

V.—*On the Laws relating to Joint-stock Companies.*—By Joseph John Murphy, Esq.

[Read 19th January, 1857.]

THE question of limited or unlimited liability in partnership is very simple in theory: being reducible to these two principles, that one must be answerable with one's whole property for the results of one's own actions; and that no one ought to be held answerable for the actions of another man. In fewer words, that legal responsibility ought to be co-extensive with moral responsibility.

Thus, every one must be held accountable to the whole extent of his fortune for all debts incurred in his own business: any disclaimer notwithstanding.

But any one placing money in another man's business, and taking no part in the management, may be justly permitted to receive a rate of remuneration proportioned to the profits, instead of a fixed rate of interest, without becoming accountable for the debts of the business to a greater extent than the amount of money he has placed there.

Such a connexion is technically called a limited partnership. It is authorised by the laws of France, Holland, and America: and it is to be hoped that Parliament may soon legalise it here.

The subject of joint-stock companies is much less simple: though, being supposed, whether truly or not, to be of greater importance, and being also more generally understood, it has among us taken precedence in legislation of the question of limited private partnership.

The limited liability act of 1856 has placed the law of joint-stock companies in a satisfactory state, so far as regards the position of the shareholders. They can obtain a charter of incorporation by simply applying for it, and the liability of shareholders is limited to the amount of the shares.

But if the principle I have stated is sound—that mercantile liability for the consequences of a man's own actions ought to be unlimited—it follows, that in every concern the acting partners ought to be under unlimited liability. The acting partners of a joint-stock company are the directors; and yet the law does not recognise their unlimited liability. This ought to be changed.

I do not say this merely because theory demands it, though sound theory does demand it: but, because the present position of directors is altogether unsatisfactory. It is known that many directors permit their names to be displayed before the public, without habitually attending the meetings of their boards. This is most objectionable—it is scarcely honest—though, being sanctioned by law and public opinion, it is done by men of irreproachable character. It is well known also that many directors who are regular in attending their boards are mere dummies, going there to make a quorum and to pocket their guinea. And even those who really interest themselves in the affairs of their companies, appear gene-

rally to do so rather in the spirit of men working on the committee of some public institution, than of attending to their own private business. The total neglect of all sound principles of book-keeping, and all precautions against fraud, which have been lately disclosed in the management of the Great Northern Railway, would have been impossible, had the directors paid the same attention to the company's business that every merchant must pay to his own, under penalty of being ruined.

Were every director liable for the debts of his company, people would not be so willing to permit their names to be displayed as merely nominal and ornamental directors; and companies would be compelled to adopt the system, which indeed they ought to adopt even under the existing law, of employing a small number of well paid directors, and requiring them to devote their whole time to their companies' business.\* It is under this system that the banks of the North of Ireland have prospered, and there is no reason why it should not be equally applicable to companies of all kinds.

I do not think it can be denied that the want of liability on the part of directors is the chief cause of the disgraceful state of life insurance companies, many of which have become insolvent, in consequence of granting policies at rates of premium which must necessarily be unremunerative. They began business on principles which demonstrably must ensure failure; and this, like all branches of insurance, is a business where a moderate degree of success ought to be demonstrably certain. Such a state of things would be impossible, if directors were held responsible like partners; and if a retired director, like a retired partner, were held responsible for the debts of an insolvent concern, in case it could be proved to have been insolvent at the time when he left it.

In the case of life insurance companies, no lapse of time ought to be a bar to such responsibility—for the nature of life insurance is such, that a company may be insolvent for a long time before it is found out.

I do not argue against limited liability—I argue against no liability. And I am able to state that my views both as to the limited liability of sleeping partners and shareholders, and the unlimited liability of acting partners and directors, are those of Mr. Levi, the eminent professor of mercantile law in the London University.

A letter signed by Thomas Tapping, of Essex-court, Temple, has been lately published in the *Morning Post*, mentioning a gross abuse of the Limited Liability Act. A shopkeeper or tradesman of some kind has converted his business into a joint-stock company, giving shares to the members of his family; with the purpose (for no other purpose is assignable,) of evading that unlimited liability for the debts of his concern, which the common law, and common sense, attach to every one trading on his own account. If this legal quibble and mercantile dodge finds many imitators, we may expect to hear an outcry against limited liability; but it is not limited liability that is in fault—it is the existing system of no liability. Were directors liable to their last shilling, the actual manager of a

\* On this subject see the leading article of the *Economist*, for 6th December, 1856.

business would not be able to screen himself by calling it a joint-stock company. I am not making an attack on the Limited Liability Act. It introduced no new principle; it only opened to all who choose to make use of them, those powers of incorporation and limited liability which had previously been frequently granted as exceptional privileges by Royal or Parliamentary Charter—and its true principle of limited liability for shareholders, as well as its false principle of no liability for directors, were both imitated from the practice of those earlier charters. Life insurance companies, in which the abuses of the joint-stock system are the worst, are not in any way affected by the Limited Liability Act; they work under earlier acts and charters.

The shareholder of a company with limited liability differs from the limited partner of a private firm in this: that his share may be transferred to any one, without needing the consent of the other shareholders. Another difference follows from this. Although a limited partner cannot be permitted to take a part in the management, for then he would be an acting partner, and an acting partner, as I have stated, has no right to limit his liability; yet he may have access to all information concerning the business. But it is impossible for the fluctuating multitude of shareholders that compose a joint-stock company to be entrusted with this privilege—they must either forego it or delegate it. To forego it, would be to place themselves without control in the hands of their directors, and to remain in ignorance of all that the directors may choose to conceal—a position with which no man of sense ought to be satisfied. The best approximation—for the best is but an approximation—to a substitute for the perfect information and full powers of control enjoyed by the limited partners of a private concern, would probably be the appointment of unpaid auditors along with the paid directors, and endowing them with full powers of inspection, but no power to make appointments, or to take part in the management, except by a veto on the acts of the directors, or by calling a meeting of shareholders. The auditors would thus exercise, as the representatives of the shareholders, those powers of inspection and control which the limited partners of a private firm are competent to exercise on their own account. If the auditors transgress the limits of their function, and act as directors, the law ought to treat them as directors, by making them liable for all the debts of the company: and the same liability ought to be entailed by the auditors taking payment for their services. The object of this last clause would be, to get rid of the class of people who accept office merely for the payment.

Thus to provide that auditors shall possess full powers, but receive no payment and enjoy no patronage, would probably do all that legislation can do to ensure the great object of an efficient audit.

Sound companies would not have any difficulty in obtaining auditors on the terms. The most useful men on a board are not those who attend it for payment; and large boards are not desirable, owing to the evils of divided responsibility.

There is another change in the law affecting joint-stock companies, which ought to follow as a result from the principle that a man must be responsible for his own actions.

Not only the actual holder of a share, but every one who has been the holder, ought to be liable for all the calls on it. The language of the legislature to parties desirous to obtain powers for the formation of companies, ought to be something like this:—"Gentlemen, if you really mean to carry out the enterprise, we will give you every facility; but if you only mean to sell the shares, we will throw every obstacle in your way. We therefore require, as a proof that this is a *bona-fide* enterprise, and not a mere share-jobbing speculation, that every one through whose hands a share passes shall endorse it, and be liable for the calls in the reverse order of the endorsements."

I believe, though I am not able to find my authority, that this principle has been already recognised by the legislature, though never efficiently enforced. I do not know whether the law is in force now, but I understand that at the time of the railway mania of 1845, the original allottee of every share was liable for all the calls on it. This was no obstacle to the operations of the speculators of Capel-court, who took care never to permit their names to appear as original allottees; but put forward mere men of straw in that capacity. It would have been only carrying out and enforcing the principle, had Parliament required those who purchased the rights of the original allottees to undertake their responsibilities also: and such a course would have prevented the follies and rogueries of the railway mania, by preventing any one from getting up a railway scheme, unless with the intention of making the railway. The disasters of that year were not caused by a mania for making railways; they were caused by a mania for jobbing in railway shares; and the jobbers who found themselves in possession of the shares at the time when the reaction came, and shares were depreciated, were in many cases glad to avail themselves of the act that enabled companies which had not begun to make their railways, to wind up and dissolve. That Act was the natural result of the policy of Parliament, in granting powers to make railways, without taking adequate security that the shareholders had the means and the intention of actually making them. I believe that Act was a national necessity; but, if so, the necessity was a national disgrace.

It will be said that such a provision as I propose would be a great discouragement to enterprise. This objection confounds enterprise with speculation; two things which differ, exactly as making razors to shave differs from making razors to sell. To obtain a Railway Act for the purpose of making the railway, is enterprise; to obtain it for the purpose of selling the shares, is speculation. Enterprise, which is honest industry and lawful trade, ought never to be discouraged; but speculation, which is gambling, ought to be discouraged always. Or, if this use of the word speculation is offensive to any one, the difference may be stated thus:—To get up a company, in hope that the enterprise will pay, is legitimate speculation; but to get it up in hope of persuading some one else that it will pay, and selling him the shares, is speculation on speculation, and is illegitimate.

No one who takes powers to carry out an enterprise ought to object to be bound over to do so. This would not be any peculiar restriction

on joint-stock enterprise—it would be only placing joint-stock enterprise under the same responsibilities legally, that private enterprise is under naturally. No man begins to construct a house or a steam-engine in hope of selling it unfinished; and every one beginning a house or a steam-engine binds himself over to pay up the calls on his enterprise,—in other words, to finish what he has begun. I maintain that joint-stock companies ought to work under the same natural and honest conditions.

I do not deny that occasional cases of hardship might occur under such a law as I propose. But shareholders are sometimes proceeded against for the calls on their shares under the existing law; and such proceedings would be less, not more, common under a law that would prevent any one from bringing out any scheme which he did not believe to be sound.

In the event of the insolvency of the shareholder, the company demanding the amount of his calls ought not to be permitted to prejudice the creditors by claiming as a creditor, but ought to pass on to the next endorser.

If it is asked, why ought the power to enforce the payment of calls to exist at all? why ought not shareholders to be permitted to forfeit their shares, and have done with them? I reply, that a company obtaining powers to execute works cannot be permitted to disfigure the country by leaving the works unfinished; and even when this objection is not applicable, the events of 1845 prove that we need such a check on illegitimate speculation.\*

It is evident, however, that a person possessing shares by inheritance and not by purchase, ought to be permitted to forfeit them, instead of being proceeded against for the calls; for it is an admitted principle that a debt cannot be inherited, except as a charge on inherited property; and in the case supposed, of the shareholder preferring the forfeiture of the shares to the payment of the calls, the debt exceeds the value of the property.

It would be necessary to let mining-shares be an exception to the rule of holding every one who has been a shareholder, liable for the payment of the calls; because, in all other companies, with but few exceptions, the outlay may be estimated beforehand; but in mining, the necessary outlay can never be estimated, the capital account can never be declared closed, and the company must have the power of demanding assistance to the undertaking from the individual shareholders, whenever the state of the enterprise may demand it.

The system that I propose with respect to liability for calls, would of course render it necessary to leave no outstanding calls after the capital account is closed; so that in the case of a completed enterprise, the nominal capital would not exceed the paid-up capital. This would prevent companies from raising money by means of new calls, for the purpose of extending their business. But prosperous companies would be able to raise money easily, by means either of borrowing or of issuing new shares; and it is by no means evident that unsuccessful ones ought to possess facilities for extension.

\* I have been informed, since the reading of this paper, that a provision, similar in principle to that which I propose, has lately become law in France.

A law, making every one through whose hands a share has passed liable for the calls on it, would of course throw obstacles in the way of all share-jobbing, and would consequently render such operations as those of the *Credit Mobilier* impossible—a result which I am sure that most persons in this country will regard as desirable. A vast company, jobbing in the shares of other companies, is indeed the very extravagance of speculation.\*

The state of France and Austria at present, as well as that of England at the close of the railway mania of 1845, affords at least a presumption of the necessity of a law that shall bind over the undertakers of a joint-stock enterprise to carry it out. The French and Austrian governments, alarmed at the extent of railway speculation, and the consequent pressure on the money-market, are refusing to grant more “concessions” of railways for the present. Imagine a government, in this age of free-trade, refusing leave to its subjects to make any more of the best kind of roads known, lest the rate of interest should be raised! It reminds me of an order which, according to Adam Smith, was once issued by some provincial authority in France, that no more vineyards should be planted in land capable of producing corn, because there was not enough of corn cultivation in the district. Yet, without professing to know the secret history of the French and Austrian share-markets, I think it very probable that such restrictions are needed; but if so, it must be only as counteractive of former blunders. Since the intolerable oppression of close guilds was broken down, no government has ever thought it necessary to place direct restrictions of that kind on private enterprise; and joint-stock enterprise would be equally free from the danger of degenerating into mere speculation, and injuriously affecting the rate of interest, if it were carried on under the same just condition which nature has attached to private enterprise; that he who begins must finish, or else be at the loss of an unfinished undertaking.

I have maintained that every purchaser of a share ought to be bound to the company for the payment of the calls. The question remains, whether the company in its collective capacity ought to be bound to the State for the prosecution of its enterprise. On this subject I have already remarked what every one must assent to—that a company having begun a public work cannot be permitted to leave it unfinished; and even when it is begun, I think that every individual or company taking powers to execute a public work, ought to be bound to execute it. But no individual or company ought to be bound to carry out an enterprise, when it is of a private nature, such as spinning or mining; a company formed for such a purpose ought to be permitted to dissolve, and divide its remaining capital among the shareholders.

There is another change in the law, which ought to follow from the principle that no one should be legally answerable for any one's actions except his own.

\* See “Notes on the *Société Générale de Crédit Mobilier*,” by Professor Walsh, published in the *Dublin Statistical Journal* for July, 1856. See also “The *Credit Mobilier*, and Banking Companies in France,” in the *National Review* for January, 1857.

A company ought not to be permitted to engage in any enterprise, except that which is named in the deed of incorporation. I do not mean that a capital account once closed ought never to be reopened, or that no works ought to be executed except those contemplated at first. This would be opposed to the clear necessity of the case. A railway company, for instance, must have power to change a single line into a double one,—perhaps into a quadruple one, if engineers can manage this; to construct new buildings for the accommodation of an unexpected traffic; and to charge the costs of such works to capital. For these purposes, every company ought to have power to borrow money or to issue new shares. But in issuing new shares, the law ought to prohibit the giving any preference to one party above another. The usual system of giving the preference to the old shareholders looks fair at first sight, but in practice it acts injuriously, by creating a diversity of interest between the richer shareholders, who are able to avail themselves of the privilege, and the poorer ones, who are not.

Companies ought to have power to extend their business and increase their capital. But I also maintain that they ought not to be permitted to undertake what are technically extensions, but really new enterprises.

It is an error in reasoning, to treat a company as an individual, who may do what he will with his own. All will admit that directors may not do what they will with the funds of a company, even though they be acting in good faith for the shareholders' benefit; they cannot be permitted to deviate far from the ordinary routine of management, without the special sanction of the shareholders. But it is equally true, though not equally evident, that the majority of the shareholders have a just right to do what they please with the company's funds, only so far as to decide how the object declared in the deed of incorporation may be best effected; but not to devote those funds to the carrying out of other objects.

This view of the subject is that taken by our law. No power, I believe, exists under any public statute, for a company to undertake any enterprise which is not named in the deed of incorporation. It is done in every separate case by a private Act of Parliament. But the practice of Parliament has been habitually at variance with the principle which is recognised by the law, and deducible, as I maintain, from the maxims of justice and the nature of a contract.

The individual members of a joint-stock company are in justice bound, not by the will of the majority, but only by the deed of incorporation. This will be made evident by putting an extreme case. Suppose a majority of shareholders in a steam-boat company, to be convinced that mining would be more profitable, they certainly would not have any just right to pass a vote, in defiance of the wishes of the minority, changing their company into a mining one. The remonstrance of the minority would be unanswerable:—"We entered into an engagement, and subscribed our money to work steam-boats, not mines." Yet, this is only an extreme form of the case which is constantly occurring, when a railway company makes or purchases railways, canals, docks, or steam-boats, which were not contemplated in its original deed of incorporation. Suppose a ma-

jury of shareholders in the London and North-western railway to decide on purchasing the Trent Valley line, the dissenting minority may truly object:—"We entered into an engagement to make a railway from London to Warrington, not to purchase the Trent Valley." If the reply, that what the majority propose is best for the interests of all, is good in this actual case, it is equally good in the supposed case of changing a steam-boat company into a mining one. Not only the old companies have been permitted to make new lines; but, whether intentionally or not, Parliament has managed to place nearly all the internal communications of Great Britain in the hands of a few companies, which have multiplied their originally contemplated mileage manifold. We know the result; the trunk lines pay well, but the branches weigh them down. The English railways have been made, but at a cost immensely greater than was necessary; and so great as to yield but small dividends on some of the greatest lines of communication in the world.

Had Parliament pursued a different course, and confined companies to their original enterprises, the country would, in all probability, have been as well served as it is, and at much less cost; for I believe that no railway in the kingdom has been unsuccessful for want of traffic; and the local lines would have been made with economy instead of extravagance, by local companies, whose profits depended on economy; instead of great centralised companies, actuated in their construction by a variety of motives, of which the hope of direct profit was often the smallest, and the influence of some interested director perhaps the greatest.

In answer to the common argument, that the system of permitting old companies to make extensions and branches, and consequently to compete with each other, causes the public to be well served; I will only point to the fact, that while the Great Western Company was for years fighting with the London and North-western, over every shred of traffic in the western part of the Midland counties, it neglected the South Wales line, which we shall soon find to be one of the most important in the empire\*—and did not open it till 1856.

A large number of local companies, instead of a few centralised ones, would, no doubt, have made a stringent government control necessary. This, however, need not weigh much on either side of the argument. We must, soon or late, have a stringent government control of railways.

I will say no more on this subject, except to refer you to the able article entitled, "Railway Morals, and Railway Policy," published in the *Edinburgh Review* for October, 1854.

I know that the influential class is prejudiced against these views. But they are supported by general unconscious common sense. We call railway enterprises sound and healthy, not when they are cen-

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\* Because at its eastern end it brings the anthracite beds of South Wales into communication with the markets of the metropolis; and at its western end it terminates at Milford Haven, which, on account of its geographical position, its excellence as a harbour, and its vicinity to vast supplies of anthracite and iron, is the best port in Great Britain for communication with Transatlantic countries.



tralised at Capel-court or at Euston-square, but when they are brought forward and worked in the localities, and by the people they are to benefit.

I have now made three distinct leading propositions, all deducible from the principle that every one ought to be answerable for his own acts, and those alone. They are:—

1st. That the directors of a joint stock company ought to be liable for its debts, like the acting partners of a private concern.

2nd. That every person through whose hands a share has passed by purchase ought to be liable for all the calls on it, except in the case of mining companies.

And, 3rd. That companies ought not to be permitted to undertake any enterprises, except such as are named in their deeds of incorporation.

I am not personally interested in any company. But I make no apology for attempting the subject. Parliamentary reform does not come exclusively from members of Parliament, nor law reform exclusively from lawyers; and in every branch of national improvement, we often receive the most valuable suggestions from private and unprofessional men, who are interested in these subjects only as citizens.

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#### APPENDIX.

*To the Editor of the Dublin Statistical Journal.*

Belfast, 23rd January, 1857.

My dear Sir,

I was somewhat disappointed to perceive, in the discussion which followed the reading of my paper on the law of Joint Stock Companies, how far the most intelligent people of this country are from regarding limited liability as a settled question.

If not contrary to your usual practice, I shall be obliged by your publishing these remarks on the general question of limited liability, as a note to my paper.

This question has been much complicated by the accidental circumstance of Parliament having legislated on the subject of limited liability in joint-stock companies, before it has settled the same question for private partnerships.

The permission of limited liability in private partnerships became a logical necessity when the usury laws were repealed; and, though we often pride ourselves on not being logical, yet, in matters of law and administration, a logical necessity is in general felt soon or late to be a practical necessity.

The law at present permits one man to place money in another man's business, and to be remunerated by any fixed rate of interest that may be agreed on; and, so far is he from becoming liable as a partner, that, in the event of insolvency, he shares as a creditor.

The law also permits salaries to be paid at a rate proportioned to the profits of the business which pays them, without the person so paid becoming liable as a partner.

The advocates of limited liability in private partnerships demand nothing more than this, that the law should permit the payment of interest, as it permits the payment of salaries; that the capitalist who advances money, as well as the clerk who gives his services, should be enabled to receive a rate of remuneration proportioned to the profits of the business, without becoming liable as a partner.

Many of the advocates of limited liability, indeed, and myself among others, demand somewhat less than this: for they think that the capitalist holding such a position—the limited partner—ought, in the event of insolvency, to be unable to claim as a creditor, at least until the other creditors are paid.

I do not think such a system could give rise to any other abuses than those to which the existing law of free-trade in the rate of interest is liable: and this law is satisfactory on the whole.

No one can admit the justice of limited liability in private partnerships, without admitting it in joint-stock companies also; and the case for its utility, indeed, I may say its necessity, is much clearer for the latter.

Truly yours,

JOSEPH JOHN MURPHY.

## VI.—*Prize Financial Essay.*

[From the Journal of the Society of Arts, January 30, 1857.]

The following are the conditions relating to the competition for the prize of 200 Guineas, placed in the hands of the Council of the Society of Arts by Mr. Henry Johnson, to be awarded for “The best Essay on the present financial position of the country as affected by recent events, in which the principle of a sinking fund should be discussed, and also an investigation made as to the best mode of gradually liquidating the National Debt.”

### CONDITIONS.

1. The Essay to be sent to the Society of Arts by the 31st day of December, 1857. Each Essay to be marked “Finance Essay,” and to have a motto or distinctive mark attached, which mark must also be written on a sealed letter, containing the name and address of the author.

2. The Essays will be delivered by the Council of the Society to the adjudicators, who will fix a day for making their award, which will be more or less distant, according to the number and size of the Essays.

3. The letters, containing the names and addresses of the authors, will remain with the Society of Arts, and none will be opened except that bearing the motto or mark attached to the Essay to which the adjudicators award the Prize.

4. The adjudicators shall not be expected to give any reasons for their award, beyond stating that in their judgment the Essay is the