Re William Thomas & Co Ltd* [1915] 1 Ch 325, 329.

⁴⁰ Lindley, 1860 Treatise (n 33) 204 [200].

⁴¹ *Maunsell v Midland Great Western (Ireland) Railway Company* (1863) 71 ER 58, 73-4 (Wood VC).

⁴² The Grants of Privileges to Companies Act 1834 (4 & 5 Will 4 c 94) (the '1834 Act') and The Chartered Companies Act 1837 (7 Will 4 & 1 Vict c 73) (the '1837 Act') applied to any company and body of persons in Scotland and England and provided that the Crown could confer upon them by letters patent those privileges which it might confer by charter.

⁴³ L.C.B. Gower, J.B. Cronin, A.J. Easson and Lord Wedderburn of Charlton, *Gower's Principles of Modern Company Law* (4th edn, Sweet & Maxwell 1979) 31.

⁴⁴ Between 1834 and 1837, only three or four out of some twenty five applications for letters patent were approved, whilst, between 1837 and 1854, only around fifty companies were registered under the 1837 Act: Bishop Hunt, *The Development of the Business Corporation in England, 1800-1867* (HUP 1936) 60 and 83.

⁴⁵ Gower et al (n 43) 40.

⁴⁶ Cited in Hunt (n 44) 57-58.

works of that description.⁴⁷ In a fashion similar to the restrictive conferral of limited liability prior to its widespread availability under the 1855 Act,⁴⁸ the state retained control over those companies granted the power of corporate membership.

The state's restrictive conferral of privileges was compounded by the approach of the courts who would construct a company's constitution strictly. The constitution defined the purposes for which the company existed and dictated the powers of its directors.⁴⁹ If the purposes were deviated from or powers exceeded then the act could be challenged in the courts as ultra vires (i.e. beyond the powers of the company). One apt example would be the use of the funds of a company (X) by its directors to acquire shares in another company (Y) when this was not warranted under X's constitution. If the transaction was deemed to be ultra vires then even the unanimous consent of its members could not ratify the act for it was void from the outset.⁵⁰ The doctrine of ultra vires provided a powerful tool for aggrieved members or, in cases of insolvency, the company's liquidator. They could challenge the use or intended use of corporate funds by the directors to purchase shares, or acquire further shares, in another company. The purpose being, typically, to prevent company funds from being expended in the first place, or where funds had been expended, to have them returned to the company.

In many respects, the power of corporate membership was treated much like any power: where a transaction was entered into by the directors when the company's constitution did not authorise or warrant it then it was ultra vires and void. It was, however,

⁴⁷ *ibid* 58.

⁴⁸ Between 1837 and 1855, one hundred and sixty three applications were made to the Board of Trade requesting charters to be granted conferring limited liability, and of these ninety seven were granted and sixty refused or delayed: Leone Levi, 'On Joint Stock Companies' (1870) 33 *Journal of the Statistical Society of London* 1, 14. Levi does not clarify what became of the remaining six applications.

⁴⁹ Lindley, 1860 *Treatise* (n 33) 203-204 [199]-[200].

⁵⁰ *ibid*. In the context of a company incorporated by private Act, see *The East Anglian Railways Company v The Eastern Counties Railway Company* (1851) 11 CB 775, 812 and 813; 138 ER 680, 695. In the context of a company incorporated by registration under the 1862 Act see *Ashbury Railway Carriage and Iron Company (Limited) v Hector Riche* (1874-75) LR 7 HL 653, 672.

the manner in which the court constructed the constitution, particularly the scope given to key terms in the objects or purposes clauses, which drew the line between an intra and ultra vires action. This factor defined the boundaries of the power. The court's strict treatment of it is evident from a series of cases between 1850 and 1866.

In the 1850 decision of *Salomons v Laing*,⁵¹ a railway company ('South Coast Railway') was permitted under its incorporating Act of Parliament, the primary constitutional document of a company created by private Act, to hold shares in another railway company, Portsmouth Railway. Nevertheless, South Coast Railway chose not to hold the shares itself. The 2,000 shares in Portsmouth Railway were held on trust for it by some of its directors. South Coast Railway was not authorised to subscribe for or purchase any further shares in Portsmouth Railway. Nevertheless, an additional 4,667 shares were subsequently acquired with the use of company funds.⁵² Again, these were held on trust for it by certain directors. A member of South Coast Railway pursued an action against the company and some of its directors alleging that the acquisition of the additional shares was ultra vires. Lord Langdale⁵³ agreed holding that a railway company was 'bound to apply all the monies and property of the company for the purposes directed and provided for by the [incorporating] Act, and for no other purpose whatever.'⁵⁴ Any application not 'distinctly authorised by the Act' was illegal.⁵⁵ Whilst this reasoning could be applied to any act unauthorised by the

⁵¹ (1850) 12 Beavan 339; 50 ER 1091.

⁵² The transaction was intended to inject capital into Portsmouth Railway to enable a line to be completed.

⁵³ Lord Langdale was credited with introducing ultra vires doctrine to the law of joint-stock companies in *Colman* (n 39) four years earlier: *Brice* (n 20) vi; H Rajak, 'Judicial Control: Corporations and the Decline of Ultra Vires' (1995) 26 *Cambrian L Rev* 9, 9. Lord Langdale had reasoned in *Colman* that, 'the powers which are given by an Act of Parliament...extend no farther 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.' *Colman* 14, 487 (emphasis added).

⁵⁴ *Salomons* (n 51) 352, 1097 (Lord Langdale MR).

⁵⁵ *ibid.* This approach was followed in a series of cases between 1850 and 1855 (*East Anglian Railways Company* (n 50) 891, 694; *Rushout* (n 36) 309, 1130; *Macgregor v The Official Manager of the Dover and Deal Railway and Cinque Ports, Thanet and Coast Junction Company* (1852) 18 *QB Reports* 618, 631-2; 118 ER 233, 238), and was deemed to be 'well-settled' doctrine by 1855: *Eastern Counties Railway Company v Hawkes* (1855) V House of Lords Cases 331, 348; 10 ER 928, 935.

constitution, he recognised the potentially severe financial implications associated with the power. He held that purchasing shares in addition to those provided for by the Act would increase the risks to which Parliament had 'permitted the shareholders to be exposed' and involve them in liabilities to which they had never consented.⁵⁶

The approach in *Salomons* was followed in *Maunsell v Midland Great Western (Ireland) Railway Company*⁵⁷ some thirteen years later. Certain members of the Midland Great Western (Ireland) Railway Company ('Midland') sought an injunction to prevent Midland and its directors from entering in to an agreement with another railway company. This included an obligation to subscribe for shares in it. Wood VC found this part of the agreement to be beyond the powers of the directors. He reasoned that it was ultra vires for a company incorporated by private Act to use corporate funds for any purpose which was not within the 'four corners' of the Act, even where it would be for its benefit.⁵⁸

There was further clarification as to how the courts would construct a company's constitution in *Joint Stock Discount Company v Brown*,⁵⁹ a decision delivered the year before *Barned's*. The objects clause in the memorandum of an incorporated company ('Joint Stock Discount') provided, inter alia, that it was established for the purpose of 'investing in' shares. The directors had agreed that the formation of a limited joint-stock bank, *Barned's Banking Company*, would be beneficial and that they would take 10,000 shares in it to hold as nominees for Joint Stock Discount.⁶⁰ Both companies later went into liquidation. The official liquidator of Joint Stock Discount pursued a claim against certain of its directors alleging that

⁵⁶ *Salomons* (n 51) 353; 1097 (Lord Langdale MR) (emphasis added).

⁵⁷ (1863) 71 ER 58.

⁵⁸ *ibid* 66.

⁵⁹ (1866-67) LR 3 Eq 139.

⁶⁰ It would emerge in subsequent litigation on the matter (see *Joint Stock Discount Company v Brown* (1869) LR 8 Eq 381, hereafter '*Brown II*') that the directors of Joint Stock Discount were connected with a large speculation in a venture in the United States. The investment in *Barned's Banking's* was intended, rather circuitously, to offer some relief from their financial difficulties. A scheme was devised to rectify the position but it depended upon *Barned's Banking* remaining solvent. Joint Stock Discount's investment in *Barned's Banking* was intended to demonstrate the latter's credibility and thereby induce investment in the troubled bank by the public.

the acquisition of the shares was ultra vires. Wood VC agreed,⁶¹ finding the directors liable to account for the funds of the company expended on the shares. He reasoned that the words 'investing in' could encompass 'buying shares for the purpose of selling them again, or for investment, or anything of that kind' but not 'buying shares for the purpose of enlarging the particular business which the company have to conduct.'⁶² Rather than making a temporary investment, the directors had made a permanent investment in assisting the bank. This was a 'totally different transaction' and so not permitted under the memorandum.⁶³

It is clear from these early cases that the doctrine of ultra vires was applied by the courts to govern two relationships, the first being the relationship between the state and the company itself. There was a clear awareness of the potential power of companies incorporated by private Act of Parliament. The doctrine, when used alongside the states' restrictive conferral of corporate privileges, afforded a means of controlling this.⁶⁴ It allowed courts to regulate the boundaries within which statutory companies were required by their constitution to operate. Importantly, powers conferred upon a statutory company by the state were perceived as being unique to that company.⁶⁵ Indeed, the particular purposes or objects specified by the incorporators were the states' 'motive or inducement' for granting the powers in the first place.⁶⁶ They were conferred to facilitate particular and predetermined public objectives which the state, not the company, had deemed to be desirable. They could, therefore, be seen as material terms of a unique and particular 'contract' between the state and the company,⁶⁷ one deemed to have been entered upon incorporation or upon privileges being conferred by letters patent. These terms were material in the sense that they were

⁶¹ An amended claim came before James VC in *Brown II* (n 59). He affirmed the reasoning of Wood VC in *Brown* on the question of ultra vires.

⁶² *Brown* (n 59) 151 (Wood VC) (emphasis added).

⁶³ *ibid* 148.

⁶⁴ Rajak, 'Foundations' (n 38) 233; Rajak, 'Judicial Control' (n 53) 29.

⁶⁵ Salomons (n 51) 353; 1097.

⁶⁶ *ibid* 352-3; 1097 (Lord Langdale MR) (emphasis added).

⁶⁷ Ireland, Grigg-Spall and Kelly utilise the phrase 'statutory contract' in respect of the relationship between the company and its members: Ireland, Grigg-Spall and Kelly (n 6) 160.

granted on the understanding that they would be utilised for these clearly articulated, pre-agreed purposes or to fulfil particular objects. Corporate funds were prohibited from being channelled to any other purpose or object, even where this would have been of financial benefit to the company. The company's departure from the stated purposes or objects could be seen as a unilateral alteration of the contract, turning it into one to which the state may not have agreed ex ante.

A statutory company's activities could have a significant impact on society. This afforded another reason for the court's firm application of ultra vires doctrine. In *The East Anglian Railways Co v The Eastern Counties Railway Co*, Jervis CJ found that the safety of railway lines could be 'seriously impaired' if funds 'necessary, and destined by parliament for the maintenance of the railway' were spent on other activities, 'not contemplated when the act was obtained, and not expressly sanctioned by the legislature.'⁶⁸ There was, thus, genuine concern as to the public's safety if there was underinvestment in line maintenance, something that was a real risk if funds could be applied to invest and speculate in shares. Corporate funds were only to be used for the purposes intended by the state.

The doctrine was also invoked to govern the relationship between the company and its members, present and future. In this manner, it was used to afford legal protection to the share as a form of tradeable property.⁶⁹ It did so in two key ways, each of which offered indirect protection to the company's investors and society more broadly.⁷⁰ First, invocation of the doctrine enabled the private rights of investors to be protected.⁷¹ A company's profits were, unless needed for further investment in the company, seen as belonging to its members.⁷² A member's stake in this profit could not be distributed without their consent.⁷³ Whilst members may be deemed to have given their implied consent to actions authorised

⁶⁸ (1851) 11 CB 775, 812; 138 ER 680, 695.

⁶⁹ Ireland et al (n 6) 160; Paddy Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62 MLR 32, 42.

⁷⁰ Rajak, 'Judicial Control' (n 53) 17.

⁷¹ Colman (n 39) 14; 487.

⁷² Salomons (n 51) 352; 1097 (Lord Langdale MR).

⁷³ *ibid.*

by the company's constitution upon their purchase of its shares, they were not deemed to have consented to actions falling outside those authorised by the constitution. Thus, where company funds were used to acquire shares in another company when this was not authorised by the constitution it deprived members of their full stake in the profits without their consent. There was also the view that investors had a 'right' to have their money applied to the purpose or purposes specified by the incorporating Act.⁷⁴ If an investor's decision to purchase a company's shares was based on its specified, published purposes then departure from them could be seen as frustrating the investor's legitimate expectations. Again, the idea of 'contract' comes to light.⁷⁵ This time it was between the company and its members, with the purposes and objects comprising its material terms.

Secondly, and highly significantly for the purposes of this article, the courts also invoked ultra vires doctrine to render shares a safer outlet for investors. Shares could be bought and sold with ease by the experienced and inexperienced alike. In *Colman and Salomons*, it was clear that Lord Langdale was acutely aware that certain financial risks went hand-in-hand with this. There was the potential for 'extraordinary losses' to be imposed upon members if the company in which the shares were held became insolvent.⁷⁶ Whilst members of incorporated companies, whether by private Act of Parliament or by registration under the Acts of 1855 and 1856, may have benefited from the statutory conferral of limited liability, share values were often high with a large amount uncalled on them.⁷⁷ The latter trait meant that limited liability 'was not immediately effective' in the early limited companies.⁷⁸ Some members invested their entire capital in the initial amount to be paid up and 'would have little

⁷⁴ *Bagshaw v The Eastern Union Railway Company* (1850) 2 Macnaghten & Gordon 389, 400; 42 ER 151, 155.

⁷⁵ Paul Omar, 'Powers, Purposes and Objects: The Protracted Demise of the Ultra Vires Rule' (2004) 16 *Bond Law Review* 1 93, 93; Ireland et al (n 6) 160.

⁷⁶ *Colman* (n 39) 18; 489 (Lord Langdale MR).

⁷⁷ Jefferys found that of the 3,720 companies formed between 1856 and 1865 inclusive, only 16% had shares below £5 in value and 52% had shares from £10 up to £100. Moreover, it was not until the 1880's and that the 'trend towards the small fully paid up share' was established: Jefferys (n 11) 45-46 and 54.

⁷⁸ Geoffrey Todd, 'Some Aspects of Joint Stock Companies, 1844-1900' (1932) 44 *EHR* 1 46, 68-69.

or no reserve' from which to meet any future call on the shares.⁷⁹ The insolvency of the company, and the subsequent call on amounts unpaid on its shares could, and often did, bankrupt its members.⁸⁰ The courts recognised that investing in shares was not a risk-free activity and could result in a member's financial ruin. But, this was a risk to which the state was deemed to have permitted members to be exposed.⁸¹ This may be inferred quite clearly from the enactment of legislation imposing personal liability upon members.

The courts did, however, seek to reduce the prospect of additional risk being imposed upon members after the purchase of their shares, such as where directors exceeded their powers by using company funds to purchase another company's shares. For Lord Langdale in *Colman*, it was in the public interest to 'defend' investors 'from all liabilities beyond those necessarily occasioned by the powers given by the...[incorporating] Acts'.⁸² A company's constitution was a publicly-available document. Its members were deemed to have had full knowledge of its contents,⁸³ and accepted the risks associated with actions authorised by it when they purchased its shares. So, where the constitution of a company (X) explicitly permitted the directors to acquire the shares of another company (Y), X's members were taken to have had notice of this and accepted the associated risks. The position was very different where the transaction was not authorised by the constitution and the courts would provide a remedy here.

This desire to protect members from additional financial risk was seen clearly in *Brown*. That 'investing in' shares was viewed as an entirely different transaction to the purchase of shares so as to enlarge a business suggested that memorandums would be interpreted in a highly literal manner. However, the decision did not prohibit corporate membership, even where the shares were sought to enlarge a business. It merely required

⁷⁹ *ibid.*

⁸⁰ *Harris* (n 13) 358; *Lipton* (n 6) 461-462.

⁸¹ *Salomons* (n 51) 352; 1097 (Lord Langdale MR).

⁸² *Colman* (n 39) 14; 487 (Lord Langdale MR) (emphasis added).

⁸³ *Macgregor* (n 55) 631-2; 238.

that the power, and any limitation of it, be set out in the memorandum with absolute clarity as to its scope if it was to be unchallengeable. With an enlarged business came the prospect of enlarged liabilities for its members. If the memorandum was vague or imprecise as to the breadth of a power, a conservative construction which prohibited the transaction certainly fitted with the manner in which the courts had approached the power since *Salomons*: to protect members from the financial risk over and above that intrinsic to the market for shares. Even arguments that the success of the company would be furthered through the acquisition of the shares in question would not permit the strict wording of the constitution to be overridden.⁸⁴

2. The Decisions in *Barned's* and *Asiatic Banking*

Significantly and somewhat surprisingly given that the indirect ownership of shares by companies had long accepted by the courts by 1867, *Barned's* marked the first instance under English law in which the lawfulness of corporate membership was formally contested. An incorporated company, The Contract Corporation Limited ('Contract Corporation'), sought to assist a traditional partnership to convert to a joint-stock company and agreed to apply for shares in it. This was, *prima facie*, permitted under Contract Corporation's constitution.⁸⁵ Nevertheless, the shares in the new company, *Barned's* Banking Company,⁸⁶ were held on trust for Contract Corporation in the names of some of its directors. One of the directors then sought to transfer the shares which he held to Contract Corporation. After the deed of transfer for the shares had been submitted for registration, but had not yet been registered,

⁸⁴ Maunsell (n 41).

⁸⁵ Its memorandum stated that one of the company's objects was: 'To purchase or accept any...shares in any foreign or English company, and to negotiate the sale of any such securities' (emphasis added).

⁸⁶ This was the same bank to which the cases *Brown* and *Brown II* were concerned: see *supra*, nn 59-63 and accompanying text. *Joint Stock Discount* and *Contract Corporation* may be linked by the fact that they were represented by the same solicitor, Mr Rixon, who also sat on the board of directors of both companies. Mr Rixon was a chief advisor to *Contract Corporation* and advised *Joint Stock Discount* to engage in the scheme to 'prop up' the troubled bank, *Barned's* Banking: see *supra*, n 60.

Contract Corporation entered into winding-up proceedings. Barned's Banking also entered into winding-up proceedings. The official liquidator of Contract Corporation appealed against an earlier decision placing Contract Corporation on the list of contributories to Barned's Banking in respect of the director's shares, the incentive being to preserve funds in the estate of the insolvent company for the benefit of its creditors.

The Court of Appeal affirmed the earlier decision holding Contract Corporation liable as a contributory. For the purposes of this article, two findings of the court are of particular relevance. Firstly, a company could be a member of another company if authorised by its memorandum and articles.⁸⁷ Whilst Cairns LJ did not proffer any reasoning in respect of this position nor provide authority for it, the decision delivered the year before in *Brown* did offer some support for it.⁸⁸ Though in that case, as we have seen, the phrase 'investing in' in the objects clause of the memorandum was construed strictly so as to render the acquisition of a controlling interest in another company ultra vires. Secondly, a limited company was a 'person' for the purposes of the 1862 Act and so was capable of being a 'member' of another limited company. This was, perhaps, the most significant aspect of the decision for it precluded any argument that corporate membership was, in fact, unlawful and so prohibited under the Act. Had such an argument been accepted then the constitution's authorisation of corporate membership would have been irrelevant. The share purchase would have been invalid, entitling Contract Corporation to repudiate the contract. Taken together, the power of corporate membership was now available as of right to all companies registered under the Act provided that their constitution was permissive.

In addressing the argument of counsel for the official liquidator that under the 1862 Act one company could not become a member of another company, Cairns LJ held that,⁸⁹

⁸⁷ *Barned's* (n 9) 112. The constitution of a company incorporated under the 1862 Act comprised two documents: a memorandum of association and articles of association. Whilst the former document defined limitations on the company's powers, the latter set out its internal regulations and how they could be changed.

⁸⁸ Cairns LJ, or Sir Hugh Cairns QC as he then was, was counsel for the plaintiffs in *Maunsell*. As we have seen in Section B, he argued successfully that the entering into of the obligation to subscribe for shares in the other company was ultra vires.

⁸⁹ *Barned's* (n 9) 113 (emphasis added).

if that argument is to prevail, it must be upon the words of the Act of Parliament of 1862, because there is no apparent or prima facie objection to a corporation so joining with another corporation in trade. A trading corporation, as we all well know, may enter into trade or partnership along with an individual. There is no reason at common law, so far as I know, why one corporate body should not become a member of another corporate body.

Cairns LJ adopted three main lines of reasoning in arriving at his assertion that it was 'entirely warranted' upon the proper construction of the 1862 Act for a corporate body to be a member.⁹⁰ Firstly, he considered the lawfulness of corporate membership under what was deemed to be analogous legislation. He noted that the Chartered Companies Act 1837⁹¹ (the '1837 Act'), the Joint Stock Companies Registration, Incorporation and Regulation Act 1844 (the '1844 Act'),⁹² the Companies Clauses Consolidation Act 1845⁹³ (the '1845 Act') and the Winding-Up Act 1848 (the '1848 Act'),⁹⁴ all provided that companies could be members of other companies.⁹⁵ Upon inspection, the 1837 Act was silent as to the capacity of corporate bodies to be members of companies upon whom privileges could be granted under the Act. It neither defined 'Person', 'Shareholder' nor 'Member'. It merely referred indirectly to the capacity of 'Bodies Politic' to be members of such companies.⁹⁶ Cairns LJ did, however, find quite correctly that the interpretation clauses of the 1844,⁹⁷ 1845⁹⁸ and 1848⁹⁹ Acts explicitly

⁹⁰ *ibid* 115 (Cairns LJ).

⁹¹ 7 Will 4 & 1 Vict c 73.

⁹² 7 & 8 Vict c 110.

⁹³ 8 & 9 Vict c 16.

⁹⁴ 11 & 12 Vict c 45.

⁹⁵ Indeed, a similar observation was made by Lindley: '[i]t has been assumed by the legislature, in many of the statutes relating to companies, that corporations may lawfully be shareholders': Lindley, 1860 Treatise (n 33) 119 [78]. Only the 1837 and 1844 Acts were cited as authority for his assertion.

⁹⁶ See e.g. sections 6 and 10 of the 1837 Act.

⁹⁷ Section 3 provided that 'Shareholder' was to mean 'any Person entitled to a Share in a Company, and who has executed the Deed of Settlement, or a deed referring to it'. The section also provided that 'Person' was 'to apply to Bodies Politic or Corporate, whether sole or aggregated.'

provided that the term 'Person' in each Act should include corporate bodies, whether sole or aggregate. Indeed, each went so far as to define the term 'Person' within the context of the term 'Shareholder' or 'Member'. Whilst he did point to legislation which acknowledged the prospect of corporate membership, he did not refer to other highly relevant companies' legislation, namely the 1855 and 1856 Acts, which did not.¹⁰⁰

Secondly, he examined the text of the 1862 Act itself for explicit references to the lawfulness of corporate membership. He noted that, contrary to the companies' legislation noted previously, there was no interpretation clause in the 1862 Act to clarify whether either subscribers to the memorandum or subsequent members could include a corporate body. The definition of 'Members' in section 23 of the 1862 Act merely stated that,¹⁰¹

The subscribers of the Memorandum of Association of any company under this Act shall be deemed to have agreed to become members of the company whose Memorandum they have subscribed, and upon the registration of the company shall be entered as members on the register of members hereinafter mentioned; and every other person who has agreed to become a member of a company under this Act, and whose name is entered on the register of members shall be deemed to be a member of the company.

⁹⁸ Section 3 provided that 'Shareholder' was to mean 'Shareholder, Proprietor, or Member of the Company; and in referring to any such Shareholder Expressions properly applicable to a Person shall be held to apply to a Corporation.'

⁹⁹ Section 3 provided that 'Member' was to mean 'any Person entitled to a Share of the Assets or accruing Profits of any such Company [a Partnership, Association, Company, corporate or unincorporate] at the Time of presenting the Petition for dissolving the same or winding up the Affairs thereof under this Act.' The section also provided that 'Person' 'shall include Corporations'.

¹⁰⁰ See *infra*, section C2.

¹⁰¹ This is markedly similar to its modern equivalent under the Companies Act 2006: 'The subscribers of a company's memorandum are deemed to have agreed to become members of the company, and on its registration become members and must be entered as such in its register of members': CA 2006, s 112(1). 'Every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company': CA 2006, s 112(2).

He acknowledged that the words of the 1862 Act 'appear[ed] throughout to point to persons...as if the shareholders were all to be persons in their natural capacity.'¹⁰² Whilst this finding seemed fatal to the argument that corporate membership was compatible with the text of the Act, he contended that there were 'traces' that the terms shareholder and persons, 'must have been intended to be used in a larger sense.'¹⁰³ For example, he referred to the 49th clause of Table A of the 1862 Act. This was a provision requiring that an instrument appointing a proxy was to be in writing and signed by the appointor 'or if such appointor is a corporation, under their common seal.' Thus, he reasoned that if an appointor could be a company, then a company could be a member.

Finally, Cairns LJ used deductive reasoning, based on the implications of certain provisions of the Act. He noted that the 1862 Act was an 'Act amending and consolidating the whole of the prior laws with regard to joint stock companies'.¹⁰⁴ Under sections 180 to 200 of the Act, companies formed under the 1837 and 1844 Acts could be registered under the 1862 Act, and thereby subject to its provisions. Thus, a company which could become registered under the 1862 Act might be a company entitled to have corporate bodies amongst its members.¹⁰⁵ He concluded that if the general words used in these sections were to be read as comprising corporate members there was no reason why the same words should not be read in the same way in the rest of the 1862 Act.¹⁰⁶

A similarly expansive construction of the 1862 Act was adopted in *Asiatic Banking* one year later. A company, The Royal Bank of India, was formed in 1863 under an Indian Act of 1857 which was almost identical to the 1856 Act. It had taken security over 1,000 shares in the Asiatic Banking Corporation ('Asiatic Banking') in respect of money lent to the

¹⁰² *Barned's* (n 9) 113 (Cairns LJ) (emphasis added).

¹⁰³ *ibid.*

¹⁰⁴ *ibid* 114.

¹⁰⁵ *ibid.*

¹⁰⁶ *ibid* 115.

latter. These were later registered in the Royal Bank of India's name by the directors.¹⁰⁷ Asiatic Banking was subsequently wound-up. The Royal Bank of India was placed on the list of its contributories and sought to be removed from it.

The court held that the Royal Bank of India and its directors were empowered to register the shares and that it was rightly included on the list. To deal first with the question of the lawfulness of corporate membership, Selwyn LJ 'entirely agreed' with the judgment of Cairns LJ in *Barned's* that 'there [was] not, either by the common or statute law, anything to prohibit one trading corporation from taking or accepting shares in another trading corporation.'¹⁰⁸ He held that,¹⁰⁹

although in the statute of 1862 the words "person or persons" continually occur, still I think it must be taken to include corporations, and looking at the question as a mere abstract question, in my judgment there is nothing to prevent a corporation from being a shareholder in another trading corporation.

Having resolved that corporate membership was lawful under the 1862 Act, Selwyn LJ deemed the manner in which the bank came to own shares to be entirely within its scope and objects and, indeed, within the scope of every ordinary banking business.¹¹⁰ Two activities were, however, highlighted as ultra vires, one being specific to the bank and the other directed at banks generally. Firstly, the bank did not possess a general capacity to 'speculate' in shares by purchasing them, for example, on the Stock Exchange.¹¹¹ Secondly, no bank was authorised to 'become a partner with merchants, or shipowners, or builders, or

¹⁰⁷ Registration of the shares, as opposed to merely taking security in respect of them, was deemed to be the appropriate course of action by the bank. It followed an opinion of an Indian court that in the latter circumstance the shares remained the borrower's property, with the bank being mere equitable mortgagees in respect of them.

¹⁰⁸ Asiatic Banking (n 10) 257 (Selwyn LJ).

¹⁰⁹ *ibid* (emphasis added).

¹¹⁰ *ibid* 263.

¹¹¹ *ibid* 262-3 (Giffard LJ).

to engage in transactions of that sort'.¹¹² They were, however, authorised to lend upon the basis of security being taken over the shares of such businesses and, if deemed necessary, register them in its name.¹¹³

Leaving consideration of the treatment of a limited company as a 'person' for the purposes of the 1862 Act until the following section, the remainder of this section will examine the use of ultra vires doctrine by the court in *Barned's* and *Asiatic Banking*. It was not the case that the doctrine played a less important role in these cases than it did in the pre-*Barned's* jurisprudence, it was just that its emphasis was different. It was not used to govern the relationship between the state and individual companies, a key theme of the earlier jurisprudence. A consequence of *Barned's* and *Asiatic Banking* was that incorporators of a company registered under the 1862 Act enjoyed the autonomy to determine whether it was to possess the power of corporate membership and whether any limitations were to be placed on it. This facilitated a substantial shift in power from the state to incorporators to determine how the company's relationship with other companies was to be structured. The state was no longer 'gate-keeper' to the power as it was in the case of statutory companies. This transition chimes with a similar movement with regards the conferral of limited liability under the 1855 and 1856 Acts.¹¹⁴ The decisions in *Barned's* and *Asiatic Banking*, thus, replicated the same capacity for contractual freedom in respect to the drafting of the constitution which had, traditionally, been accorded to unincorporated companies.¹¹⁵ But,

¹¹² *ibid* 263 (Giffard LJ) (emphasis added).

¹¹³ *ibid*.

¹¹⁴ Colin Mackie, 'From Privilege to Right: Themes in the Emergence of Limited Liability' (2011) *Juridical Review* 4 293.

¹¹⁵ In England and Scotland, members of an unincorporated company were personally liable for its debts (Lindley, 1860 *Treatise* (n 33) [300] and Francis William Clark, *A Treatise on the Law of Partnership and Joint-Stock Companies According to the Law of Scotland* (T & T Clark 1866) 285). It was, however, common for promoters to insert clauses into the deed of settlement limiting a member's liability to any amount outstanding on their shares: see Section D. Thus, the promoters achieved through contract what incorporators of limited companies achieved through incorporation.

this was accomplished within the confines of a legal framework which resolved many of problems associated with regulating that particular form of company.¹¹⁶

The power of corporate membership had moved closer to being available as of right. But, importantly, it was not a right in the true sense of the word. For the right to be available, the objects or purpose clause must have authorised the particular transaction in question. A company incorporated under the 1862 Act could not alter the conditions contained in its memorandum, such as the objects or purposes for which it was created.¹¹⁷ This point was made explicitly clear in the 1874 decision of the House of Lords in *Ashbury Railway Carriage and Iron Company (Ltd) v Riche*.¹¹⁸ So, if the memorandum was not permissive of corporate membership then it could not, subsequently, be amended so as to render it within the vires of the company.¹¹⁹ A new company, with a memorandum permissive of the desired transaction, had to be created if the right of corporate membership was to be available.¹²⁰

An important theme emerging from the decisions in *Barned's* and *Asiatic Banking* was that companies and, where relevant, their members were responsible for obligations arising from intra vires actions. It was present in *Barned's* but stronger in *Asiatic Banking*. Indeed, explicit consideration of ultra vires doctrine in the former was brief, with Cairns LJ providing no authority to evidence his assertion that corporate membership was permissible where authorised by the constitution of a company incorporated by registration. Nevertheless, this finding meant that a company which possessed the power to take shares in another company and did in fact do so, whether directly or indirectly, could not later

¹¹⁶ For instance, an unincorporated company's lack of corporate personality made it very difficult for it to be sued on contracts since all the partners had to be joined on the writ: David Perrot, 'Changes in Attitude to Limited Liability – the European Experience' in Tony Orhnia (ed), *Limited Liability and the Corporation* (Croom Helm 1982) 98.

¹¹⁷ CA 1862, s 12; *Ashbury* (n 50) 670.

¹¹⁸ (1874-75) LR 7 HL 653.

¹¹⁹ *ibid* 671.

¹²⁰ The application of the doctrine was, however, softened somewhat in the 1880 decision of *AG v Great Eastern Railway Company* (1880) 5 App Cas 473. The doctrine was to be applied reasonably so 'things [which] may fairly be regarded as incidental to, or consequential upon...' that which the constitution authorised were to be treated as intra vires unless expressly prohibited: *ibid* 478.

contend that their acquisition was ultra vires. Acceptance of such an argument would have enabled the underlying contract for the shares to be repudiated and the corporate member's liability to contribute to the company's assets disclaimed. The decisions, thus, cemented conceptions of morality, justice, business reality and responsibility in the context of corporate membership. These underpinned both judgements. In the final paragraph of his judgement in *Barned's*, Cairns LJ held that the 'legal obligation of the case coincides with the moral obligation, and that those who are the real owners of these shares will be the persons to bear the responsibility for them.'¹²¹ Whilst in *Asiatic Banking*, the final line of Giffard LJ's judgement stated the following: 'I must say the justice of the case is entirely in this instance with what the law most clearly is.'¹²² The court was clearly uncomfortable with the idea that the bank and, in turn, its members could benefit financially from holding shares in other companies yet deny responsibility for resulting burdens by contending that this was, in fact, ultra vires. Selwyn LJ did acknowledge that his decision to permit corporate membership would result in 'very great hardship' for the bank's members as they would be exposed to a liability attaching to a company, or indeed companies, to which they had nothing to do.¹²³ However, this was deemed to be a risk inherent in lending money against shares, a core activity of the bank. The members had to accept both the 'benefits' and 'dangers' associated with the bank's core commercial activities.¹²⁴

Where the constitution of a company (X) permitted the shares of another company (Y) to be acquired, then this would expose X's members to a greater degree of financial risk than would be the case if the right had not existed. Prior to X's acquisition of Y's shares, X's members need only have been concerned with how well X was trading. Post-acquisition, they had to monitor both companies for the insolvency of either could have financial implications for them. But, exposure of a company's members to liability to account for

¹²¹ *Barned's* (n 9) 118 (emphasis added).

¹²² *Asiatic Banking* (n 10) 263 (emphasis added).

¹²³ *ibid* 260.

¹²⁴ *ibid* 260-261 (Selwyn LJ).

amounts unpaid on their shares, even if the sum was substantial, was an indirect but intended consequence of the manner in which ultra vires doctrine was applied in both cases. Where the acquisition of Y's shares fell squarely within X's powers then X's members were required to bear financial responsibility for any amount unpaid on their shares should Y become insolvent with outstanding debts. If the prospect of the financial ruin of X's members was permitted to alter this stance then this would unfairly prejudice Y and its other members.

The potentially harsh financial consequences for investors emphasised the importance of the relationship between ultra vires doctrine and notice. In *Asiatic Banking*, the court made clear that the taking of security over shares, and their subsequent registration in the name of the holder, was a very different activity to investment in shares, whether active or passive. A distinction was being drawn between transactions which not only reinforced but furthered the bank's core commercial activity and those which permeated beyond this. Activities which fell within the latter category, such as speculative investment on the Stock Exchange, required absolute clarity in the constitution as to whether it was intended that such powers be available to the bank's directors. With clarity came effective notice. The court would only permit members to bear the financial risk associated with the types of transactions to which they were deemed to have had notice of, and thereby impliedly consented to. Whilst in *Barned's*, the memorandum was explicitly clear that Contract Corporation could purchase the shares of 'any' company, foreign or domestic. A potential investor could have familiarised themselves with this publicly-available document and made an informed decision ex ante as to the prudence of acquiring shares in Contract Corporation. Whilst harsh, the courts could not insulate a member from the consequences of their failure to do so. These would lay with the investor for they were deemed to have constructive notice of the constitution prior to their acquisition of the shares.¹²⁵

It could be argued that the members of Contract Corporation and *Asiatic Banking* were not dealt with in the same sympathetic and paternalistic manner as those in *Colman*

¹²⁵ *Royal British Bank v Turquand* (1855) 5 E & B 248; (1856) 6 E & B 327.

and Salomons. However, these early cases only sought to reduce the additional risk to which members were exposed through attempts by the directors to exceed the powers conferred by the constitution; the risk associated with investing in shares remained with the investor. *Barned's* and *Asiatic Banking* affirmed that company funds could only be used to acquire shares in another company if this was authorised by the constitution. Ultra vires doctrine was still readily available to aggrieved members or, in situations of insolvency, a liquidator to prevent a company's funds from being utilised in this way when the constitution did not confer this power.

Asiatic Banking is of further significance for it acknowledged a wider role for ultra vires doctrine than it had traditionally played. This was protecting those who dealt, or may deal, with a bank, a role referred to explicitly in the context of a company and its trade creditors in the later decision in *Ashbury*.¹²⁶ Persons who deposited their funds with a bank were one category of persons who could be considered to have dealt with it. Ultra vires doctrine offered them a degree of protection, both prior to, and after, doing so. In the case of the former, as with potential investors and trade creditors, depositors could, if they so desired, access and investigate the objects and purposes for which a given bank had been created. This enabled them to make an informed decision as to whether the risk associated with its objects or purposes rendered it a bank which should be avoided.¹²⁷

The role played by ultra vires doctrine in protecting depositors after their funds were placed with a bank derives from the assertion in *Asiatic Banking* that no bank possessed the power (i.e. vires) to acquire a controlling interest in a trading company. Such a restriction of power was, of course, not placed on such companies themselves. One explanation for the court's approach derives from the fact that these transactions could have placed the funds of the bank's depositors at risk if a company in which the bank held shares subsequently entered into insolvency with unpaid debts. By restricting a bank to share acquisitions which

¹²⁶ *Ashbury* (n 118) 684.

¹²⁷ Griffin makes this observation in the context of the trade creditors of a company. See Stephen Griffin, 'The Rise and Fall of the Ultra Vires Rule in Corporate Law' (1998) 2 *Mountbatten Journal of Legal Studies* 15, 8.

furthered its core activity, i.e. registering shares in its own name as security for funds advanced, then the sums placed by depositors would benefit from a higher degree of protection. Asiatic Banking did, however, drive home the fact that the registration of shares as security could still entail significant financial risk for a bank and its members.

To conclude this section, in order to explain accurately the legal factors that shaped the emergence of the right of corporate membership in early UK company law, the differing yet complementary roles played by public and private ordering must be acknowledged. The importance of doing so has been emphasised in recent literature in the field of legal institutionalism. The claim made there that conceptualising law as either public or private ordering is 'mistaken' certainly holds true in the case of the lawfulness, or otherwise, of corporate membership in a given instance.¹²⁸ It is clear from the above discussion that legal institutions – the legislature and the courts – created the 'space' for the right of corporate membership to emerge by finding that a company could be a 'member' for the purposes of the 1862 Act. Equally clear, however, is the fact that it was the incorporators of companies registered under the Act who actually brought this right into existence, who filled this space. They did so by drafting the constitution in a manner which enabled the company to hold, acquire, purchase, invest or speculate in the shares of another company if this was desired. Members were taken to have had notice of, and consented to, the contents of a company's constitution, thus, forming something of a quasi-contract with the company when they purchased its shares.¹²⁹

¹²⁸ Simon Deakin, David Gindis, Geoffrey M Hodgson, Kainan Huang and Katharina Pisto, 'Legal Institutionalism: Capitalism and the Constitutive Role of Law' (2016) *Journal of Comparative Economics* (advance online access: doi:10.1016/j.jce.2016.04.005).

¹²⁹ The 1862 Act specifically acknowledged the contractual nature of the articles: 'When registered,...[the articles of association]...shall bind the company and the members to the same extent as if each member had subscribed his name and affixed his seal thereto, and there were in such Articles contained a covenant on the part of himself, his heirs, executors, and administrators, to conform to all regulations contained in such articles...': 1862 Act, s 16. The memorandum, it has been contended, possessed a similarly quasi-contractual character, with the objects and purposes clauses forming what were akin to material terms of a contract between the company and its members. These clauses would, as we have seen, typically specify whether the shares of another company could be taken.

Through public ordering, the state empowered incorporators to contract for the right of corporate membership by rendering this particular form of private ordering lawful. So, the role of legal institutions in the emergence of the right and, in turn, the emergence of the corporate group, should not be downplayed. However, private ordering through the terms of the constitutional 'contract' was essential to enable a given company to take shares in another. Strictly speaking, the right was conceived by the incorporators themselves rather than conferred as such by the state. This fact has, to date, been overlooked in the literature.

C. COMPANIES AS 'MEMBERS' UNDER THE 1862 ACT

This section will analyse the reasoning in *Barned's* and *Asiatic Banking* in respect of the finding that a limited company was a 'person' for the purposes of the 1862 Act and so capable of being a 'member' of another limited company. It will consider whether the conferral of limited liability to corporate members was an intended consequence.

In many ways, the decision that a limited company could be a 'member' for the purposes of the 1862 Act may be deemed unsurprising. It may be seen as a logical and necessary consequence of the parallel decision that a company could be a member of another company if authorised by its constitution. Moreover, as we saw in section B, the practice of companies acquiring shares in other companies through the use of trustees was common throughout the 1850s and 1860s. The lawfulness of doing so had not previously been challenged by or before the courts and so the judiciary could be seen as having given their tacit approval to the practice. Therefore, it could be considered unlikely, though not inconceivable, that the courts would find corporate membership incompatible with the 1862 Act (i.e. that a company could not be a 'member' for the purposes of the Act). So, it was not a case of the courts going 'off the rails' as such in arriving at their respective decisions.

However, issue may be taken with the manner in which both courts approached the legal question at hand and the repercussions of this for contemporary company law. The argument developed in this section connects closely with that developed in the latter stages

of the previous section.¹³⁰ It is submitted that the desire to ensure that Contract Corporation and The Royal Bank of India bore legal responsibility for the shares in question led both courts to approach the legal question as to whether a limited company could be a 'member' for the purposes of Act in a somewhat instrumental manner. The facilitative approach of the courts certainly remedied the injustice that would have arisen if either company had been permitted to avoid the obligations associated with the shares as a consequence of corporate membership having been found to be unlawful. However, it resulted in their failure to consider the wider implications of allowing limited companies to be 'members' of other limited companies. This was absent entirely from the judgements. Notable omissions were, of course, the potential for limited liability to be accorded to a corporate member and capacity to create tiers of companies within an enterprise. That these issues were neither acknowledged nor considered is of immense significance for contemporary company law. They lie at the very heart of many of the problems associated with the regulation of modern corporate groups yet were seemingly inadvertent consequences of the decisions upon which it has been presumed that their origin may be traced. Consideration of the wider implications of corporate membership would have better informed the courts assessment of the question as to whether it should, in fact, have been lawful under the Act and so capable of being within the vires of a company incorporated by registration.

Instrumentality may be inferred from two aspects of the judgements, both of which will now be considered: firstly, the analogy drawn with partnerships; and, secondly, the manner in which the 1862 Act was constructed. The points raised here also indicate that the legal arguments advanced to support the lawfulness of corporate membership under the Act were not as incontrovertible as the judgements in either decision would suggest.

¹³⁰ See text accompany nn 121-4.

1. A Troublesome Analogy

In both *Barned's* and *Asiatic Banking* the courts appeared to view the relationship created by corporate membership as mirroring, or at least largely similar to, that created when a partnership was entered into. That Cairns LJ saw these relationships as analogous may be inferred from his reasoning.¹³¹ Firstly, he viewed the taking of one company's shares by another company as akin to their 'joining' together in trade.¹³² Secondly, he was of the opinion that as a company could enter into 'trade or partnership' with an individual there was no reason why a company should not be able to do so with another company.¹³³ Whilst in *Asiatic Banking*, Giffard LJ reasoned that a bank was not authorised to 'become a partner' with a company by purchasing shares in it.¹³⁴

At an abstract level, a company was just another investor who could contribute much needed capital to a commercial venture in return for a dividend. The desire to facilitate entrepreneurship and investment was a key reason for the general conferral of another important corporate right, that of statutory limited liability under the 1855 and 1856 Acts. During the Parliamentary debates on the Limited Liability Bill in 1855, there was a belief that the absence of limited liability was distorting market forces and that its conferral to members of companies registered under the ensuing Act would mobilise the more efficient circulation of capital in the economy.¹³⁵ For Edward Pleydell-Bouverie, then Vice-president of the Board of Trade, 'as legislators [they] ought not to place any dam across the channels in which capital was disposed to run.'¹³⁶ A similar argument could be deployed in respect of corporate membership. Failing to permit it could also function as a dam, blocking the flow of capital in an economy. Upon this view, it was not something that should be discouraged.

¹³¹ The relevant section of this reasoning is quoted in full at supra n 89 and accompanying text.

¹³² *Barned's* (n 9) 113.

¹³³ *ibid.*

¹³⁴ *Asiatic Banking* (n 10) 263.

¹³⁵ Mackie (n 114) 308.

¹³⁶ HC Deb 29 June 1855, vol 139, col 329.

In addressing the question of the lawfulness of corporate membership under the 1862 Act, the courts were being required to deal with new models of business. The tried and tested principles of partnership provided a firm footing for them. These had underpinned the logic behind, and the drafting of, the Acts of 1855¹³⁷ and 1856,¹³⁸ two important predecessors to the 1862 Act. The requirement for seven or more persons to come together to incorporate a company under the 1862 Act also chimes with idea of partnership. The court's reliance on partnership principles could, therefore, be seen as entirely natural and, perhaps, offered stability and continuity at a time of dramatic transition between old and new models of business.

The invocation of partnership principles is not evidence of instrumentality in itself. It does, however, demonstrate the application of long established and accepted ideas to the legal question at hand. This rendered the outcome more likely to side with the compatibility of corporate membership with the 1862 Act than would have been the case if more negative connotations had been attributed to the holding or acquisition of shares by a limited company. This could have included, for example, the potential for monopolies to develop within a given industry or the prospect of one limited company gaining control of a competitor so as to harm its business. These types of issues did come to the fore in the United States in the late nineteenth and early twentieth century leading some courts there to conclude that corporate membership was contrary to public policy and unlawful.¹³⁹ In the UK jurisprudence, there appeared to be no recognition of the potential downsides to corporate membership.

¹³⁷ The requirement for twenty-five shareholders under the 1855 Act appears to have been taken from the 1844 Act's definition of a large partnership: Michael Lobban, 'Corporate Identity and Limited Liability in France and England 1825-67' (1996) 25 *Anglo-Am L Rev* 397, 428 citing a letter from Lord Denman to *The Times*, August 18, 1855.

¹³⁸ The 1856 Act enabled all partnerships or associations consisting of more than six, and less than twenty members, to obtain limited liability for their members provided that certain conditions were satisfied.

¹³⁹ *Pearson v Railroad Co.*, 62 NH 537 (1883, SC NH) at 551; *De la Vergne Refrigerating Machine Co v German Savings Institution* 175 US 40 (1899) at 48; *Somners v Apalachicola Northern Railroad Co.*, 75 Fla 159, 78 So 25 (1918, SC Fla) at 219, 43; *Buckeye Marble & Freestone Co. v. Harvey*, 92 Tenn. 115, 20 S.W. 427, 18 L. R. A. 252, 36 Am. St. Rep. 71

The application of partnership principles to the legal question at hand also masked crucial differences between corporate members and partners. This may explain why the wider implications of corporate membership were not foreseen at this formative stage. Firstly, there were differences in the ‘accessibility’ of members and partners to actions by creditors. Viewed from the perspective of the two limited companies related by share ownership and engaged in a commercial venture, their relationship may have exhibited features similar to a partnership. Both may have worked together to generate and share profit, drawing together resources, human and financial. However, when viewed from the perspective of those external to the commercial venture, such as non-contractual creditors of the company in which the shares were held, the relationship was markedly different. This was particularly so with regards to the number of ‘targets’ that were available to them.

The joining together of two persons, legal or natural, in partnership may be seen to create a horizontal relationship for the purposes of attributing liability. Either partner could have been held jointly and severally liable for the debts of the partnership. The assets of both partners could, if the claimant had so wished, have been accessed.¹⁴⁰ Furthermore, in contrast to the members of a limited company, a partner with natural legal personality would not have benefited from limited liability and so could be held personally liable for the full extent of the debts of the partnership.¹⁴¹ Conversely, the taking of one limited company’s shares by another limited company may be seen to create a vertical relationship. Owing to the limited liability conferred upon the corporate member, they could not, generally, be held liable for the debts of the company in which the shares were held beyond any amount unpaid on their shares. Once fully paid-up, only the assets of the company in which the shares were held could be accessed. The number of ‘targets’ available to a claimant was, generally, reduced to one when corporate membership was permitted.

Secondly, there was, at least upon a contemporary perspective, a replication of protection afforded in the context of corporate membership which was not afforded in the

¹⁴⁰ Lindley, 1860 Treatise (n 33) [301].

¹⁴¹ *ibid.*

case of partnership. Where limited company (X Ltd) held shares in another limited company (Y Ltd), an individual who held shares in X Ltd benefited from two levels of protection. Under the first level, their own personal wealth was, in theory, protected against the insolvency of X Ltd by the limited liability conferred to them by statute. Under the second level, the assets of X Ltd were protected by the limited liability conferred to it by statute should Y Ltd become insolvent. In reality, the extent of the protection afforded at each level would depend upon the denomination of the shares and the amount, if any, left uncalled. Limited liability 'in fact' would not be available until the 1880s when the £1 share became common.¹⁴² Nevertheless, the replication of protection was not raised with individual members who only benefited from one level of limited liability. It may also be contrasted with the unlimited personal liability for partnership debts of partners with natural legal personality. This distinction was not drawn.

Finally, there was the prospect for corporate control made permissible by corporate membership which was not present in the case of partnerships. This concerned the prospect of one company gaining a controlling interest in another company through the acquisition of its shares. Whilst Cairns LJ rightly asserted that a limited company could enter into a partnership with an individual, what he does not acknowledge is that it could not control the actions of the individual in their role as a partner. In contrast, where one limited company was a member of another limited company it could restrict the autonomy of the former in general meeting. Under the 1862 Act, a minimum of seven members were required to incorporate a company with limited liability.¹⁴³ The 'one man' company would not, in effect, be rendered lawful until 1897 when the House of Lords in *Salomon* found that six of the members could be nominees of the seventh.¹⁴⁴ But, at the time of the decisions in *Barned's* and *Asiatic Banking* there was nothing to prevent a corporate member from being the dominant member in the requisite group of seven or more persons and utilising this power to enforce its desires in a manner similar to a 'one man' company.

¹⁴² Jefferys (n 11) 46.

¹⁴³ CA 1862, s 6.

¹⁴⁴ *Salomon* (n 16) 45.

2. A Matter of Construction

The perceived immorality and injustice which would have followed a finding that Contract Corporation's and Asiatic Banking's acquisition of the shares in question was unlawful appeared to influence the manner in which the 1862 Act was constructed. Cairns LJ's construction, an approach affirmed impliedly in *Asiatic Banking*, is indicative of instrumentality in three respects. These points also evidence the fact that it was neither intended by the originators of the Act nor foreseen by Cairns LJ in his construction of it that a limited company itself, and not just its individual members, could benefit from limited liability through its holding of shares in another limited company.

First, whilst Cairns LJ did point to legislation which explicitly acknowledged the prospect of corporate membership, he did not refer to other highly relevant companies' legislation, namely the 1855 and 1856 Acts, which did not. Neither defined the term 'Person' or 'Shareholder' nor were there any firm indications in either Act that corporate membership was foreseen or intended. When the Companies Bill was introduced to Parliament in 1862, in the context of the definition of 'member' in what was then section 22, it stated that the 'Corresponding Clause[s] in the former Acts' were sections 8 and 19 of the 1856 Act.¹⁴⁵ So, the definition of 'member' in the 1862 Act derived from the 1856 Act. Sections 8 and 19 of the 1856 Act provided that a subscriber to the memorandum,¹⁴⁶ and any other 'Person' who 'accepted' shares in the company and whose name was entered into the Register of Shareholders would be deemed to be a 'Shareholder'.¹⁴⁷ Its silence on the issue of corporate membership offers no assistance in interpreting the 1862 Act. However, it demonstrates that the draftsmen and legislature will not have had the legislation which Cairns LJ cited – the

¹⁴⁵ Bill for Incorporation, Regulation and Winding-up of Trading Companies and other Associations (1862) (Paper No 85) (Vol 271) ii <<http://parlipapers.chadwyck.co.uk/fulltext/fulltext.do?area=hcpp&id=1862-037887&pagenum=1&backto=FULLREC>> accessed 14 June 2016.

¹⁴⁶ 1856 Act, s 8.

¹⁴⁷ 1856 Act, s 19.

Acts of 1837, 1844, 1845 and 1848 – at the forefront of their minds when drafting and debating the Companies Bill 1862.

Of the legislation relating to companies, incorporated or otherwise, the 1855 and 1856 Acts were the closest relatives to the 1862 Act. This was due to their conferral of limited liability to the members of those companies incorporated by registration under them. For this reason they offered firmer points of reference than the legislation which Cairns LJ cited, none of which actually bore any real resemblance to the 1862 Act. For example, the 1845 Act neither altered the law relating to statutory companies nor dealt with the liability of their members.¹⁴⁸ It merely allowed for certain common provisions to be incorporated automatically into their constitutions. Omission of the 1855 and 1856 Acts from his analysis certainly weakens the strength of Cairns LJ's reasoning on this point. It suggests that he was selecting examples from legislation which supported his position on the legal question rather than taking a balanced view on the legislative landscape as a whole.

Section 16 of the 1855 Act stated that the 1855 Act, which did not apply to Scotland,¹⁴⁹ was 'so far as is consistent with the Contents and Subject Matter thereof' to be 'taken to be Part of and construed with' the 1844 Act and the Joint Stock Companies Act 1847 (the '1847 Act'). It stated further that all the provisions of the 1844 and 1847 Acts were to apply to all persons and companies applying for, or obtaining, a certificate of registration with limited liability. This was unless they were varied by the 1855 Act. The 1844 Act did state that a body corporate could fall within the definition of shareholder. Therefore, whilst the 1855 Act did not explicitly permit corporate membership, its silence on the point may have meant that the relevant provision of the 1844 Act remained intact. Thus, there was certainly an argument that, through section 16, the 1855 Act may have permitted corporate membership, albeit indirectly.

¹⁴⁸ T.B. Napier, 'The History of Joint Stock and Limited Liability Companies' in *A Century of Law Reform*, Chapter XII (Macmillan 1901) 379, 393.

¹⁴⁹ 1855 Act, s 18.

The fundamental question, however, was whether it was consistent with the content and scope of the 1855 Act to confer limited liability upon a corporate member. On the face of it, this may be presumed from the fact that the 1855 Act enabled members of companies registered under the 1844 Act to benefit from limited liability provided that certain conditions were satisfied. But, importantly, analysis of the Parliamentary debates in Hansard indicates that this question was not addressed in any shape or form by either House during discussions on the Limited Liability Bill. The 1855 Act was not only rushed, but forced through Parliament at the height of the widely unpopular Crimean war meaning that rational and detailed debate as to the wider implications of the doctrine was absent.¹⁵⁰ In any event, the copious references to ‘man’ and ‘men’ in Bouverie’s introduction of the Bill to the Commons is strongly suggestive of the fact that the primary benefit which it was intended to bestow – limited member liability – was targeted exclusively at members with natural legal personality.¹⁵¹ Thus, it may be prudent not to place too much reliance on section 16.

The 1856 Act, which applied to the whole of the United Kingdom, did not employ the drafting technique of the 1855 Act. In fact, it explicitly repealed both the 1844 and the 1855 Act.¹⁵² This left a question mark over the legality of corporate membership under it. The numerous references to ‘men’, ‘individuals’ and ‘people’ in Robert Lowe’s, then Vice-President of the Board of Trade, introduction of the Bill to the Commons in early 1856 suggests that he foresaw natural legal persons as the only intended beneficiaries of the protection to which the ensuing Act offered members.¹⁵³ Moreover, it is clear from Hansard that there was no mention in the debates in either House as to the prospect of corporate members obtaining the benefit of limited liability under the ensuing Act.

Secondly, it is of significance that Cairns LJ demanded prohibitive, rather than permissive wording regarding the issue of corporate membership under the 1862 Act. Put

¹⁵⁰ Mackie (n 114) 299 and 313.

¹⁵¹ See HC Deb 29 June 1855, vol 139, cols 319-329.

¹⁵² 1856 Act, s 107.

¹⁵³ See HC Deb 1 February 1856, vol 140, cols 116-138.

another way, he began with the presumption that corporate membership would be allowed (i.e. a limited company could be a 'member' for the purposes of the 1862 Act) unless the Act stated otherwise.¹⁵⁴ This approach was followed by Selwyn LJ in *Asiatic Banking* who could not find anything in the common law or statute to 'prohibit' corporate membership.¹⁵⁵ Clearly, an alternative and, indeed, entirely legitimate approach given the ramifications of the decision could have been to demand that the statute explicitly permitted corporate membership before it would be allowed. This was the position adopted in the United States. There, as late as 1888, the courts were, generally, unfavourable to corporate membership unless the state legislature had given its express authority.¹⁵⁶ Moreover, in the UK, certain legislation deemed by Cairns LJ to be analogous to the 1862 Act had found it necessary to cater explicitly for corporate membership. Given that the Act had amended and consolidated much of the legislation relating to companies,¹⁵⁷ it is surprising that it did not also do so.

The permissive approach of the court contrasts markedly with restrictive manner in which the courts constructed private Acts of Parliaments and memorandums in the pre-*Barned's* jurisprudence. There, as we have seen in cases such as *Salomons*, any application of company funds not 'distinctly authorised' by the incorporating Act was illegal.¹⁵⁸ The common theme which could be extracted from the early caselaw, from *Colman* to *Brown*, was that a private Act or memorandum would be interpreted to the letter by the courts. If it was silent, imprecise or vague as to whether a particular power could be exercised (e.g. whether the shares of another company could be acquired) it would not be permitted. This standpoint had been applied repeatedly and robustly by the courts in the

¹⁵⁴ *Barned's* (n 9) 113.

¹⁵⁵ *Asiatic Banking* (n 10) 257.

¹⁵⁶ William Compton, 'Early History of Stock Ownership by Corporations' (1940) 9 *George Washington L Rev* 125, 130; James Bonbright and Gardiner Means, *The Holding Company, Its Public Significance and its Regulation* (McGraw-Hill 1932) 56.

¹⁵⁷ Upon introducing an earlier version of Bill for the Incorporation, Regulation, and Winding-up of Trade Companies and other Associations for its first reading in the House of Lords, the Lord Chancellor gave an indication as to the extent of the consolidation: 'The Bill was a consolidation of all the provisions contained in all the former Acts': HL Deb 10 February 1859, vol 152, col 219.

¹⁵⁸ *Salomons* (n 51) 352; 1097 (Lord Langdale MR).

period 1846-66. The opposite position was taken in *Barned's*, departing from the approach taken in two decades of highly informative jurisprudence.

Nevertheless, Cairns LJ in *Barned's* chose to bring limited companies within the scope of the term 'person' under the 1862 Act as so capable of being a 'member' of another limited company. Whilst at some level, companies, as legal persons, were being equated with natural persons, there remained an important distinction between the two following *Barned's*. Whilst a limited company was to be treated as a 'person' for the purposes of the Act, it did not possess the general and implied right to be treated as a 'member' for the purposes of the Act; it could only be considered to be a 'member' where its constitution was permissive of its holding or acquisition of shares in the first place. So, some limited companies could be treated as 'members' whilst others could not. This distinction was, of course, not applicable in the case of natural persons.

The question as to whether a company was a 'person' for the purposes of a given legislative framework was still being grappled with some thirteen years after the decision in *Barned's*, this time by the House of Lords in *The Pharmaceutical Society v The London and Provincial Supply Association Ltd.*¹⁵⁹ There, Lord Selbourne LC acknowledged that the term 'person' was 'ambiguous' and its interpretation not free from difficulty.¹⁶⁰ He was, however, of the opinion that there was a presumption that the term 'person' in a public statute included both a corporation and a natural person 'unless there should be any reason for a contrary construction.'¹⁶¹ Whilst Lord Blackburn agreed, he did not believe the presumption to be 'at all a strong one'.¹⁶² He was of the opinion that the 'object' of the relevant Act should dictate how the term 'person' was to be construed.¹⁶³

¹⁵⁹ (1880) 5 App Cas 857.

¹⁶⁰ *ibid* 861.

¹⁶¹ *ibid* 861-862.

¹⁶² *ibid* 868-9.

¹⁶³ *ibid* 869.

Cairns LJ used a variety of techniques to construct the 1862 Act,¹⁶⁴ but he did not explicitly consider the overarching object of the Act. Its preamble stated that it was enacted so as to consolidate and amend the laws relating to incorporation, regulation and winding-up of trading companies. This does not offer any particular assistance. Central, however, to the Act was its affirmation of the position under the 1856 Act that any 'seven or more persons' may form an incorporated a company with limited liability.¹⁶⁵ That a limited company, whose own individual members already possessed limited liability, would also benefit from this protection may have provided the reason required by Lord Selbourne LC for 'person' to be given a construction contrary to its inclusion of companies. Bringing companies within reach of the term 'person' generally for the purpose of regulation would expose them to a variety of additional frameworks. This may have been very useful indeed for some purposes. But, in the context of a limited company being treated as a 'person' for the purposes of membership, it created regulatory implications which were not foreseen in the late 1860s and are still being felt over one hundred and fifty years later.

Finally, Cairns LJ's use of deductive reasoning, based on the implications of certain provisions of the 1862 Act, is also troublesome. He noted, as we have seen, that companies formed under the 1837 and 1844 Acts could be registered under the 1862 Act and so subject to its provisions.¹⁶⁶ Thus, a company which could become registered under the 1862 Act might be a company entitled to have among its members, corporate bodies, whether sole or aggregate.¹⁶⁷ It is, however, problematic to utilise this argument to justify unfettered acceptance of corporate membership in respect of those companies registered under the 1862 Act. First, whilst companies granted privileges under the 1837 Act or incorporated by private Act of Parliament could, if the state had so conferred the power, become members in another corporate body, it was both time-consuming and expensive to obtain such privileges

¹⁶⁴ See supra nn 90-106 and accompanying text.

¹⁶⁵ 1862 Act, s 6.

¹⁶⁶ *Barned's* (n 9) 114.

¹⁶⁷ *ibid.*

or a private Act.¹⁶⁸ They were conferred rarely by the state, and even where they were they would have been interpreted to the letter by the courts.

Secondly, the inclusion of companies within the category of persons capable of being members of companies formed under the 1837 Act or registered under the 1844 Act could, in fact, have been beneficial to the creditors of the companies in which the shares were held. The position was very different in respect of corporate members of companies registered under the 1855, 1856 and 1862 Acts. The limited liability which would come to be afforded to them would, at least when share denominations began to fall, prevent their own assets from being accessed by a creditor. In the context of the 1837 and 1844 Acts, allowing companies to be members of companies formed or registered under them would provide a target for their creditors to pursue with potentially greater wealth than their individual members. Whilst limited liability could be conferred as a privilege under the 1837 Act,¹⁶⁹ its existence was not guaranteed. The state could reject the application for it or it may not have been sought in the first place. Moreover, the members of an unincorporated corporate body registered under the 1844 Act did not benefit from statutorily conferred limited liability. The Act bestowed legal personality upon joint-stock companies but their members remained personally liable to an unlimited extent for claims against the company for up to three years after they had ceased to become a member.¹⁷⁰ Whilst it was common commercial practice for trading companies registered under the 1844 Act to limit member liability in the deed of settlement,¹⁷¹ the default position was unlimited personal liability for their members. In any event, these contractual limitations of liability did not cover non-contractual liabilities.¹⁷²

Thus, it may be argued that Cairns LJ was taking what had traditionally been a narrowly confined and restricted power and conferring it broadly within legislation of a

¹⁶⁸ See supra nn 41-48 and accompanying text.

¹⁶⁹ 1837 Act, s 4.

¹⁷⁰ 1844 Act, s 66.

¹⁷¹ See infra, section D.

¹⁷² See infra nn 184-190 and accompanying text.

different character and with entirely different implications for the company's creditors and, indeed, society more broadly.

D. LIMITED LIABILITY AND CORPORATE MEMBERS

One of the most significant ramifications of *Barned's* and *Asiatic Banking* for contemporary company law arose from the subsequent interpretation of these cases. It would come to be taken that as a 'person' capable of being a member of a limited company, limited companies themselves and not just their individual members were to benefit from the limited liability conferred by companies' legislation. This was neither acknowledged nor appreciated in either case. Indeed, the issue of limited member liability was neither considered explicitly nor impliedly in the decision of either court or, indeed, in the subsequent decade.

The relationship between the corporate power to hold and acquire shares in another company and a 'contractualised' form of limited liability for corporate members was, however, considered in the 1878 decision of *Re European Society Arbitration Acts*.¹⁷³ This decision is important as not only was the court content to permit corporate membership but it was deemed appropriate to limit member liability for the debts of the company in which the shares were held. The case concerned the deed of settlement of an unincorporated joint-stock company, British Nation Life Assurance Association ('British Nation'), registered under the 1844 Act. The deed contained a power to purchase any company of a similar nature. Importantly, it also stated that every document under which the association became liable to pay money was required to contain a clause limiting member liability to the amount payable on their shares. British Nation resolved to purchase an unincorporated insurance company. The shares were held by certain nominees for the association, including its officers and directors. There was then a purported transfer of these shares by deed to the association. An order was made to wind-up the unincorporated insurance company. The liquidator

¹⁷³ (1878) LR 8 Ch D 679.

contended that the association should be placed on the list of contributories to the assets of the insolvent insurance company.

In finding against the liquidator, James LJ held that the association should not be placed on the list of contributories as the purported transfer of shares to it was ultra vires and void. The deed of settlement did permit the insurance company's shares to be purchased, and so the manner in which the acquisition was structured (i.e. through nominees) was not in itself ultra vires. But, James LJ found that the association's members had never agreed to the transfer nor, in his opinion, would they have. The financial implications of doing so went entirely against the basis of limited member liability set out in its constitution.¹⁷⁴ The association was, however, bound to indemnify its nominees in respect of their liabilities for the shares which they held but this was limited to the extent of their unpaid capital as per the deed of settlement.¹⁷⁵ Thus, it may be inferred from *European Society* that where a corporate member, and in turn its own individual members, would be liable to an unlimited extent for the debts and obligations of the company in which the shares were held, it could alter this position through an appropriately worded clause in its deed of settlement. The court could have found this contractual form of limited liability to be unlawful but chose not to.

In essence, *European Society* was merely an extension of the freedom of contract philosophy adopted by the courts in response to commercial practices in the mid-nineteenth century. By 1844, it had become commonplace for unincorporated joint-stock companies in the insurance industry to insert clauses into policies limiting the liability of their members to the extent of their unpaid shares.¹⁷⁶ This practice was later extended to trading companies.¹⁷⁷ Maitland notes that whilst the courts were 'very unwilling' to concede that parties had agreed to such a clause, they 'had to admit that personal liability could be

¹⁷⁴ *ibid* 706.

¹⁷⁵ *ibid* 708-109.

¹⁷⁶ Hunt (n 44) 100.

¹⁷⁷ *ibid*.

excluded through sufficiently explicit words.¹⁷⁸ Indeed, this was the position following the decisions in *Halket v The Merchant Traders' Ship, Loan and Insurance Association*,¹⁷⁹ and *Hallett v Dowdall*,¹⁸⁰ where the use of limitation of liability clauses in insurance policies to exclude the personal liability of members under the 1844 Act was affirmed. Butler contends that Hallett was the 'major event' that explained the arrival of a statutory limited liability.¹⁸¹ Whilst the matter was more complex than this,¹⁸² it certainly played a key role. It gave strength to the argument deployed in Parliament that the Limited Liability Bill did not propose anything new as under the common law 'any two persons under a special contract could limit their liability.'¹⁸³ However, the situation was, as we shall see, different for attempted exclusions of liability in respect of non-contractual debts. These were not permitted.

European Society may be seen to acknowledge a form of limited liability in respect of a corporate member. It is, therefore, inaccurate to assert that recognition of the fact that a corporate member could benefit from a limitation of liability was absent entirely from the reasoning of the courts in the jurisprudence of 1850-80. However, the limitation of liability accorded in *European Society* should be perceived as being of a narrow kind. The reach of the decision should be restricted to contractual debts and not extended so as to cover non-contractual debts. Whilst contractual creditors of a company could, generally, decide in advance whether or not to deal with the company,¹⁸⁴ non-contractual creditors were not afforded this luxury. The jurisprudence prior to *European Society* indicated that liability to third parties, such as non-contractual creditors, could not be limited contractually. In *Walburn*

¹⁷⁸ Herbert Fisher (ed), *The Collected Papers of Frederic William Maitland*, vol III "Trust and Corporation" (CUP 1911), 392 <<http://oll.libertyfund.org/title/873/70330>> accessed 14 June 2016.

¹⁷⁹ (1849) 116 ER 1530.

¹⁸⁰ (1852) 118 ER 1.

¹⁸¹ Henry Butler, 'General Incorporation in Nineteenth Century England: Interaction of Common Law and Legislative Processes' (1986) 6 *Int'l Rev L & Econ* 169, 182.

¹⁸² See Mackie (n 114) for a discussion of the factors which led to the emergence of limited liability in 1855-1856.

¹⁸³ HL Deb 11 August 1855, vol 139, col 2126 (Earl Granville).

¹⁸⁴ Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 *Yale LJ* 1879, 1920-1.

v Ingilby,¹⁸⁵ Lord Brougham held that a clause in the deed of settlement of a joint-stock company which limited the liability of a subscriber to the extent of his share was, 'wholly nugatory...as between the company and strangers' and could 'serve no purpose whatever, unless to give notice' to those who 'deal' with the company.¹⁸⁶ Members could, therefore, not agree amongst themselves to 'restrict' their liability to third parties.¹⁸⁷ As Harris notes, '[n]oncontractual claims, based on torts...and the like, were...not affected by contractual limitation of responsibility.'¹⁸⁸ The limitation of liability under contract was, therefore, 'only partial'.¹⁸⁹ Upon this basis, even where the corporate body had sought to limit the liability of its members, corporate or individual, under contract, the members would still be liable to third parties who were not party to the contract. Thus, European Society should not have altered the rights of non-contractual claimants. Tort victims would, for example, appear to be one example of a third party that should have had a right of action against a corporate member in similar factual circumstances.

There is the argument that early companies' legislation resolved any residual uncertainty as regards the position of non-contractual creditors. This proposition seems to lose ground when the consideration, or lack thereof, given to the issue in Parliament during the passing of the bills which became the Acts of 1855 and 1856, the originating legislation on the statutory conferral of limited liability, is examined. There, Parliament failed to consider the effect of these Acts upon non-contractual creditors.¹⁹⁰ Indeed, neither House considered this body of creditors in the respective parliamentary debates. They focused entirely on contractual debts. Thus, not only was it not permissible under English common law to limit, under contract, the liability of corporate members in respect of the company's non-contractual debts, the statutory conferral of limited liability was not originally intended to

¹⁸⁵ (1833) 39 ER 604.

¹⁸⁶ *ibid* 611 (Lord Brougham).

¹⁸⁷ *ibid*.

¹⁸⁸ Ron Harris, *Industrializing English Law: Entrepreneurship & Business Organization, 1720-1844* (Cambridge 2000), 143.

¹⁸⁹ *ibid*.

¹⁹⁰ Mackie (n 114) 308.

cover such claims. It was subsequently extended inadvertently to insulate members – companies and natural legal persons – from liability for non-contractual debts.

Whilst there was no adjudication on the broader consequences, economic, social, moral or legal, of conferring limited liability upon corporate members in the period 1850-80, the courts had highlighted and, indeed, addressed the perceived inequity and injustice in limited companies avoiding liabilities for which they were deemed to be morally responsible. As we have seen, in both *Barned's* and *Asiatic Banking*, the moral point was certainly reflected in the reasoning of both courts. It is, therefore, somewhat ironic that the facilitative interpretation of the 1862 Act by the Court of Appeal in both cases, which enabled a legal obligation to be imposed upon the responsible entity, paved the way for one limited company to shield itself from liability by merely incorporating another limited company to carry out a risky activity. It is interesting to ponder whether a court in the formative period of 1850-1880 would have been swayed by the same moral obligation felt by Cairns LJ where there had been a deliberate attempt to structure an enterprise so as to avoid legitimate claims by tort victims. Seemingly the fate of modern non-contractual creditors was sealed by the fact that at this early stage in the development of the jurisprudence, the court was not required to ensure that, in the context of a non-contractual claim, those who were the 'real owners' of a liability were to be the persons to bear the responsibility for it. The jurisprudence may have taken a very different trajectory had such a case been heard.

E. CONCLUSION

This article sought to elucidate the historical basis in UK company law of the right for a company to be a member of another company and, through this position, benefit from limited liability. Such a study was lacking in the literature but was important for it would inform subsequent research into whether the inviolability accorded by the courts to limited liability in the parent-subsidary relationship was justified. An original discovery was that the Court of Appeal in *Barned's* and *Asiatic Banking* found corporate membership to be compatible with

the Companies Act 1862 to ensure that the companies in question bore legal responsibility for shares which they held or were held on their behalf. This prevented them from disclaiming liabilities associated with the shares by contending that their very ownership was unlawful. Whilst justice may have been achieved on the facts presented by these cases, the instrumental approach of the courts resulted in their failing to consider the wider consequences of their decisions. This was an important and original finding.

One crucial consequence overseen by the courts flowed from the authority for which these formative decisions were subsequently taken: as members of a limited company, limited companies themselves were entitled to benefit from the conferral of limited liability under companies' legislation. That their own individual members already benefited from this very same statutory protection was not acknowledged nor considered by the Court of Appeal in either *Barned's* or *Asiatic Banking*. Indeed, the issue of limited member liability seemingly had no bearing, or at least was neither considered explicitly or impliedly, in the decision of either court. It appeared that the right for limited companies to be members of other limited companies and the consequential right for them, as members, to benefit from limited liability had not converged conceptually in the mind of the judiciary at this early stage. It was only with the passage of time that these two quite separate rights came to taken, upon a reading of the companies' legislation alongside the decisions in *Barned's* and *Asiatic Banking*, as a single right available to a company upon its incorporation by registration.

The theme of unintended consequence may be observed from this study: decisions which permitted liability to be imposed upon the responsible persons would, with time, provide the jurisprudential basis for a parent company to shield itself from liability by undertaking a hazardous activity through a subsidiary. This capacity to create multiple layers of protection ignores the equitable dimension which underpinned the court's approach to corporate membership in both *Barned's* and *Asiatic Banking*. This fact was lost conveniently in the mists of time. Rediscovered, it could inform contemporary debate and discussion surrounding the development of appropriate legal responses to the issues raised by strategic corporate structuring.