The Evolution of the Limited Liability of Legal Persons in the Common Law World

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I. Introduction and Working Hypothesis

The institution of the legal person has a long history and evolution. It comes in many forms in different legal systems but has similar characteristics based upon similar societal objectives. One of the most controversial issues in legal circles is the extent to which a legal person- created under the law- should enjoy the privilege of limited liability. Natural persons do not, and often conduct some of the same activities for which the legal person enjoys protection from liability. One school of thought holds that limited liability is an essential element of at least certain classes of legal persons, a characteristic whose preservation is necessary for the proper functioning of the overall economic well-being of society. Another school of thought holds that the legal person, as an institution created for some perceived benefit to society, does not have an absolute right to limited liability. For proponents of the latter view, any limitation of liability tolerated by society should be the result of a careful weighing of various principles. This dissertation traces the evolution of this debate, outlines a continuing quandary regarding the existence and extent of limited liability, and examines alternative ways forward to address the quandary.

The legal person started in the municipal/public sphere and over time spread to the commercial/private sphere, where it now has its most pronounced presence. Limited liability was not a feature of early legal persons. This casts doubt on arguments that it is an intrinsic feature of the corporate form. Why this was so is one of the focal points of the first third (Parts I-III) of this dissertation, which traces the evolution of the corporate legal form in the common law world. That tracing exercise covers two key jurisdictions in the common law world: England and the United States. By highlighting particular legal milestones in each country's development of the law related to legal persons, this section will also shed light on key doctrinal differences which each legal system appears to have taken on specific points. The divergent paths taken by these branches of the common law legal family provides another counterargument to claims of the intrinsic necessity of limited liability treatment for corporations. An analysis of the milestones permits an evaluation of oft-debated points as to whether policy calls for a specific, static treatment of the liability question, or whether there is room for flexibility based upon an evolving context.

A thorough treatment of the doctrinal points in the simpler, single-entity, context is a prerequisite for considering the debate in relation to the more complex environment facing today's multi-corporate, often multinational, enterprise. The next section (Part IV) of this dissertation then examines these same issues in the modern, multi-entity enterprise context. This context deserves particular scrutiny because of the nuances created when dealing with the attribution of responsibility across numerous legal persons. This raises additional issues compared to the attribution of responsibility across a single entity and the natural persons behind it. Historically, the primary concerns triggered by these complex groups of companies related to matters other than liability. This section also considers arguments regarding whether there should be any differentiation in treatment based on such size and complexity of such multi-corporate businesses, and what the driving factors of any such differentiation might be.

The following two sections (Part V and VI) describe the legal system's response to the perceived excessive rigidness of limited liability rules, which appeared even more pronounced and questionable against the backdrop of the corporate group. The initial response came from the courts, which devised theories for justifying the disregarding of corporate limited liability on a case-by-case basis. These theories came to be known as "piercing the corporate veil" and are referred to in this dissertation as "private action veil-piercing." The counterpart, described herein as "public action veil-piercing", refers to the reaction of the legislature to create additional exceptions to the general rule of limited liability for corporations in specific situations where there are deemed to be overriding public policy concerns. The collective encroachment of these developments on the sanctity of the general rule of limited liability permits a better understanding of the policy issues covered in the final two sections.

In order to better understand the inner workings and external impact of veil-piercing, Part VII examines some empirical analyses conducted on the practice of piercing to date. Such analyses aid in understanding how the relevant legal rules work in practice, whom they impact, and in what ways. This section thus enables the reader to form a view as to whether such liability rules should be tailored to specific classes of persons or situations. One such group historically considered in need of special protection is the tort plaintiff/judgment creditor. This sets the stage for the final section, which considers the likelihood of alternatives to the current legal regimes relating to the limited liability of legal persons. The arguments and potential benefits of each alternative are also described, along with a discussion of the practical challenges to the adoption and implementation of such alternatives.

II. Origins and General Purposes of the Legal Person [1]

A high level overview of the evolution of the legal person as a separate "being" is helpful to the subsequent issues covered in this dissertation. The tendency of groups within societies to collaborate and cooperate goes back as far as our understanding of such societies. Early collaboration and cooperation originated informally, and only later took on a legal umbrella when the societies deemed it useful. Eventually the fiction of the legal person was created to facilitate social cooperation. Even then, such cooperation arose primarily in specific areas. It was not until the past few centuries that the legal person reached the ubiquitous status in society that we know today. But legal persons evolved without any definitive thinking about what they were from a doctrinal perspective; they were attributed with characteristics to match the needs of their organizers. Analyses of legal persons and their characteristics came later, such that any discussion of "essential" characteristics must recognize this relatively unrestrained historical evolution.

One of the first examples of societal cooperation was the defensive alliance, or peace guild. Early "peace guilds", which pledged mutual protection to their members, are considered predecessors of the modern corporation.[2] In addition to defensive motivations, practical considerations of organizing and monitoring communities led to the creation of municipal corporations. These arose from the common residence of members, whose leaders took care of the general political administration of communities. As Christianity spread throughout Europe, a common faith also led to the creation of corporate bodies to administer church affairs and property. These ecclesiastical corporations also utilized the benefits of being recognized as a separate legal person.

Europe was a crucible for the development of legal persons. The Romans had both types of enterprises, municipalities or public administration bodies, as well as commercially-oriented guilds and companies, with rules established in law[3]. England had its own examples from the 2nd millennium as its political and legal system took shape. The records related to the first legal persons in ancient England generally have to do with the incorporation of communities or towns. By imbuing such organizations with their own legal personality, the legal system facilitated public administration of the affairs of the residents. They also made it easier for communities to initiate public works, including entrusting the ownership of the resulting efforts to future generations by allocating these to the respective legal persons (e.g. municipal corporations). This dynamic applied equally to the ecclesiastical corporations, dedicated to promoting works of faith for both present and future generations.

Over time, smaller groups within such communities replicated the mechanisms of municipalities and churches, e.g. in trades and professions, often intruding even further into the lives of their members. Some medieval craft guilds engaged in the minute supervision of the livelihood- and to some extent their lives- of their members. Such craft guilds originally arose from the common interests of the members of the various professions and trades. Once their authority was legally recognized, even non-members could become bound by their by-laws, as long as these were not opposed to the law of the land and underlying public policy.

The next stage in the evolution of the enterprise was the extension of such organizations' groups beyond their immediate localities. For example, the earliest regularly chartered English companies dealing with foreign trade spread the practice of conducting their activities through the legal person

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[1] This section draws in particular on the following writings on the topic of the early legal persons: Susan Reynolds, The Idea of the Corporation in Western Christendom before 1300, pgs. 27-32 in Law and Social Change in British History, Royal Historical Society Study in History Series No. 40; Cecil Thomas Carr, Early Forms of Corporateness in Select Essays in Anglo-American Legal History Vol. III pgs. 161-179 (AALS 1909).
[2] Williston, Samuel, History of the Law of Business Corporations before 1800, Harv. L. Rev. Vol. II No. 3 (Oct. 15th, 1888), pgs. 106-07. Indeed the nation of Switzerland began with just such a mutual commitment.
[3] Id. at 106. See also R.W. Lee, Elements of Roman Law, at pages 103-105 (Thomson, Sweet & Maxwell 4th ed.). See also Detlef Liebs, Römisches Recht (UTB Vanderhoek 1975).

form beyond the narrow, local communities served by the guilds. In fact, trade helped such guilds maintain relationships with counterpart organizations in foreign lands.

Similarly, groups of persons plying the same trade or craft began to utilize legal persons not only to facilitate group ownership of property, but also to establish and monitor adherence to rules of membership. Last but certainly not least, religious organizations utilized the legal person form to organize their communal practices and facilitate the spread of their respective faiths. All of these enterprises: municipal, professional, and ecclesiastical, were attracted to the benefits of the institution of the legal person as described below.

A. The Evolution of the General Purposes of the Legal Person[4]

Each type utilized different specific structures, but the legal person form was attractive to all of them because of similar characteristics and objectives of the respective proponents. It is useful to examine the nature of these benefits, and the main characteristics of early enterprise to provide a framework for the main topics in this dissertation. In a way, the legal person which the modern enterprise typifies is the latest iteration in a long line of entities pursuing purposes deemed useful by and for societies. Though specific purposes may vary, certain general purposes are common to all legal persons. These are tied to specific characteristics of legal persons, which may or may not be considered "essential."

At the outset, it is helpful to review the societal and economic drivers which led to the creation of legal persons in their various forms and influenced their development over time. An understanding of these broader factors is crucial to analyzing the related legal theories and doctrines related to the activities of such enterprises. Though not legal concepts themselves, these factors define the contours of the broader policy considerations which determine and define the legal rules analyzed in this dissertation. Some elements or characteristics have even been highlighted as essential or intrinsic to the legal person. The extent to which such "essential" elements have withstood the test of time provides an indication as to just how flexible the institution of the legal person is and whether all the elements deemed "essential" really deserve that designation. The main justifications for creating a separate legal person are outlined below.

B. General Purpose- Regulating Succession of Positions and Property

The concept of a legal person separate and distinct from its owners goes back at least as far as the times of the Roman Empire[5]. At that time the family was the basic unit of society, with property and rights generally passing from father to the oldest son in the family in keeping with the tradition of primogeniture. In a similar fashion, the need for a basic vehicle of communal effort led to the creation of the legal person, to facilitate the transition from generation to generation in relation to communal goods and interests. The property succession feature of the legal person was thus at the heart of its inception. It became part and parcel of the early legal persons established within the Roman Empire and thus impacted legal systems throughout Europe and beyond.

The Roman state was renowned for its efficient public administration, including great public works. These included a far-reaching system of roads, aqueducts for the delivery of water, and the delivery of other public goods. Such projects were meant to last forever, or at least for a period of several human lifetimes. Out of this disparity between the duration of the average human lifetime compared to public utility projects meant to last for a relative eternity came the practical need for a legal mechanism to extend the legal life of such projects or services beyond that of the human persons

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[4] This section draws in particular on the following sources: Helen M. Lam, History of English Law, Chapter V in Selected Historical Essays of F.W. Maitland, Cambridge University Press (Selden Society) 1957; Williston, Samuel, History of the Law of Business Corporations before 1800, Harv. L. Rev. Vol. II No. 3 (Oct. 15th, 1888), pgs. 106-07; Simeon Eben Baldwin, History of the Law of Private Corporations in the Colonies and the States, Vol. III of Selected Essays in Anglo-American Legal History (AALS and Lawbook Exchange Ltd. 1992).

[5] See footnote 3.

responsible for their administration. In the absence of such a mechanism, the administration of such crucial public projects or services may have been ceased upon the death of one or more of the human persons charged with the monitoring and maintenance of those public works. At the very least, the death of members of the group responsible could lead to disruptions in the delivery of these public goods or public administration. From a legal standpoint, it was necessary to distinguish between the property managed by such caretakers for the collective good from their own personal property.

The legal system's solution to this challenge was to create a legal separation between the existence of the humans who managed towns and villages or owned and operated these great public works and the existence of the underlying public goods themselves. In other words, the overall "enterprise" was granted its own legal existence. This was and is, of course, a legal fiction. Legal persons do not exist in the same way as human beings. The legal treatment of their hypothetical existence has two prerequisites: 1) an act of (legal) creation, justified by the underlying purpose to be pursued by the legal person, and 2) the means to carry out, or at least attempt, the intended purpose, to support their recognition as legitimate and distinct persons recognized under law.

By granting political legitimacy to this legal fiction, the law endowed such institutions or bodies with a life of their own. Created by humans, these bodies could be imbued with indefinite, even perpetual existence- perpetual at least until humans rendered its existence at an end. This rendering could be achieved by assigning a fixed duration to the life of the enterprise or by defining circumstances under which the enterprise's "life" would be deemed to end. This could be, for example, when the underlying objective of the enterprise had been achieved (such as the completion of a particular project) or other conditions (such as the lack of funds to continue the functioning of the enterprise) which made the continued achievement of the objective no longer possible. It is worth emphasizing the "public goods" component of the early legal person, as this plays an important role in the issues surrounding responsibility and legal liability.

This basic characteristic of the enterprise, potentially indefinite existence, is important to analyzing the question of responsibility for the actions attributed to the enterprise. For example, if ruling against a legal person in a given tort or contract litigation would trigger its insolvency, a court in modern times may weigh the restitution objective against the longer term benefits the defendant would provide if it were to remain solvent and in existence. The ability to exist in perpetuity is also a cornerstone concept when looking at the broader questions surrounding the creation of enterprise groups. This relatively recent legal phenomenon is dealt with in further detail later on in this dissertation. Once enterprises were able to legally own each other, they began to grow even larger and faster. This had the natural effect of magnifying the collective impact of the actions attributed to such enterprises, and enhancing the power of those who had decision-making authority over them.

C. General Purpose- the Legal Person as a Collective Financing Vehicle[6]

Another rationale for the creation of enterprises was their practical and neutral utility as a conduit of resources. By pooling the contributions of multiple residents, citizens, or owner-investors, the enterprise as a separate legal person provided a vehicle for the administration of funds in a manner which could: 1) afford for the collective group what the members could not afford individually, and 2) be set up so as to mitigate human bias or subjectivity. This financial neutrality could be brought about by the framework of rules which set out how initial financing was to be raised, permissible uses for funds raised as well as any future earnings of the enterprise, the incurrence and payment of debt obligations, and so on. The attribution of such rules to an entity with potentially indefinite existence- as opposed to a person or group of persons- may make it easier to place the groups' interests ahead of any individual interests. Once the objectives of the legal person are defined, they tend to take on a life of their own, becoming the guiding principles for those managing them.

[6] This characteristic is explored in more detail in section III. C.

Legal persons have always reflected the nature of the societies and economies in which they were created and operated. Their ownership and financing also reflected the nature of the available forms of capital and the providers thereof. In predominantly agrarian societies, landowners were often the ruling class and land the primary object of investment. Following the industrial age, industrialists began to displace landowners as the main economic movers. Machinery and equipment became the main asset of ownership for the legal person created to provide the legal frame of operation for the business. Later, the consumer and capital components of the economy gained importance, with financiers providing capital as a key ingredient in enterprise creation and multi-corporate enterprise building.

As the number of enterprises grew, and the areas of collective efforts to which they related expanded, the nature of the financing of the enterprise gained increased importance as well. Given the relative concentration of wealth in societies throughout most of history, the pool of persons with the financial wherewithal to create and operate an enterprise was relatively small. In the absence of developed lending mechanisms or markets for raising capital, communities generally had to resort to this relatively small group of persons to support new, or expand existing, economic initiatives. In the last two centuries in particular, the development of organized markets for capital dramatically changed the dynamics of business financing. Once shares or units in a legal person became easily exchangeable, the shareholder role approximated a "pure investor" role. Ownership in "public" companies offered through equity sales on organized capital markets became accessible to the general public. This has arguably gone to the other end of the continuum in today's massive, liquid capital markets and pension finance systems. Some indirect involvement, and arguably responsibility, of the investors remains via voting rights. Whether that is a sufficient linchpin for personal liability in all cases is one of the central themes of this dissertation.

As legal mechanisms for lending and financing became more reliable and robust, this acted as a catalyst for risk-taking and new enterprises. More important for the consideration of liability attribution, such mechanisms facilitated the distancing between enterprise ownership and enterprise management or operation. They facilitated the spread of enterprise activity, as owners of wealth could increasingly delegate the management and operation aspects of an enterprise. These trends also enhanced the nature of the legal fiction of the enterprise as a separate entity with potentially perpetual life. By loosening the reliance or dependence of the enterprise on the continued existence (and solvency) of particular individuals, the "own life" dimension of the enterprise grew in stature.

Thus the overall financing conditions in place at a given time in a given country acted as a drag on, or driver of, enterprise creation. Where those conditions were relatively poor, holders of wealth were forced to be much more cautious in their lending or financing decisions. Moreover, these conditions forced them to be more directly involved in the operation of a given enterprise. This changed dramatically with the rise of organized capital markets. As we shall see, the level of involvement of owner-investors is a key factor in relation to the attribution of liability to, as well as amongst, corporate enterprises.

D. General Purpose- Risk Allocation

A survey of the early history of the legal person leaves one modern-day characteristic conspicuous by its absence: limited liability. Then as now, humans were behind the legal persons, which sometimes caused harm as a result of actions taken on their behalf. This thus raises questions of redress for anyone injured by those acts. The separation of the legal person and its attendant acts from the persons of the individuals running it was meant to draw a line in relation to their liability. The law began to call for clear designation of the capacity in which legal persons were acting, granting exemption from liability to individuals when exercising their duties as officials of corporations. The transitory nature of the officeholders, combined with the inanimate and potentially indefinite life of the enterprise blurred the lines of responsibility in such an intrinsic way that it seemed to disappear altogether. Where the frame of reference for the same act was a natural person, those charged with resolving a dispute might have had less difficulty in finding responsibility.

One cannot view the legal rules of the time based upon modern concepts of equality and human rights. During the period when corporations were primarily formed for municipal administration or to create and manage infrastructure, the value of an individual was tied to his or her rank in society. Moreover, the public nature of the underlying acts and the benefits which the first corporations brought to the respective society prevailed in any discussions about their justification or liability for the consequences of their acts. Any potential disadvantages or risks which such ventures brought with them were deemed outweighed by the overall benefits. Any liability exposure, as we understand that term today, would primarily have been in relation to debts or monies owed by such corporations, which were expected to stick to their agreements just like natural persons were ("pacta sunt servanda"). Harms in the nature of torts which resulted from the activities of such corporations may have been considered a necessary evil, or the price to pay for the overall benefits to society. The heavy public dimension to the underlying activities may have resulted in a sort of general immunity to claims for redress for non-contractual (i.e. debt) harms produced by such legal persons.

The exposure of officeholders' personal property was not a central tenet of early corporations. In fact, it did not really become so until corporations were used for private commercial ventures of the few compared to more socially-oriented purposes of the early community-focused enterprises. Tracing this feature of the earliest enterprises is not easy given the lack of surviving materials regarding how they operated. Amongst legal historians there is an open debate as to whether early forms of legal persons could commit a tort or even a crime. Roman law seemed to say no, "at least whenever *dolus* or *culpa* was necessary to make the act … wrongful."[7] Some question whether even the Roman legal system afforded the members of a *societas* complete immunity from actions of redress directed against them[8].

Early English law said yes, at least in relation to certain torts (e.g. trespass and trover)[9]. Modern US law also says yes, in certain situations. The answer seems somewhat clearer in relation to crimes, as most legal systems have an intent requirement which corporations, as legal fictions acting only through the human beings in charge of its operation, are generally deemed incapable of forming. Thus early English law held that corporations were incapable of committing treason[10]. But even here there are exceptions to any general rule, for example with United States statutes attributing criminal responsibility to the directors and officers of a corporation found to have committed certain acts.

The above highlights the quandary at the heart of the recognition of the separate legal person. In the effort to achieve the objectives which justify creating the legal person, natural persons carry out activities on their behalf. Those same persons would be fully responsible for those same acts if carried out in their individual capacity under the applicable liability rules[11]. Yet for legal persons there are different rules. The justification for this distinction is that on balance the advantages of the collective action carried out through legal persons outweighs the disadvantages. The fact that such collective action can also be carried out without a separate legal person would become a key counterargument in the debates around liability rules. But at this early stage, the generally philanthropic or municipal purposes behind the first corporations pushed the analysis in favor of more protective rules for the legal persons.

The nature of that debate shifts considerably when looking at the modern profit-seeking business corporation. While today the role of the legal person institution in facilitating the limitation of liability of its owners is touted as a central feature, this was not a core component throughout much of the legal development of the enterprise. As we shall see, the role of liability did not gain real prominence until the mid- to late 19th century. By then the nature of the activities undertaken by

[7] Williston pg. 124. (citing Savigny §§94-95).
[8] See See also R.W. Lee, Elements of Roman Law, at pages 103-105 (Thomson, Sweet & Maxwell 4th ed.).
[9] Id.
[10] Id.
[11] See Stephen Griffin, Company Law Handbook, 3rd ed., Law Society (2013); see also Nicholas Stewart QC, Natalie Campbell, and Simon Baughen, The Law of Unincorporated Associations (Oxford Univ. Press 2011), in particular chapter 1 (The Nature of Unincorporated Associations), and chapter 8 (Tort Liability and Crime).

corporations on the whole had changed rather dramatically. Though the corporate vehicle continued to serve as the basis for municipal and public asset administration, this function would eventually pale in comparison to its increasing use in economy and trade. It was not until industrialization and the widespread use of corporations for manufacturing that limited liability as a corporate attribute began to take on greater significance. Thus when analyzing the modern policy and law regarding single-entity and multiple-entity enterprise liability, it is helpful to keep in mind the historical context and the evolving nature of the basic purposes which underpinned the fiction of the earliest legal persons.

III. The Evolution of the Purpose-Responsibility Tandem and the Main Characteristics of the Enterprise as a Legal Person

The success of the enterprise as an institution of public administration led to its gradual deployment as the basic economic unit for much of private economic activity as well. No longer was public administration the sole or primary driver of creation of such enterprises. A later development of equal importance was the proliferation of private business enterprises using the corporate form. As a merchant class began to develop across various realms, there were many more economic actors at play than during feudal times, when royalty and their supporters held, or controlled, most of the economic wealth of the day. Over time mercantile activity came to represent a growing share of the economy, and with this came a tremendous growth in the interest in enterprises. The gradual dispersion in the concentration of economic wealth and power accelerated the trend towards standardizing the rules related to incorporation or enterprise creation. Later came a push-down in the level of state authority or approval needed. All the above factors culminated in the creation of a pool of commercial enterprises which reflected the political and economic conditions anywhere at any given time. It also resulted in a reevaluation of the rules related to the liability exposure of the owners or members of such commercial enterprises.

A. Setting the Stage- Early Entity Law in England[12]

Some of the earliest corporations in England had their roots in the guilds and parishes of the medieval period, and may trace back to Anglo-Saxon structures which existed on the European continent. At this time, the parish church was, along with the tavern, a focal point for societal interaction. Practitioners of the same crafts and trades tended to cluster around the same neighborhoods in the City of London. Similar to their peace guilds and municipal predecessors, these mini-societies arose based upon mutual needs and interests. There was strength in numbers, and cooperating as extended families helped the members both advance their common interests in the broader society (including vis-à-vis the king) as well as support each other in times of need. The common bond behind these "pre-corporations" was based upon practical necessity and a form of risk-sharing, a common source of livelihood and shared religious orientation. Members of craft and trade guilds often prayed together in the same church, and had a patron saint for their organization.

It is difficult to say exactly when such groupings began to form, or exactly how they cooperated, in their early existence. It was not until such groups became formalized, and officially recognized, that records began to be created memorializing their activities. A particularly important step, from a legal history standpoint, was the chartering or "legalizing" of the rights, privileges, and obligations which such groups claimed[13]. The chartering process, by officially sanctifying what may have been in practice for decades or longer, was a key step in the spread of the corporate form beyond the ecclesiastical/municipal realm. Increasingly, such collaborative efforts spread to the economic sphere, though even here the religious and social dimensions remained important throughout the medieval period. To gain a better understanding of the nature of these early organizations, it is useful to briefly examine the early chartering process which led to their legitimization. Our focus will be on

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[12] This section draws in particular on the following sources: Helen M. Lam, History of English Law, Chapter V in Selected Historical Essays of F.W. Maitland, Cambridge University Press (Selden Society) 1957; Williston, Samuel, History of the Law of Business Corporations before 1800, Harv. L. Rev. Vol. II No. 3 (Oct. 15th, 1888), pgs. 106-07; Book II, The Sorts and Conditions of Men, Ch. II §12 Corporations and Churches, in Frederick Pollock and Frederic William Maitland, The History of English Law from the time of Edward I, 2nd ed. Cambridge University Press (1968).

[13] Blackstone (see infra Section III C.) notes this in his early description of the law applicable to corporations, writing that in addition to royal charter, they could also be established by "prescription", i.e. the continual practice without objection of the state. But a grant of authority, whether express (e.g. in a charter) or inherent (e.g. by the Crown's historic non-interference with the activities of a group) was deemed a prerequisite to the early corporations.

the dozen companies which were granted special status, the so-called "Great Twelve Companies."[14] These provide a good sample for reviewing how the general purpose fed into the specific characteristics of companies.

B. The Company Purpose over Time

The level of responsibility attributed to a natural or legal person by a given legal system represents specific policy choices. It is thus worth reviewing the evolution of the corporate purpose over several distinct periods. Unlike with a natural person, the purpose of a legal person is defined by its creators, and practiced and sometimes modified by those entrusted with its management. To best achieve that purpose, a corporation is endowed with specific characteristics. Therefore, any analysis of the appropriateness of rules around liability- the specific corporate characteristic under scrutiny in this dissertation- must weigh this purpose against the factual impact of its activities on society.

1. Municipal and Ecclesiastical Roots

Some of the earliest forms of corporations in medieval England consisted of both secular (e.g. townships, "mayor and commonalty", "dean and chapter" of the early universities) and religious (e.g. parish, abbot and convent) institutions[15]. The decision to incorporate was a very intentional one, driven by the belief that there were some advantages to be gained by those involved with or affected by the underlying activities. Ecclesiastical corporations existed for definite purposes, such as "for the honor of a patron saint, for the defence of the Holy Land, [or] the relief of lepers."[16] Temporal corporations, such as municipalities, were examples of "land communities" who were primarily driven by the desire to better organize and effectively manage the (mainly agrarian) societies within their remit[17].

Though both groups may have sought similar benefits from incorporation, the motivation behind their respective members bore some important distinctions. Members of a monastery or convent, for example, became so as the result of a volitional decision to follow a particular way of life defined by the respective corporate purpose[18]. Members of a municipality, on the other hand, often became so as the result of chance, such as through the inheritance or purchase of a property. For them, the link to the group was "*a tenement, not a place in a community.*[19]" The nature of "joining" a group and the group's fundamental purpose were and remain key elements in relation to determining the rules for attributing responsibility for the consequences of the collective action carried out through the institution of a corporation[20].

Even in those early phases of the evolving English legal system, the jurists of the day periodically had to contend with questions around the legal responsibility of the collective body, such as a corporation, including the actions undertaken in its name and on its behalf. The general principle applied in such instances was that contained in the Roman law maxim: "*Si quid universati debetur singulis non debetur; nec quod debet universitas singuli debent*[21]." Roughly translated: "that which the group owes, an individual [in the group] does not owe, nor does the group owe that which the individual owes."

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[14] See Section A. 2. below. This group provides a good sample size and offers a significant body of material for research to elucidate the underlying research topics.
[15] See Book II, The Sorts and Conditions of Men, Ch. II §12 Corporations and Churches, in Frederick Pollock and Frederic William Maitland, The History of English Law from the time of Edward I, 2nd ed. Cambridge University Press (1968).
[16] Id. at pg. 510.
[17] Id.
[18] Id.
[19] Id.
[20] Id., noting that "*In these respects, the [religious] chapters and convents stood nearer to our modern joint-stock companies than to the medieval boroughs.*"
[21] Id. at page 487.

In other words, the corporations and the incorporators were to be seen as separate legal persons, with their belongings accordingly treated as separate as well. As early as 1437, English courts were ruling that a claimholder seeking recovery for a debt or damages against a commonalty only had recourse against the goods held in common[22].

There are three important points to keep in mind in relation to the early liability rules applied to early corporations of the type described above. First, they invariably related to money debts owed. Second, despite the relative uniformity of rulings, there were inherent exceptions from the outset. The King's power to seek satisfaction of debts (e.g. taxes) due by the community extended to the private possessions of the members of that community[23]. This entailed a specific public policy choice in favor of the Crown's need for financing over the private property rights of individuals and the collective rights embodied in a corporation. Third, the inherent weighing of interests in making such public policy choices entails consideration of the underlying purpose of a corporation, which in this early stage was primarily municipal or ecclesiastical. Both dynamics are worth keeping in mind in relation to the coverage of the subsequent stages of the evolution of corporate law covered below.

2. The Guilds and the Livery Companies[24]

One of the earliest waves of incorporations was that of the trade and craft guilds, which sought to gain official recognition of their status as well as certain rights and privileges through incorporation. Soon more and more groups sought approval via a royal charter. They were motivated both by some of the practical advantages of the corporate status outlined at the outset of this dissertation. For some there was an additional desire to protect their competitive position, often by obtaining a monopoly position through the chartering process.

The Weavers are considered to be the first such group to have formalized the recognition of their status as well as attempted to secure certain privileges related to the trade in cloth. In 1130 a representative of the group made a payment to the Royal Exchequer, which was duly noted on the so-called Pipe Roll[25]. This payment is believed to be linked to a charter from Henry II recognizing "*all the liberties and customs which they had in the time of King Henry my grandfather*[26]." The mentioned rights and privileges included the right to regulate craftsmen involved in the weaver craft, elect members to administer the activities of the group, including collecting fees and punishing members for violations through an internal court[27]. They were quickly followed by dozens of other companies which sought to procure a company charter.

In 1515, the Mayor and Aldermen of London set down the order of precedence for the 48 "livery" companies prevalent at the time. The first twelve represented the wealthiest and most influential economic institutions of the day, and became known as the "Great Twelve Companies." They were on the one hand independent groupings of citizens bound together by common interests and beliefs, but on the other hand they were at times key instruments of the state, particularly as England began to expand its influence beyond the boundaries of its island home. In this dissertation the twelve are presented in the chronological order of the grant of their oldest charter.

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[22] Id. at 493, citing the Yearbook of Michaelmas 16, Henry VI.
[23] Id.
[24] This section draws in particular on the following sources: The websites of the respective companies generally contain digital copies of the respective companies' corporate charters. Some copies are also found in the library of the Law Society of England & Wales as well as Bodleian Library at Oxford University.
[25] The Pipe Rolls are a collection of financial records of the English Exchequer, reflecting the annual audits of accounts and payments as presented by Crown officials to the Treasury. The entry for 1130 shows that a person by the name of Robert Levestan made a payment of 16 pounds on behalf of the Weavers. See Company History of the Weavers, available at http://www.weavers.org.uk/history (visited Nov. 29th, 2012).
[26] Charter of the Worshipful Company of Weavers of 1155. Id.
[27] Id.

1) *The Goldsmiths*

The respective expertise of the guilds' members often made them useful to the Crown. The Goldsmiths' Company received its first royal charter in 1327 and, in keeping with the practice of the guilds, selected Saint Dunstan as its "patron saint.[28]" The Goldsmiths regulated the work product of those working with gold, for example requiring that each member indicate their identity on their wares to facilitate tracing these back to their creators.

Given the importance of coinage to the royal economy, the Company was also entrusted with certain semi-public functions, including setting weight and quality standards and monitoring its members' adherence to these standards. That tradition continues to this day, with the Company administering an annual trial to check that the UK coins produced at the Royal Mint are within the statutory limits for metallic composition, weight and size[29]. The Goldsmiths' Company, like many of the London so-called "livery" companies, also pursued charitable works from its early days, reflecting the spiritual dimension of such Companies' activities and purposes. This frequently entailed the creation of schools and colleges, the establishment of almshouses, and even the payment of stipends to church entities to cover church services devoted to their members, both living and departed. For many of the Livery Companies, such charitable pursuits have become their primary activity today, the commercial aspect having faded with changes in the economy and society.

2) *The Mercers*

The Mercers Company, comprised of general traders, had been acting as a guild for a long time before a lawsuit in 1304 first made reference to them acting as a "corporate body.[30]"In addition to the standard function of regulating its members, the Company also looked after the families of members who had fallen upon hard times, such as at the death of a member and head of household. The Royal Charter granted the Company in 1394 included the right to act as a "perpetual commonality", including the right to hold and transfer property[31].

A second Royal Charter approved a common seal to confirm the legitimacy of business dealings of the Company's members. Such privileges came with obligations, however, such as in the early 17th century when King James I gained the "support" of the London corporations of the day for the so-called Plantation in Northern Ireland. The Crown indirectly financed the colonization of the area by dividing up the areas in the north and having the Twelve Companies draw lots to see for which areas they were deemed to be responsible[32]. This interaction between the early craft/trade corporations and foreign ventures of the Crown would soon be mirrored by the great trading corporations, which acted far beyond England and even Europe.

3) *The Haberdashers*

Another early London corporation was responsible for the organization and regulation of haberdashers, persons involved in the creation of a wide range of decorative items (beads, ribbons, pins), clothing accessories (purses, gloves, caps), toys and more[33]. Its members also generally

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[28] See the timeline of the Company's history available at http://www.thegoldsmiths.co.uk/about-the-company/history/. (visited Nov. 29th, 2012). A "patron saint" was a concept borrowed from the Catholic Church, the idea being that each trade or profession had a particular saint "responsible" for watching over them. The patron saints of the early London corporations were often included in their regalia, such as the coat-of-arms.

[29] This event is considered one of the oldest, continuously running judicial procedures in England. See http://www.thegoldsmiths.co.uk/about-the-company/the-trial-of-the-pyx/ (visited Nov. 29th, 2012). The author witnessed the 2014 "trial" (weighing ceremony) in person.

[30] For a detailed overview of the Company's history see http://www.mercers.co.uk/700-years-history (visited Nov. 29th, 2012).

[31] Id.

[32] Id.

[33] See the "Company History" section at http://www.haberdashers.co.uk/ (visited Nov. 29th, 2012).

worshipped in the same church (Saint Paul's), and were divided between the Livery (employers) and Yeomanry (employees). The type of membership determined the nature of the rights and obligations, with the former enjoying a so-called right of patrimony. This meant that membership could be passed on to one's children, consistent with the practice of the day by which parents generally passed on their respective trade, generally to their sons.

The Company gained its Royal Charter in 1448, permitting it to hold land and have its own Hall for meetings[34]. Such Company Halls were important for the administration of the affairs of each Company. Those affairs included direct regulation of the production and sale of goods falling within the scope of "haberdashery", said scope being not always easy to define. Those in charge had the right to search all "haberdashers shops" within three miles of the City of London, and destroy goods that were deemed not up to standard[35]. One fascinating aspect of such quasi-police rights of some early craft corporations was that they often extended to non-members as well by virtue of the geographic boundary of the authority granted in the Charters. Over time, the haberdasher trade became too dispersed, and difficult to regulate. The main activities of the Company then morphed into the educational and charitable programs which had heretofore been supplementary to the traditional regulatory role.

Other examples from the day show the frequent close relationship between the chartered corporations and the Crown. For example, the companies often sent some of their members to military duty. Some Companies even managed to have some of the royalty become members. For the state, the companies became an important source of revenue for the exchequer. Indeed in some respects the companies owed their very existence to their ability to provide such revenue. They also aided the state by acting as an extended administrative agency and even police force[36] through the regulation of their members and their extended communities.

4) *The Fishmongers*

The fishmongers were a community of persons involved in the fish trade in the London Area. They were organized long before a charter from King Edward I around 1272 granted their organization legal recognition and a monopoly on the sale of fish[37]. This privilege was reconfirmed in later charters from King Edward II and III[38]. Given the key role of fish in the diet of the masses during the middle ages, this monopoly privilege enabled members of the Fishmongers guild to become quite wealthy. The Fishmonger Livery Company was well-connected politically and even had its own court of law to resolve any disputes arising out of piscine commerce. Eventually the Company lost its monopoly, but continued to have an influence in the affairs of both fishermen and fish distribution in greater London[39]. As with most of the Livery companies, its Great Hall was the center of action and symbol of its history and expected permanence[40]. The company continues to maintain a link to the fish trade, though the nature of its company purpose has shifted from predominantly commercial to more philanthropic.

5) *The Vintners*

The origins of the Vintners Company traces back to pre-Norman times, when as early as the 12th century, writings reference groups of traders and merchants in wine coordinating their efforts and

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[34] Id.
[35] Id.
[36] Cite to Company which pursued assault charges against member who fled the Realm.
[37] The Fishmongers- History, available at http://www.fishhall.org.uk/history-heritage/, last visited Sept. 9th 2014.
[38] Id.
[39] Id.
[40] The original Fishmonger's Hall, like much of London, was destroyed in the Great Fire of 1666. Since then, the hall has been rebuilt and moved twice. Id.

setting the prices for various wines and wine products[41]. The first official recognition came in the form of a royal charter in 1363, through which members of the company received a monopoly on trade with Gascony, a region in France[42]. This monopoly had a geographic reach which covered all of England, and even permitted the company to conduct searches and investigations of any potential violations of their royal privileges[43]. To understand the importance of such privileges, it is worth noting that by the middle of the 15th century, wine represented roughly one third of imports into England.

The power of the Vintners Company dissipated in the 16th century, when King Edward IV considerably restricted their monopoly rights to the wine trade in England. During the reign of the Stuarts, the Company found itself on the wrong side of English politics, suffering increased taxation and reduced support because of its connection to King Charles I[44]. The loss of the Company's hall in the Great Fire of 1666 almost tolled its death knell, but it made a comeback under later holders of the English throne. These restored some of the earlier trading privileges which had been withdrawn by other monarchs, with the exception of the right to search competitors for potential violations[45]. The preferential treatment of some companies occasionally led to public protest. During one heated campaign against the Livery Companies in the 19th century, the Vintners fared better than most, possibly thanks to its ability to show that it was not only meeting, but exceeding, its commitments to charitable causes.

Even in the late 20th century, the Vintners stood out amongst the Livery companies by succeeding in receiving a renewed charter aimed at protecting its position[46]. Under the revised charter, the Company was authorized to establish the Wine Standards Board, which has delegated authority from the government to enforce wine standards and regulations under EU law[47]. Thus the Company is a good example of how many of the livery companies have been able to adjust to the demands of modern economy (and democracy), while retaining some of the key vestiges of their medieval origins.

6) *The Merchant (Taylors) Tailors*

The Merchant Taylors Company has its origins in the beginning of the 14th century[48], when practitioners of both tailoring and linen armourers[49] banded together to form a religious and social fraternity to protect and expand their interests in their craft. It received its first royal charter from Edward I in 1327, and by the end of the 15th century controlled much of the production of and trade in clothing products[50]. That position was fortified in an additional charter from 1503, under which the guild was known by the lengthy name of the "Gild of Merchant Taylors of the Fraternity of St. John Baptist in the City of London[51]." As the political power of the merchant class grew, English politics became increasingly driven by trading issues. Trading became a profession in and of itself. The trading dimension of a company's character and activities began to predominate, with many of its members shifting to the more lucrative trade in goods rather than being craftsmen[52]. This trend continued with the origin and growth of the Chartered Trading Companies, discussed in the next section.

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[41] The Vintners, company history, available at http://www.vintnershall.co.uk/, last visited Sept. 9th 2014.
[42] Id.
[43] Id.
[44] Id.
[45] Id.
[46] Id.
[47] Id.
[48] See website of the Merchant Taylors at http://www.merchant-taylors.co.uk/ (last visited Sept. 9th 2014).
[49] These were the producers of the padded tunics and other undergarments which were worn under armour in medieval times. Id.
[50] Id.
[51] Id.
[52] Id.

7) *The Skinners*

The Worshipful Company of the Skinners has its origins in the fur trade of the medieval age, and received its first charter from Edward I in 1327[53]. It maintained control over the trade in fur products, particularly in foreign ermine and sable, which were reserved for the English royalty and aristocracy[54]. As with the Merchant Taylors, the skinners gradually evolved away from being craftsmen to being traders in fur goods. Because of the overlap in the two product areas, these two companies were often at conflict, which at one point even led to death[55]. The rivalry between the livery companies for power and recognition lasted over the centuries. The Crown periodically relied on these entities when it needed funds or assistance in its foreign ventures.

8) *The Grocers*

The Worshipful Company of the Grocers has its origins in the Pepperers Guild, whose roots trace back to around 1100[56]. The role of the Pepperers was to prevent "garbling" or the alteration of the purity of certain spices and medicinal drugs, including many imported products[57]. They also maintained the so-called King's Beam for precise weighing at key entry points for products in England[58]. In 1345 the pepperers reformulated as the Company of Grocers[59] of London, receiving a royal charter reaffirming their traditional privileges. Here we see another example of a company, and its charter, connected to quasi-public function, that of monitoring the quality and purity of certain goods.

9) *The Drapers*

The Drapers Company received its first royal charter in 1438 as a "legal corporate fraternity" with the privileges of perpetual succession and a corporate seal[60]. The full name of the company was "The Master and Wardens and Brethren and Sisters of the Guild or Fraternity of the Blessed Mary the Virgin of the Mystery of the Drapers of the City of London.[61]" As with other livery companies, and as the name suggests, the Drapers had their roots in a common livelihood and local church in London. There was a broad spectrum of members, ranging from small drapery shop owners to merchants and traders in drapery goods (wool and cloth), to those who financed the drapery trade.

The charter privileges allowed the company to regulate the trade in woolen cloth in London, controlling the sale of cloth at fairs, setting the standards and units of measurement, and so forth[62]. The Drapers Company grew wealthy along with the expansion of the trade, and eventually obtained its own meeting hall. This better enabled its members to coordinate their activities as well as providing a valuable asset which was handed down from generation to generation of members. As England expanded its control over Ireland, the Drapers participated in the acquisition of estates there

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[53] See website of the London Livery Companies, Merchant Taylors section (last visited Sept. 9th 2014). See also https://www.theskinnerscompany.org.uk/ (last visited Nov. 27, 2016).

[54] Id. Other classes had to be satisfied with less luxurious types of fur, such as lambskin, rabbit and cat. Id.

[55] This high point in the conflict between the two companies was in 1484 and revolved around the position each company should have in the annual Lord Mayor's boat race. In order to prevent future disputes, the Lord Mayor decided that the companies should alternate taking the lead. *Id*. This episode shows the importance which livery company members attached to their ranking and image at such important events in the royal and mayoral calendar.

[56] See „A Brief History of the Grocer's Company", available at http://grocershall.co.uk/the-company/history/ , (last visited Dec. 3rd, 2013).

[57] Id.

[58] Id.

[59] The term "grocer" is believed to derive from the Latin word "grossarius", or someone who deals in gross volumes. In other words, a wholesale merchant.

[60] See The Drapers Company, Company History, available at http://www.thedrapers.co.uk/Company/History-And-Heritage.aspx (last visited Dec. 8th, 2014).

[61] Id.

[62] Id.

and extended their commercial reach. As the cloth trade became more international in the 17th century, the direct involvement of the company in the commercial trade decreased to almost nothing. But the privilege of perpetual succession, combined with a substantial endowment which built up over the centuries, has provided the basis for the Company's charitable work to the present day[63].

10) *The Salters*

The Salters Company is another whose roots go back far beyond medieval times, perhaps even before the Battle of Hastings which triggered the founding of the modern English kingdom[64]. Salt was a key commodity for centuries, both for its usefulness in preserving foods, as well as in connection with chemical processes which underpinned other trades, such as the treatment of leather[65]. As happened with other trades, salters tended to gather around a central area in London and increasingly coordinated their activities[66]. In 1394 King Richard II granted letters patent, or a charter, recognizing the company and its key role in the salt trade[67]. This was partly in order to quell disturbances caused by disputes between those involved in salt mining and sourcing and those merchants wishing to corner the trade[68]. The Crown also used the charter as a means of improving the state coffers through tax on the trade.

The Salters Company, like most of the livery companies, protected both the interests of its members as well as those of consumers by regulating the distribution of salt, including monitoring quality and means of measurement and sale[69]. It also shared with the other livery companies the common practice of training apprentices, an important aspect of maintaining order and stability in the trade[70]. It also protected its members, particularly if they or their family members fell upon hard times. One way such companies did this was in their establishment of almshouses, which over time served not just members but also general members of the community[71].

As the importance of salt declined centuries later, particularly with the advent of refrigeration, the activities of the Salters (like those of many of the livery companies) transformed to predominantly charitable activities. They often relied on the earnings generated by land, properties, and money donated to the company by its members over the centuries.

11) *The Ironmongers*

The Ironmongers, originally referred to as the Ferroners, can trace their roots as an organized back to at least 1300, when they initiated court action against certain blacksmiths in relation to the quality of iron used in London carriages, then the main form of rapid transportation[72]. They can point to an official coat-of-arms dating from 1455 and a charter of incorporation from 1463[73]. The privileges were reconfirmed and sometimes amended in subsequent charters. Depending on the political winds of the time, the monarchies often tapped the livery companies for funds to finance state endeavors, including establishing colonies and fighting wars. This has even been described as being subject to a

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[63] Id. See also http://www.thedrapers.co.uk/Company/Modern-Role.aspx (last visited Dec. 8th, 2014).
[64] See The Salters Company, Company History, available at https://www.salters.co.uk/the-salters-company/company-history/ (last visited Dec. 3rd, 2013).
[65] Id.
[66] Id.
[67] Id. The official name of the chartered company was the Fraternity and Guild of Corpus Christi in the Church of All Hallows, in recognition of the parish and church where its members met and worshipped.
[68] Id.
[69] Id.
[70] Id.
[71] Id. Some of these almshouses continue to this day in the form of charitable hospitals.
[72] See http://www.ironmongers.org/company_history.htm (last visited Dec. 8th, 2012).
[73] Id. The full name of the brotherhood was the "Honourable Crafte and Fellasship of Fraunchised Men of Ironmongers."

type of royal "extortion" when the ruling monarchs reviewed the status of the livery companies and made particular demands- both financial and behavioral- upon them[74].

Eventually the iron and coal trades shifted away from London to the Midlands. This led to a gradual shift of the Company's activities away from their original commercial focus to more charitable and political efforts (i.e. in the City of London)[75]. When industrialization took off in England, this evolutionary process was completed, and the Company's direct involvement in the respective trades essentially came to an end. Similar to other livery companies who suffered the same fate, the Ironmongers Company continued as a charitable organization, relying on the wealth (e.g. purchased property and member bequeaths) which grew over time.

12) *The Clothworkers*

At its formal establishment, the Clothworkers Company aimed to protect the interests of its members and promote the profession of clothmaking within the City of London[76]. Like many of the early English corporations, the Company had its roots in the coordinated efforts of participants in a particular trade or craft in London. Such participants already had informal arrangements regarding the maintenance of standards and the regulation of competition[77]. The receipt of a formal charter strengthened the claim to these and other privileges, and provided a basis for forcing individuals wishing to be active in a trade to join and follow Company rules. In the Clothworkers' case this formal sanctioning from the Crown came in 1528, though such corporate charter grants were generally deemed to be an affirmation of rights which had accrued through practice and action over the years[78]. Later jurists took care to point out that this was only with and contingent upon the implicit affirmation of the monarchy[79].

As can be seen from the above brief historical overview of these select Livery Companies (and there were hundreds by this time controlling a large portion of the English economy), the evolution of the company vehicle was rather haphazard. This applied both in terms of the process of their creation and operation, as well as in terms of their underlying substance and activity. The summary reveals several commonalities which such organizations had with the modern-day corporation, including:

- An overall commonality of interest of the participants or members
- The requirement for official approval of both the organization and its specific activities by the state (i.e. the Crown). Certain privileges were only obtainable through such formal processes. Of these, one of the most important was perhaps the right of self-government as a community, provided of course that such internal rules did not run afoul of the law.
- The importance of the perpetual succession of the organization, in particular in relation to property held by it, with a clear separation between the Company and its members at any point in time.
- A name, along with a seal or coat-of-arms, or other means of distinguishing and identifying the Company, its members, or goods and products produced in accordance with its regulations. In a company's dealings, the name also served as an indication or evidence of consent of these legal persons, analogous to the signature of a natural person.
- A central location for the administration of its affairs, such as a Company Hall, for hosting regular meetings and events of the Company and providing it with a "management center." Livery companies sometimes used churches, or the halls of other corporations, in periods where they did not have their own hall or office.

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[74] Id.
[75] Id.
[76] See http://www.clothworkers.co.uk/History.aspx (last visited Dec. 8th, 2012).
[77] Id.
[78] Id.
[79] See, e.g. the discussion regarding Blackstone's treatise in Section III C.

The above characteristics describe the essence of the company at the end of the 16th century, a time when the common law began to take on increasingly definite contours, particularly in relation to mercantile law. The nature of the law applicable to corporations in medieval England evolved over centuries, with practice often setting the stage for later formal discussions (e.g. by legislators or judges) regarding the nature of the corporation and its activities. The Livery companies provide a useful backdrop for considering the main drivers in company creation as well as some color on their role in society. Their common features of pooled interests, lineage and objective of succession and continuation, charitable and often religious dimensions, all helped shape the body of law which began to apply to them. Nuances continued to arise in specific instances, and courts were occasionally called upon to provide more detail on the common threads which linked the various types of corporations (municipal, trade, crafts, etc.).

Gradually the case law began to define the requirements and contours of the corporation from a legal perspective. One of the earliest of these was the *Case of Sutton's Hospital*[80]. This case is perhaps the earliest example of a comprehensive treatment of the nature of a company under English common law at the time. The decision was summarized by Coke, whose analysis reflected the "essence" of the corporation as it was perceived at the time. Understanding its holding is thus important to analyses of the characteristics of companies formed as corporations, in particular what characteristics were considered essential.

In the case, the plaintiff contested the legal incorporation of a hospital based on specific, technical arguments about the process necessary to create a legal person under letters patent from the King[81]. These included arguments concerning the sequence and level of completion of subsequent steps. In particular the complaint alleged deficiencies in establishing the legal person in a lawful manner (e.g. by grant of authority from the King), donating the property which would serve as the facility for the hospital and school, being specific (i.e. describing the grant "in metes and bounds") about:

- the initial funding donation,
- then appointment of persons (e.g. headmasters and other administrators) to run the newly-found institution, and
- opening the school to the intended recipients of the grantor's (Sutton's) charity, the poor.

The plaintiff argued that the failure of any of these steps, in the specific order, would make the whole incorporation void and the letters patent "repugnant." Because the donor was deceased at the time of the litigation, with his affairs regulated by his will, there was no way to discern intent or rectify the alleged original errors. The Court disagreed with the plaintiff, countering each point with a more liberal rationale regarding the incorporation process and refusing to hold to a rigid interpretation of either the sequence or the specifics of the execution of the individual steps in the incorporation process. Though the details of the dispute are an interesting reflection of the state of the law in the late 16th century, their main value for the topics of this dissertation is in the weeding out of the nature of the legal person under medieval English common law and in its focus on the process elements of incorporation.

The *Sutton's Hospital* case set out the basic elements of a corporation under English law. Coke, one of the leading jurists of the day[82], described these as follows:

> *"What things are the essence of a corporation? Now it is to see what things are of the essence of a Corporation.*

[80] The Case of Sutton's Hospital - *Sir Edward Coke,* Selected Writings of Sir Edward Coke, vol. I *[1600]*.
[81] The dispute is believed to have been motivated by personal objections related to the structure and planned management of the hospital as opposed to a challenge to the underlying charitable purpose.
[82] For more on Coke and other early jurists in English law, see Chapter V, History of English Law, in Selected Historical Essays of F.W. Maitland, Cambridge University Press (Selden Society) 1987.

1. *Lawful authority of Incorporation; and that may be by four means, scil. by the Common Law, as the King himself, &c. by authority of Parliament; by the King's Charter (as in this case) and by prescription[83].*
2. *The second which is of the essence of the Incorporation, are persons to be incorporated, and that in two manners, persons natural, or bodies incorporate and political.*
3. *A name by which they are Incorporated; as in this case Governors of the Lands. &c.*
4. *Of a place, for without a place no Incorporation can be made; and here the place is the Charter-house in the County of Middlesex[84].*
5. *By words sufficient in Law, but not restrained to any certain, legal and prescript form of words.[85]"*

These four elements: legitimate establishment[86], defined participants, separate legal name, and location, were to become cornerstone requirements of the corporate entity. They describe the "what" of a given corporation, and remain relevant to this day. Their relative importance has fluctuated along with the main purposes driving the corporate form and the nature of activities carried out under its cloak. The final element is a description of the "how", i.e. the process by which a corporation is legally created. Let's look at each element in turn.

To this day the requirement of defined participants has persisted in the requirement that a minimum level of transparency exists concerning the owners and operators of corporate entities. Given Coke's reference to both "bodies incorporate and political" as well as "persons natural", it is worth considering just how revolutionary the legislative sanctioning of corporate-corporate acquisition and ownership in US corporate law at the end of the 19th century really was. The quote suggests the permissibility of corporate bodies being incorporated in other, e.g. larger entities. Perhaps this was utilized in relation to municipal corporate bodies being joined as society became more urbanized and previously separate municipalities began to combine or similar guilds joined forces. The extent of such activity is beyond the scope of this dissertation.

The corporate name continues to be important even in the age of self-incorporation. A „name check", in which the current availability of a given corporate name in a given jurisdiction is analyzed prior to approving an application, is a standard component of the modern incorporation process. Though generally still a technical requirement of the incorporation process, the location requirement has been reduced to more or less a formality, which can generally be met by having a local address. This can be provided by a local agent instructed for this purpose. The primary purpose of the rule is to guarantee the ability to contact and send mail to the management of the corporation, e.g. for the service of process in litigation involving a corporation.

Other elements and obligations were added over time, as discussed in later sections of this dissertation. It is worth noting that the limited liability of legal persons or groups was not included as one of the essential elements of the corporation in the first centuries of its existence. Indeed, it did not become a central theme of corporation law until relatively recently. Legal scholars have deemed this significant in their analyses of the extent to which this attribute should be considered an essential element of the corporation or corporate group today[87].

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[83] Prescription generally refers to associations which had not gone through a formal incorporation process, but not business corporations, where a formal charter was necessary to procure legal recognition of specific privileges. Williston at pg. 114.

[84] Vide 3 Hen. 6 Det. 20. 17 Edw. 3. 59b. & 45 Edw. 3. 27

[85] *The Case of Sutton's Hospital.* - Sir Edward Coke, *Selected Writings of Sir Edward Coke, vol. I* [1600]

[86] See discussion infra Section III B. 2 regarding the gradual trend away from a top-level, discretionary process at the highest legislative or executive levels of the state to an accessible, almost routinized administrative process.

[87] See discussions in sections III. A. 4., III. C. 4. and VII.

Around the time that the common law was clarifying the nature of the corporate form, the Crown was involving the chartered livery companies in its colonization of Ireland. In the early 17th century, holders of corporate charters were called upon to provide funds for settlements in Ireland, particularly in what would become the industrial north. It was a period in which Europe's monarchies began increasingly looking elsewhere for further growth opportunities. Companies began to play a key role in that effort. Whereas the early guilds and first London guild companies were very much focused on the local markets, the great trading companies which arose at the start of the 17th century sought fame and fortune in unknown, or little known, distant parts of the globe.

3. <u>The General Trading Companies</u>[88]

As Coke was writing his famous treatises, other developments were expanding the relevance of the company form to areas far beyond England. European powers had begun exploring and settling the New World, as new objects of exchange (spices and silk from the Far East, tobacco and furs from North America, gold and ivory from Africa) led to the establishment of protected trading routes. Though the monarchies of the Iberian Peninsula may have had an early start, the British Crown soon became a leading player in global trade. As the British Empire began to expand across the globe, the company form became the preferred choice for housing ventures of an unprecedented scale and reach.

The promoters of the early trading companies recognized the risks of financing distant explorations aimed at expanding trading markets. They did not enjoy the level of control over the commercial risks as the London livery companies by virtue of the management living near to and amongst the members. The promoters were the persons who determined the overall success or failure of company activities. Nor could the Crown be of much assistance (at least at first) in the event of difficulties faced in distant lands.

Those funding such foreign trading ventures had little certainty regarding what return they might make. This contrasted to the guilds and livery companies, with almost instant notice regarding the kinds of goods bartered and amounts of money paid locally. There was also the constant risk of a complete loss (e.g. if a ship sank or was destroyed or a foreign trading outpost expelled), initially without the safety net of well-developed insurance markets. These factors made the livery corporations relatively safer and faster forms of investment by their members. On the other hand, the local markets became satiated at a certain point, presumably quicker than the enormous profit potential which foreign trade brought with it.

To address these differences, the promoters of great trading companies used the joint-stock company as their main operating model. This legal form permitted the promoters to seek capital from a broad range of persons including "*widows, orphans and all other subjects*" who were invited to "*employ their capital.*[89]" The process of "joint stock" subscription evolved over time, with varying subscription terms tied to the duration of ship voyages. There was generally a revaluation of the stockholding values at the end of each term, with dividends paid out in proportion to the share in the company. In a sense, these trading companies were the forerunners of the modern public corporation.

Some of the underlying features of the modern corporation began to take shape during this period, including tools for the management of the risk of loss, proportionate investment and reward arrangements, transferability of shares in a venture, and so on. The guilds and livery companies had already known a form of self-funded insurance to aid members and their families in case of illness or death[90]. The development of international mercantilism brought with it influences from the

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[88] This section relies in particular on the following sources: Williston, Samuel, History of the Law of Business Corporations before 1800, Harv. L. Rev. Vol. II No. 3 (Oct. 15th, 1888) at pages 106-111, as well as the official charters of the trading companies.

[89] Id.

[90] See William Reynolds Vance, The Early History of Insurance Law, at pgs. 101-102.

Continent, including the maritime trade custom of obtaining insurance on goods in transit[91]. The leading Italian trading houses such as the Lombards had offices in London and represent the origin of the underwriting industry in England[92]. The courts brought such customs and usages into English law through their decisions, as a definitive body of commercial law began to develop[93]. This grew into a formalized insurance market, coordinated by Lloyd's of London. By 1601 it was even subject to specially drafted statutes[94].

Noteworthy in this development is the nature of the risks addressed by this burgeoning practice of obtaining assurances (insurance) from an organized market. The preamble to the 1601 Act refers to the payment of money for "assurance made of their goods, merchandises, ships and things" required in international trade[95]. It was the value of the goods that was in focus. Risks related to injuries to individuals (e.g. seamen, common carriers) were were not in focus of the early insurance mechanisms. Nor would they begin to gain attention until after the Industrial Revolution[96].

During this period all corners of the earth came within the sights of a growing merchant class. One feature these trading companies generally shared with their London livery company counterparts was a monopoly right of some sort. The so-called "regulated companies" were made up of foreign traders enjoying a monopoly over trade to a particular country/region (e.g. Africa Company, Russia Company, Turkey Company). In a similar fashion these organizations were the predecessors of the modern multinational group. Perhaps even more so than in relation to the livery companies, the regulated trading companies were often viewed in some respects as an extension of state (i.e. Crown) authority. In the words of one commentator:

> "*The corporation was far from being regarded as simply an organization for the more convenient prosecution of business. It was looked on as a public agency, to which had been provided the due regulation of foreign trade, just as the domestic trades were subject to the government of the guilds*."[97]

And as with the guilds, the trading companies required the official sanctioning of the Crown in the form of a company charter. The early charters provide evidence (e.g. in the recitals) that the corporation had a public function in "managing and ordering the trade in which it is engaged[98]" in addition to the private function of enabling profits to its members. Over time, that public function would extend incredibly far, such as the development of a "company army" to manage and control the trade in foreign locales. Some regulated trading companies also assumed quasi-diplomatic roles for the Crown, given their direct contact with the leaders of foreign lands. Three examples provide a better feeling for this next phase in the development of the company.

1) The Muscovy Company

One of the earliest companies to make a business out of trading with foreign lands was the Muscovy Company, which was originally formed in 1551 as the "Mystery and Company of Merchant Adventures for the Discovery of Regions, Dominions, Islands, and Places Unknown[99]." It received its first charter in 1555. The promoters hoped to exploit the opportunities in the region controlled by

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[91] Id. at 105-106 (noting that „*as early as 1318 the custom of making insurance upon goods subject to peril in transportation either on sea or land had become a customary incident of traffic.*“). Id at 105.
[92] Id. at 109-110.
[93] Id. at 112-113 (noting that the common law courts of the time were "ill adapted for the settlement of merchants disputes", leading to the development of specialized commercial courts.
[94] St. 43 Elizabeth c. 12 (described as the first English insurance act). Id. at 113.
[95] Id.
[96] These later developments are reviewed in Sections IV. and VI. A.4.
[97] Id. Pg. 110.
[98] Vance, The Early History of Insurance Law, at pgs. 112-114.
[99] The description is based upon information obtained from http://en.wikipedia.org/wiki/Muscovy_Company (last visited Jan. 23rd, 2015).

Muscovy, a rising power. Following the fall of Constantinople to Ottoman forces in 1453, Muscovy had become the center of power in the Eastern Christian realm. It extended far beyond modern-day Moscow, northward up to the Arctic Circle, and southward to the Black Sea. As a political, economic, and religious hub, it offered great riches to anyone who could establish preferential trading rights with the ruling czar. That was exactly the goal of the original promoters of the Muscovy Company, who raised funds to finance exploratory trading trips to Muscovy.

The company first had to prove itself to the Crown in order to obtain the special privileges it hoped would secure its economic future. Though one of the original three ships was frozen in the Arctic Circle, the others were able to reach the Russian territories and gain an audience with the Czar. Chancellor, one of the major and active promoters of the venture, returned to London with documents showing that English traders were welcome in the territories of Muscovy and could enjoy special trading privileges. Such early successes enabled the Company to receive special privileges from the Crown. In 1555 the Muscovy Company received a renewed charter under that name from Queen Mary I. With support from both monarchies, the Muscovy Company was able to gain the right to free passage, exemption from customs duties, settlement rights including a level of self-government, and even freedom from arrest. In many respects, what had begun as a private trading company became an extended arm and diplomatic link for England to the empire of Muscovy.

The performance of the Muscovy Company reflected the respective fortunes of, and relations between, the two trading nations. During its expansion phase, the Muscovy Company obtained additional trading and non-trading privileges, such as monopoly whaling rights in the North Sea area around modern-day Norway. When Muscovy suffered defeats in power struggles with its neighbors to the east, Czar Ivan IV even felt out the prospects of marriage to Queen Elizabeth I, as a possible escape plan, or to secure military support. When the English queen did not accept the offer, overall relations cooled. During such phases the Company was unable to fully exercise its special privileges. Similarly, during the civil war and Cromwellian period, Muscovy froze its support for the English businessmen in its territories. Eventually the English lost their monopoly trading privileges, as other rising European powers learned of the attractiveness of the Russian lands and products. Over time the fortunes of the Company declined, though it did continue to formally exist until the 1917 Bolshevik Revolution.

2) *The London (Virginia) Company*

The London Company was set up in 1606 as the Virginia Company of London with the goal of sailing to North America and setting up communities there on behalf of the Crown[100]. King James I granted the company a royal charter and exclusive rights to territory encompassing almost the entire eastern seaboard of North America. That initial support enabled the company's promoters to attract financing for a small fleet of ships to make the long voyage to these little known areas. It also helped them attract settlors willing to risk the dangers of both the trip and settlement in return for the chance of a new life elsewhere.

The first landing of the Company's ships was in April of 1607 in an area which is part of the state of Virginia in the United States. The settlement struggled from the outset, due to unfamiliarity with the North American climate, conflicts with the indigenous inhabitants of the area, and perhaps a lack of a critical mass to support a thriving community. Many settlors did not survive the transatlantic trip or the first few winters in the new colony. Quite a few came as indentured servants, required to work a number of years in order to pay off their passage and the costs of the original settlements.

The original share price was estimated at the equivalent of half of an average workman's wages at the time, was thus affordable only by a small class of wealthy British landowners or businessmen. The investors, who were due profits in accordance with the amount contributed, generally came up empty or received minimal returns on their shares, despite the special privileges granted to the Company.

[100] The description is based upon information obtained from http://en.wikipedia.org/wiki/London_Company (last visited Jan. 23rd, 2015).

The lack of early and significant economic success made it more difficult to attract additional investors. There were some bright spots in the Company's brief history, such as the successful cultivation and export of tobacco. But even those profitable activities were not enough to sustain the business in the long term. In 1624 the Company lost its charter. Its privileges reverted to the Crown, and the Virginia settlements became a royal colony. Several of the original 13 American colonies began either by virtue of, or through a strong connection to, activities which had been sanctioned by the Crown by way of a corporate charter. The tension between royal approval versus local self-government was a key feature in the development of American Colonial law, covered in more detail below.

3) *The East India Company (EIC)*

The East India Company, was not the first, but perhaps the most significant of the so-called Great Trading Companies. The first charter of the East India Company was granted on New Year's Eve 1600 after several failed attempts to receive Crown approval[101]. The applicants were leading businessmen and members of the landed gentry in England at the time, including the royal couple's "most dear and loving cousin, George, Earl of Cumberland", along with over a hundred fellow "adventurers", or investors and supporters of the effort to open up and monopolize trade in the East Indies[102]. The Company was set up as a joint-stock company, with the lengthy name of "The Governor and Company of Merchants of London, Trading into the East Indies."

Though the East Indies were the original geographic focus of the company and its promoters, over time its rights in relation to monopoly trading rights in India and southeast Asia would become the driving force of its activities. The East India Company attained a significance that was second to none in England, including its own lobby contingent in Parliament. During its first few voyages it even enjoyed the express protection of the Royal Navy, with specific resources dedicated to the trading ventures to protect them against pirates and other threats. The Charter granted the Company "six ships and six good pinnaces" for a period of 15 years, along with "500 mariners, English men, to guide and sail in the same"[103]. This privilege also accentuated the support which the company enjoyed to the lands its managers visited. Within a relatively short period, the East India Company would have its own private army, made up largely of local forces in the respective lands, and trained by English military officers.

The success of the East India Company, and similar companies, was to a large extent attributable to the monopoly trading privileges granted them by the Crown. This made for healthy profit margins and enabled the company's owners to build great wealth and prestige. On occasion rival business groups attacked this privilege with their own corporate charter applications, with varying degrees of success. Such attempts often faltered. Even when they were successful, the rival company was often merged with the original one to create an even more powerful company. This was the experience of the EIC, which in a short time virtually controlled all trade with India. The combined power even proved enough to oust the equivalent companies of other European monarchies (e.g. French, Portugese, and after a brief period of cooperation, the Dutch).

The intertwining of state and business was evident throughout the company's history. In times of financial need, the East India Company's treasury proved a tempting source of funds for the Crown. This need was particularly acute in times of war, which increased in both number and duration during the 18th century, as European powers vied for domination over other parts of the globe. The officers of the Company became so powerful that they essentially controlled large parts of places such as India, essentially making it an extension of England. This feature continued with the rise and expansion of the British Empire in the 19th century.

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[101] For more background on the origin and the evolution of the East India Company, see http://en.wikipedia.org/wiki/East_India_Company. (last visited Jan. 23, 2015).
[102] The text of the original charter is available at http://en.wikisource.org/wiki/Charter_Granted_by_Queen_Elizabeth_to_the_East_India_Company (last visited Jan. 23, 2015).
[103] *Id*. The Crown reserved the right to recall these resources in times of war.

A review of the company's various charters reveals the the grant of various privileges and any conditions thereon. The Company enjoyed the status as a "Body Corporate and Politick", with all of the general rights enjoyed by natural persons. In particular the Company could sue and be sued in the public courts, and in many locations was even responsible for establishing and running such courts. It had a Company name and seal, and the right to set its own internal regulations for managing the affairs across the globe. The one lever that the Crown retained was the fixed duration of the company privileges. Though its proponents often sought confirmation of the Company's rights into perpetuity, the Crown preferred terms of years, such that the charter had to be periodically submitted for preservation of those rights. This acted as some minimum level of check against the enormous power and influence which the company owners and officers enjoyed during the life of the Company.

C. Company Capital-raising over Time[104]

There is one element of a business, whatever legal form it might take, which is essential from a factual standpoint, even if not automatically viewed as a legal requirement. That is the need for some form of financing to commence and continue the object of the venture. To cover the initial costs of starting a venture, some source of startup capital is needed. For commercial enterprises, cash has become the simplest and most common form of capital injected into a company. Capital will also be required to meet the ongoing operational costs of running the venture, with the aim of having it become financially self-sufficient by being able to cover these costs from earnings in as short a time as possible.

The sources of capital have evolved over time, just as has the range of company purposes as described above. During the era of the municipal corporation, guilds and livery companies, financing was generally by means of the personal funds of the respective persons behind it (for the municipal corporation the community, for the guilds the members, and for the livery companies the owners). In other words, financing was generally an internal matter of those directly involved in establishing and managing the respective company.

As the size and capital needs of companies grew, self-financing became increasingly difficult given the limited number of individuals with sufficient excess savings available. During the mercantile period, as the livery companies began to service markets beyond that of their origins (e.g. London in the case of England), external financing became more prevalent. Foreign sellers of goods often required advance payment to secure future delivery[105]. Buyers had to meet such requirements with their own funds or by borrowing. Through simple debt arrangements, the initial capital needs could be met. Such debt obligations constituted the primary if not the entire source of liability for companies during this period. Lenders were often local and had some direct or indirect involvement in the operation of the company.

This model worked well for companies of average size of the day, but showed its limitations as mercantilism became increasingly international. The increased scope of activity meant that business ventures had much larger demands for capital compared to their predecessors. Self-financing or traditional debt arrangements were often unable to satisfy the growing appetite for capital required to finance international trading ventures. Funding a ship, or even a fleet, to engage in mercantile trade with far-off lands was a much more expensive venture than funding even a large workshop for the production of particular goods for sale in local markets. Ships first had to be built, needed large crews to operate them, and had to cover a whole range of operating expenses (use of harbors and personnel, customs and duties for import and export, provisions for crews during a journey) even before they had set out to sea with the aim of trading for profit. The money required was on a whole other scale than entrepreneurs and financers were used to.

[104] This section draws upon Brealy & Myers, Principles of Corporate Finance, (7th ed.), McGraw-Hill.
[105] See Theodore F.T. Plucknett, Chapter 8, The Eighteenth Century: Industrial Revolution, in A Concise History of the Common Law (5th ed. Butterworths 1956) at pgs. 66-67 [hereinafter Plucknett, A Concise History of the Common Law].

The collective expenses for such ventures would test the limits of even the wealthiest merchants of the day to bankroll. And given the additional risks such ventures entailed compared to smaller scale, local ventures, there was a natural caution on the part of financiers to not take on too much risk. As the era of the general trading companies began, it became clear that a new model of external financing was needed, with new instruments of capital-raising. This marked the beginning of markets for capital to complement the markets for goods and services which had already been around for centuries. It also marked a gradual change in the nature of financial supporters away from individuals having direct involvement in the business to more detached, passive, investors concerned more with specific results than the details of how those results might be achieved.

The considerable geographic distances faced by the General Trading Companies paralleled the financial and control distance between the promoter-investors and those actually managing the trading relationships in far-off lands. This signaled a trend which would continue as the group of relatively passive participants in ventures increasingly outnumbered the shrinking circle of those entrusted with direct management. This personal and organizational distance would have increasing relevance for the creation of legal regimes addressing the establishment and operation of corporations.

The phase of corporate evolution which saw the rise of the general trading company brought with it two new themes. First, by their very nature, the general trading companies operated across national borders. In a sense, they were the predecessors to the modern multinational corporation. Second, their scale and need for capital were reasons for the gradual development of markets to bring together persons seeking funds with those seeking opportunities to invest. This era marked a slow shift away from the traditional reliance on debt finance as the exclusive means of funds to a new category later to be known as equity or ownership capital. This distinction would also hold significance for the regulation of business activity undertaken in the corporate form.

London proved to be an ideal breeding ground for experiments in bringing together "adventurers" or promoters of companies, and wealthy investors seeking opportunities beyond the traditional land-oriented projects. Many of the underlying trading ventures were extremely speculative, and the general public was caught up in an investment frenzy to make a quick return. Company promoters, without the modern day legal restrictions on disclosure requirements for investments marketed to the general public[106], were raising money with the greatest of ease. In one extreme example company promoters were able to sell shares in a joint stock company whose prospectus touted "*an undertaking which shall in due time be revealed.*[107]"

The euphoric investment atmosphere came to an end with the collapse of the South Sea Company, which triggered massive selloffs in the shares of other joint-stock companies. Thousands of investors lost their money, and there was a complete backlash against the joint-stock company as a vehicle for conducting business. In response, the British Parliament passed the Bubble Act of 1720[108], which reasserted the authority of the Crown in relation to the establishment of businesses, by stating that:

> *"acting or presuming to act as a corporate body or bodies- the raising or pretending to raise transferable stock or shares; the transferring or pretending to transfer or assign any share or shares in such stock <u>without legal authority either by Act of Parliament or any charter from the Crown</u>, to warrant such acting as a body corporate or to raise such transferable stock or stocks or to transfer shares therein… should be deemed to be illegal and void, and should not be practiced or in any wise put in execution, and all such undertakings [are] deemed public nuisances.[109]"*

[106] For example, the securities laws in the United States, in particular the 1933 Securities Act, 1934 Securities and Exchange Act and 1940 Investment Company Act.
[107] For a full discussion of this era, see "Capital" on pgs. 347-357 of A.H. Manchester's Modern Legal History (Butterworth Publishing) [hereinafter "Capital"], at 348.
[108] 6 Geo. 1, c. 18 (1720).
[109] §24-25 Bubble Act (emphasis added).

Commentators have pointed out that the real target of the Bubble Act was not so much the company form, but rather the fraudulent schemes generated by promoters[110]. In fact, many of those promoters either did not use the company as a vehicle or disguised the true structure of the investment. In that sense, the financial crisis engendered by the South Sea Company and its kin was more a product of the absence of a regulated investment market than attributable to any particularly dangerous proclivities of the joint stock company as a particular legal form. But due to the association of joint-stock companies with financial trickery and collapse, it would be quite a while before the recovery of its reputation as a suitable form of financial investment.

The Stock-Jobbing Act 1733[111] addressed sales of "public or joint stock, or other public securities" including financial arrangements such as forward contracts and options[112]. The preamble to the act revealed the prevailing parliamentary view of the practice of stockbroking ("stockjobbing" in the parlance of the day) by describing it as a "wicked, pernicious, and destructive practice.[113]" This Act proved largely inoperable in practice and was largely ignored by those involved in the burgeoning stock market in the City of London. It suffered from two main deficiencies:

1) it failed to appreciate the positive aspects of securities markets in underpinning the efficient allocation of resources, and hence opted for an outright prohibition rather than regulation,

2) it failed to provide for an appropriate enforcement mechanism, which would be necessary for the effectiveness of the measure irrespective of the level of restrictions on the practice of stockbroking.

Even the courts interpreting the Act whittled away at its scope of application. One decision held that it did not cover sales of foreign securities, thus enabling a large area of financing for maritime trade[114]. Another held that it was not applicable to sales of stock in incorporated companies, which had come to represent a large portion of domestic and international trade[115]. The judicial interpretations had the effect of reducing the scope of application of the Act to sales in securities of the British government which, though significant, represented only a portion of the overall securities markets.

In response to these legislative efforts, the participants in the nascent stock exchange attempted to preserve the right of self-regulation of their activities. The Exchange itself was described as "*a tightknit, well-organized commercial club" with its "own code of honor… backed up by powerful sanctions.*[116]" Such internal enforcement mechanisms, similar to those of the guilds, were considered preferable to intervention by the state. Eventually the Act was repealed, with the government opting for a transfer tax on securities transactions rather than placing direct restrictions on stockbroking[117].

Initial efforts at regulating investment markets failed, beginning at one extreme with a total ban and within two centuries swinging to the other extreme, with rules and enforcement mechanisms that were too weak. The Parliament which passed the Bubble Act was described by some commentators as "panic-stricken[118]"and provides a good example of the former. Shortly after its passage investors' reaction of avoiding the speculative investment markets made its enforcement rarely necessary. The Bubble Act remained on the books for over a century until 1825, when Parliament repealed it by

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[110] A Guide to Companies Legislation Past and Present, in Palmer's Company Law, at 1007. (2007).
[111] An Act to prevent the infamous Practice of Stock-Jobbing". The Act was also referred to as Sir John Barnard's Act.
[112] For a description of these and other legislative measures aimed at addressing the early securities markets in England, see R.B. Ferguson, Commercial Expectations and the Guarantee of Law: Sales Transactions in Mid-Nineteenth Century England, pgs. 192-208 in Law, Economy & Society, Essays in the History of English Law 1750-1914 (Professional Books Ltd. 1984).
[113] Id. at 194-95.
[114] Id. at 195 (citing Wells v. Porter, 1836).
[115] Id. (citing Williams v. Tyre, 1854).
[116] Id. at 197.
[117] Id.
[118] Id. (citing F.W. Maitland, Collected Papers at pg. 390 (1911).

passing the Bubble Companies Act[119]. In the intervening century, investors in England continued to fund various ventures. These included companies incorporated by royal charter as well as those incorporated by private Acts of Parliament. During the near-century of the applicability of the Bubble Act, businesspeople were forced to find alternative financing structures. One of the most popular was the so-called “deed of settlement company”, unincorporated associations which were essentially large partnerships under the law, but were able to offer transferable shares through complex contractual and trust arrangements[120].

The deed of settlement was concluded between the shareholders and one or more trustees, and set out covenants which were binding on the shareholders[121]. The deed set out the shares in the capital held by each shareholder, and gave a specific name and duration to the venture[122]. In addition, the shareholders could agree to specific regulations as to how the venture was to be managed. In this sense, the deed of settlement served as a proxy for the traditional company charter, without the difficulty and expense of actually having to obtain one. In order to achieve succession of interests beyond the initial shareholder group, the deed enabled the transfer of the management function to a body of directors[123]. Generally, these were persons other than the general members or shareholders, who tended to be passive investors. Finally, the property of the company was vested in one or more of the directors as trustees.

Through these various arrangements the participants were able to achieve their underlying business objective, albeit through an unincorporated association described as “the lineal ancestor of the ordinary company under the Companies Act[124].” The various contractual and trust agreements permitted the participants to fulfill all of the essential requirements as later described by Blackstone as required under English law. What they did not achieve, however, was limited liability for the participants, who were “always liable for the debts and liabilities to the full extent of their means[125].” As described in more detail below, neither in Great Britain, nor in the later United States, was limited liability considered an essential element of a company or legal person up to and including this period. Risk or liability allocation concerns related almost exclusively to contractual debt obligations, the prevalent form of company financing at the time.

The forms of company financing also evolved with the changes in the underlying business activities. In fact, they basically reflect what came to be known as the pecking order theory in modern finance[126]. This theory proposes that there is a preferred order of financing sources, with entrepreneurs preferring to remain with a given source of financing unless exigencies force them to consider the next source in the continuum. The simplest form of finance, using one’s own funds, was traditionally the preferred option as it allowed the direct control of capital and a full capture of any rewards. This was the prevalent financing form for the guilds and livery companies, with the respective members providing initial and ongoing funds through membership contributions.

The era of the general trading companies brought with it the need for capital generally far greater than that held by their promoters, thus making external financing necessary. The basic form of external financing was that of the debt obligation[127], with the amount lent often secured by a charge against the property purchased for the company. Eventually even borrowing would not suffice, or be

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[119] See Repeal of the Bubble Act, Hansard (Commons Sitting) HC Deb 02 June 1825 vol 13 cc1018-23.
[120] Id.
[121] See “The deed of settlement company, *id*. at 1008.
[122] Id.
[123] Id.
[124] Id. The treatise refers to the Companies Act of 1862, which is described in more detail further on in this dissertation.
[125] Id.
[126] For a thorough treatment of corporate finance theory, see Brealy & Myers, Principles of Corporate Finance (7th ed.), McGraw-Hill.
[127] For a history of the common law causes of action for debt obligations, see Chapter 10, Old Personal Actions, in S.F.C. Milsom, Historical Foundations of the Common Law, 2nd ed., Butterworths (1981), at pages 253-281.

sufficiently available, to finance some of the expensive ventures undertaken by these first multinational companies. Thus came the first offerings to finance such large scale and risky ventures through a form of direct participation in the financial results, the origins of the equity investment.

With each successive round of external financing, the number of shareholders entitled to a shareof the profits grows. The promoters of a venture are forced to share any earnings with their lenders or investors, generally in some proportion to the debt or equity investment. The higher the proportion of revenue which must be shared in the form of interest payments or dividends, the lower the remaining funds available for distribution to the owners. The various forms of corporate finance and their inherent function of allocating risk are important elements in the policy decisions around the liability treatment of corporations. We shall revisit them in the following sections as we continue to trace the evolution of the modern corporation, including its sources of finance.

The above chapter in history was a guiding factor in the evolution of English company law as later described by Blackstone. The episode was one of several in the history of the common law where public perception of the legal fiction of the company was a key driver in the development of the related legal rules. It is worth noting that the "nuisances" which the Bubble Act was meant to address related not to physical harm traceable back to the company form or use, but instead to financial harm in the form of lost wealth collected for often dubious schemes. A few centuries later the area of investment markets would become the subject of its own field of law.

Because of the rather limited impact of these events in the American colonies, colonial law and legal practice in relation to companies did not develop on the same path. First, there were relatively few chartered companies active in the Colonies which could have served as the object of speculative investments of the scale as those centralized in greater London. Second, the American colonies did not yet have concentrated and semi-organized markets for investment capital. Business financing was generally still done the old-fashioned way- through lending.

Regardless of the specific legal form, or jurisdiction, the basic question of the liability of a company or its operators for conduct or acts was still not yet a central feature in discussions around corporate law. This carried over to company law as understood and applied in the American colonies. Here again, the legal legacies inherited from England, including uses and trusts[128], would resurface about a century later and prove to be a key factor in the evolution of US corporate law. But before examining that later chapter, it is worth focusing on the nature of the liability factor as it related to the legal person of the company created under common law regimes in the 18th century.

D. Early "Essential" Characteristics of the Corporation

One of the common arguments for maintaining the status quo of a given legal institution is that it is intricately tied to the underlying subject matter, such that the rule goes hand in hand with subject of the rule. This argument is often applied to discussions regarding the characteristics which are intrinsic to a corporation. Certain features which have been part of the corporation's makeup since time immemorial are deemed to be integral to its very establishment and subsequent existence. Examined over a short period, certain characteristics can indeed appear to be essential. But when the analysis is stretched over a longer period of legal evolution, the solidity of this argument in relation to some features begins to weaken. Having traced the common law corporation from its medieval origins to the 18th century, it is worth taking a pause to consider which elements might have been considered as "essential" at this juncture in time.

As the nature of economies shifted away from pure agrarian and crafts to mercantilist, a broader audience had an interest in understanding not just general areas of law, but the law of corporations in particular. The growth of the merchant class and the further evolution of an organized legal profession both created considerable demand for clearer guidelines regarding the creation and operation of corporate entities. The somewhat haphazard guidance contained in the common law

[128] Handlins, American Business Corporation, at 5.

decisional jurisprudence was not always easy to discern for the businessperson or legal practitioner. The legal profession as such was still at a relatively early stage of development. There was a need for a more comprehensive treatment of the law as it had evolved to date.

In the late 18th century, Sir William Blackstone addressed this need by publishing his famous *Commentaries on the Laws of England*[129]. Blackstone was a leading jurist of his day, and had a career which extended from private practice, to the bench, to academia, and politics[130]. The *Commentaries* have their roots in a series of lectures which Blackstone gave at Oxford in 1753 known as the Vinerian lectures[131]. These covered a whole range of topics of the common law, including the law related to Corporations. The first volume of the Commentaries was published in 1765, apparently driven by Blackstone's concerns around the unauthorized release of notes or copies of his lectures which had been circulating in the legal and academic communities[132]. Other volumes followed, and the result was a detailed and comprehensive presentation of the key principles of English common law as they had evolved up to that point in time.

Blackstone's treatise was one of the most influential sources of legal materials developed to support an emerging and growing legal profession in the post-mercantilist period. His works are noteworthy for the inherent value of their compilation of the somewhat dispersed knowhow of the common law of England at the time. The impact of such treatises expanded with the British Empire, as jurists trained in the common law spread to and used them in far-flung corners of the earth. The treatises became an instrumental source of the law in the North American colonies, and later the individual states of the United States of America[133]. The *Commentaries* became a standard source for jurists involved both in creating and applying law. In the words of one later commentator:

> *Out in America, where books were few and lawyers had a mighty task to perform, Blackstone's facile presentment of the law of the mother country was of inestimable value. It has been said that among American lawyers, the Commentaries stood for the law of England, and this at a time when the American daughter of English law was rapidly growing in stature, and was preparing herself for her destined march from the Atlantic to the Pacific Ocean.*[134]

Thus spending some time in reviewing Blackstone's analysis of the law of corporations in the mid-late 18th century will aid in analyzing the parallel evolution of US corporate law. At the time of Blackstone's compilation of the law applicable to legal persons such as companies, the large majority of corporations in existence were municipal, educational, or religious in nature. This naturally impacted the driving principles of the law regulating the formation and operation of corporations. Commercial corporations were a relatively small part of the corporate universe, and relatively young forms at that. Over time the balance would shift, along with changes in the socio-economic structure. Mercantilism and trade had grown, and a merchant class had begun to evolve. Overt debates around the incorporation process and rights and duties of corporations became more focused on practical business considerations.

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[129] William Blackstone, *Commentaries on the Laws of England* (1758). .

[130] For a thorough treatment of his life and career, see William Blackstone- A Biography, by Ian Doolittle [hereinafter "Blackstone Biography"].

[131] Blackstone Biography, pgs. 81-83. The name comes from the Viner Benefaction, essentially a fund in support of distinguished lecturers of the time.

[132] Id. at 82. Interestingly, later analyses of the original lecture notes and the text of the published Commentaries reveal some revision, in particular of sections which may have been deemed politically sensitive (e.g. dealing with ecclesiastical matters or specific historical events). A year after publication Blackstone resigned his Chair at Oxford and a few years later returned to the bench. *Id.*

[133] Blackstone also dealt with the American colonies in his Commentaries. *Id.* at footnote 122 on page 86 (noting the background for the respective addition to the first volume).

[134] See Chapter V, History of English Law, in Selected Historical Essays of F.W. Maitland, Cambridge University Press (Selden Society) 1987 at pgs. 116-17.

For Blackstone, all authority for incorporating derived from the King[135]. Recognizing that there may have been corporations which had been operating without a formal charter for centuries, or whose physical charter may have been lost or destroyed, Blackstone opined that the legal legitimacy of such organizations was underpinned by the King's implied consent found "*by the force of the common law*."[136] The King's consent could be given expressly by charter or act of Parliament[137], with the latter becoming standard practice as more attention was focused on the corporate entity.

Royal authority to grant charters could be delegated to a subject (e.g. a court official), but even in such cases the true authority was deemed to remain with the king, with the subject merely constituting the "instrument" by which a corporation was legally erected[138].The form of official sanctioning may have evolved since Blackstone's days, but the basic requirement has never completely disappeared[139]. Even in modern debates regarding limited liability and the corporation, there remain vestiges of the thinking that incorporation is a privilege granted by society, a privilege which must be justified and also has boundaries[140]. Elaborating on some of the points raised by Coke a century and a half earlier in *Sutton's Hospital*, Blackstone identified five essential factors of a corporation as follows:

> *"AFTER a corporation is so formed and named, it acquires many powers, rights, capacities, and incapacities, which we are next to consider. Some of these are necessarily and inseparably incident to every corporation; which incidents, as soon as a corporation is duly erected, are tacitly annexed of course. As,*
>
> *1. To have perpetual succession. This is the very end of its incorporation: for there cannot be a succession for ever without an incorporation; and therefore all aggregate corporations have a power necessarily implied of electing members in the room of such as go off.*
>
> *2. To sue or be sued, implead or be impleaded[141], grant or receive, by its corporate name, and do all other acts as natural persons may.*
>
> *3. To purchase lands, and hold them, for the benefit of themselves and their successors: which two are consequential of the former.*
>
> *4. To have a common seal. For a corporation, being an invisible body, cannot manifest its intentions by any personal act or oral discourse: it therefore acts and speaks only by its common seal. For, though the particular members may express their private consents to any act, by words, or signing their names, yet this does not bind the corporation: it is the fixing of the seal, and that only, which unites the several assents of the individuals, who compose the community, and makes one joint assent of the whole.*
>
> *5. To make by-laws or private statutes for the better government of the corporation; which are binding upon themselves, unless contrary to the laws of the land, and then they are void. This is also included by law in the very act of incorporation: for, as natural reason is given to the natural body for the governing it, so by-laws or statutes are a sort of political reason to govern the body politic."*

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[135] "*But with us in England, the King's consent is absolutely necessary to the erection of any corporation, either impliedly or expressly given.*" Blackstone's Commentaries, Book 1 Chapter 18, page 460. [hereinafter "Blackstone's Commentaries"].
[136] Id. at 460-61.
[137] Id.
[138] Id. at 462.
[139] See, for example, the discussion around the self-incorporation debate, infra section III B.
[140] See discussion in Section VII C.
[141] Thus litigation risk was a noteworthy issue at this time, though notions of limited liability were in their infancy. Equally important, the subject matter of litigation was generally contract disputes. The relevance of this fact is discussed in further detail in later sections.

In elaborating on the first characteristic of the corporation-perpetual succession- Blackstone emphasized the “higher calling” of the activities of most early corporations, dedicated to the “advancement of religion, of learning, and of commerce.”[142] In terms of purpose, these could be perhaps summed up as promoting the betterment of society. And that across all three human dimensions- spiritual, cerebral, and physical.

The perpetual succession characteristic was essential to the uninterrupted continuance of rights and immunities which, according to the then applicable law, would become “utterly lost and extinct” if tied only to natural persons[143]. It also permitted the automatic transfer of property from one “generation” of corporate trustees to another. This helped avoid some of the legal issues which would have made such transfers extremely cumbersome, if not impossible[144]. It is worth remembering that during the period when company law was taking definite shape, land was the primary economic asset of the day. The procedural requirements of land transfer were, and even today remain, relatively cumbersome. Having land owned by a corporation helped avoid some of those problems. This property-holding characteristic would gain in its importance as the corporate landscape evolved to encompass a whole array of property types.

Blackstone described the name of a corporation as “the very being of its constitution” and “the knot of its combination, without which it could not perform its corporate functions.[145]” A corporation should use that name in its dealings, and “by that name alone it must sue, and be sued.” The weighting of this factor is likely also a reflection of the rigidity of the procedural rules of the time, when claims could be dismissed on technical grounds with relative ease. The legacy of using the name of the separate legal person continues to this day in modern legal systems, including in particular in considerations around the proper party for redress in the litigation context.

The third requirement, the ability to own and hold land, was a recognition that for any company to pursue its ultimate objective, it needed some form of initial and ongoing financing. As the economy was still primarily agricultural, land was the most common asset for generating revenue (e.g. through rents or the sale of agricultural output) at the time. This also included property on land, which may have housed the underlying activity of the company (e.g. a school or hospital). Though not explicitly addressed in legal treatises or court decisions, this revenue-generating capacity of property and land were the means by which a corporation could obtain and sustain its separate existence. In summarizing the benefit of permitting perpetual succession of ownership of corporate land and property, Blackstone analogizes the institution of the corporation to the river which ran, and runs, through the heart of England:

> “... *the privileges and immunities, the estates and possessions, of the corporation, when once vested in them, will be forever vested, without any new conveyance to new successions; for all the individual members that have existed from the foundation to the present time, or that shall ever hereafter exist, are but one person in law, a person that never dies: in like manner as the river Thames is still the same river, though the parts which compose it are changing every instant*[146].”

The above citation reveals the extent to which the “eternal life” characteristic of the corporation had become engrained in the lore of the common law. Particularly in relation to the municipal, educational, and charitable corporations of the day, there was a presumption that these institutions would carry on forever, preserving the essence of the great nation which had given sanction to their existence. Though not explicitly identified, the practical need for a corporation to own or control

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[142] Blackstone’s Commentaries at 455.
[143] Id.
[144] Id. at 456. Blackstone refers to earlier restrictions on the transfer of real property to groups of unincorporated persons, even for charitable purposes: “*... there is no legal way of continuing the property to any other legal persons for the same purposes, but from endless conveyances from one to the other, as often as the hands are changed*.” Id.
[145] Id. at 462.
[146] Id.

assets to fund its activities is intrinsic in the ability to legally own property. As company law evolved further, this funding element- both initial funding at incorporation and the funding of ongoing operations- would become the subject of its own set of specific rules. It has direct relevance for liability rules since depletion of a company's funds may eventually threaten its very existence.

It is worth keeping this initial notion of the perpetual nature of the company in mind when considering the later development of legal doctrines to disregard the corporate entity, if only temporarily. Perhaps the desire to "preserve" the corporation's existence, well-anchored in the law by that time, produced a kind of reluctance by later courts to "pierce" the corporate veil. This reluctance might be particularly strong in situations where the consequence of doing so may have meant the "death" of the corporation in the form of its insolvency[147].

The fourth requirement, a common seal, had its origins in the medieval seal, and was already on the wane when Blackstone penned his Commentaries. He even mentioned it as one of two features, the other being by-laws, which could be deemed optional in the case of a one-person corporation[148]. . Blackstone described these as "*very unnecessary*" to a *corporate sole*, as an individual can testify his personal assent without a seal, and does not need a set of by-laws "*for the regulation of his own conduct*."[149].The seal was deemed crucial, however, in relation to corporations comprised of multiple individuals. It facilitated the expression of the collective consent of those responsible for a particular decision or action. The corporate seal- like those of royalty and nobles- signaled authenticity to relevant third parties and the outside world. In the early days of corporations in the US, the legislatures sometimes demanded the destruction of an existing seal and replacement with a new one when corporations were going through restructurings[150]. Over time the role of public registers containing detailed information about the corporations and the persons behind them would gradually assume this signaling and information-providing function.

Blackstone described the corporation as constituting one collective person, with one will, "*collected from the sense of the majority of the individuals."*[151] This collective will was empowered to establish "*rules and orders for the regulation of the whole, which are a sort of municipal laws of this little republic*.[152]" Citing the example of a college, with established rules of behavior, Blackstone pointed out that without incorporation, the nature of any adherence to such rules would be basically voluntary. Members could "*neither frame, nor receive, any laws or rules of their conduct; none at least, which would have any binding force, for want of a coercive power to create a sufficient obligation*[153]." This led to the fifth requirement, the creation of a set of internal rules for the administration of the company, borne out of practical necessity.

The intrinsic power of corporations to lay down rules of conduct provided the necessary legitimacy and certainty should enforcement of those rules become necessary. The founders of corporations were essentially free to craft such sets of rules, provided these did not conflict with any of the laws of the land[154]. This also ties into the purpose element of a company. The body of rules generally began with a company purpose, which defined the main reason for the company and the scope of its permissible activities. Early on such corporate purposes were rather narrow, but over time the law introduced more and more flexibility.

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[147] The law has come up with some novel mechanisms to deal with this eventuality, including making difficult policy choices which may undermine the commercial viability of certain corporate activities. Some examples of this are presented in Section IV.
[148] Blackstone's Commentaries at 464
[149] Id.
[150] See Simeon Eben Baldwin, History of the Law of Private Corporations in the Colonies and States, in Selected Essays in Anglo-American Legal History, Vol. 3 (American Association of Law Schools and Lawbook Exchange Ltd. New York City, 1992), at pgs. 254-55.
[151] Blackstone's Commentaries at 456.
[152] Id.
[153] Id.
[154] See also discussion of *ultra vires* infra Sections III E and VII.

As discussed earlier, the guilds could regulate the minutiae of the creation and distribution of the respective products within their remit through the company purpose. The trading companies could define the framework within which huge amounts of foreign trade would take place. In the 19th century and beyond, the industrial concerns could create detailed frameworks for the activities of the various constituent parts. Eventually English company law would become more proscriptive in this area, such as when the Companies Act introduced a standard set of general rules for companies on an opt-out basis.

Throughout this period, the overarching purpose of corporations, as well as the background of the persons involved in them, was relatively static. The governing documents, such as the company charter, spelled out both the purpose and the actors involved in pursuing that purpose. The ability of the early corporations to make dramatic changes to their purpose, or use the corporate property and privileges in a novel way (i.e. otherwise than as set out in the respective charter), was rather limited.

Early corporations were set up with the long term view in mind. This narrowness of the company purpose would lessen over time, however, particularly once ownership in corporations became unrestricted, and corporations were eventually able to "own" each other. That trend would bring with it its own dynamic in terms of company purpose and responsible actors to create the very different corporate landscape we know today[155].

Conspicuous by its absence is any specific listing of or discussion around liability rules for these entities which, as highlighted by the second requirement, could be on both the receiving as well as the giving end of litigation. It would take at least another century before the liability element would come to the fore in relation to the law of corporations. Before leaving England, and the mid-18th century, it is worth reviewing the state of the liability regime applicable to corporations, as this would serve as the starting point to efforts in the soon-to-be-created United States. The quandaries which face jurists today dealing with the actions of corporations were also relevant in Blackstone's day. As he noted in the *Commentaries*:

> "*… corporations, being composed of individuals, subject to human frailties, are liable, as well as private persons, to deviate from the end of their institution. And for that reason the law has provided proper persons to visit, enquire into, and correct all irregularities that arise in such corporations.*[156]"

Blackstone's euphemism above, "deviating from their end… since subject to human frailties," presumably refers to conduct by natural persons in the name of the legal person amounting to fraud, misrepresentation, and so on. Such acts were obviously not contemplated or desired in the company purpose. Given that most corporations up to then were of the municipal or religious kind, the "visits" and "corrections of irregularities" were primarily undertaken by the respective public officials. This meant the King (replacing the Pope after Henry VIII abolished the Catholic Church in England) or the clergy in relation to ecclesiastical corporations, and the founders, or their heirs or assigns, in relation to lay corporations[157].

Unfortunately for the detailed topics of this dissertation, Blackstone does not shed much light on the nature of such "visits" or procedures. He repeated the view of Sir Edmund Coke of a century and a half earlier, that corporations "have no souls" and thus could not be brought into ecclesiastical courts, or be excommunicated[158]. Nor could they be tried for crimes (e.g. treason or felony), "though its members may, in their individual capacities.[159]"Similarly, a corporation could not be a party in actions for battery or other personal injuries, since it "[*could] neither beat, nor be beaten, in its body*

[155] That topic is the subject of detailed review in Section IV below.
[156] Blackstone's Commentaries at 467-68.
[157] Id.
[158] Id.
[159] Blackstone's Commentaries at 464.

politic.[160]" This recognition that corporations could cause harm along with confusion around how to attribute responsibility were elements which permeated and were woven into the fabric of early corporation law. These and other presumptions about the penal/criminal liability of the corporation, and its operators, would be reconsidered on several occasions as corporate law evolved in the common law world.

As developed in Part V below, today scrutiny of the activities of corporations and the effects hereof is the purview of the public courts and regulators. Pubilc courts are occasionally called upon to decide on "hard" cases where different public interests compete. Public regulators are the institutions entrusted to "correct" or redress the perceived misbehavior of legal persons such as corporations. At this point, the absence of any blanket immunity (e.g. limited liability) for the persons behind such corporations is noteworthy. These same elements would later reappear in the jurisprudence around temporarily disregarding the legal entity in certain circumstances. The list below recaps the state of English company law towards the end of the 18th century, including the elements deemed by courts and legal commentators as being "essential", along with the respective issues of debate:

- Company Object or Purpose: A corporate purpose had always been part of the process for creating a new legal person. Some leading thinkers of the 18th century preferred a much more gradual evolution and the controlled use and growth of the enterprise. Adam Smith, for example, believed two other elements were required to make the creation of a joint-stock company reasonable, namely a public utility component and an objective need for considerable capital. Smith pondered the ability of joint-stock companies to successfully operate without exclusivity privileges in "routine" trades with "little variation", including banking, insurance, canal-digging, and supplying water (e.g. aqueducts). In other words, there were limited circumstances under which the privilege of the corporate form was justified.

- Company Name and Seal: The seal requirement for business corporations was inherited from their municipal forefathers. It was eventually limited to significant transactions, such as those out of the ordinary course of business[161]. The by-law requirement was similarly inherited, applicable as a function of the type of corporation (e.g. even to non-members of a guild), and limited to the regulation of the corporate business.[162] The main purpose of the seal was to identify transacting parties and bring more certainty to transactions. This requirement would dissipate over time.

- Company Property and Perpetual Succession: The practical need for automatic succession of property ownership hid a key factor in later debates around liability, namely the financial condition of the company. Assets of the company were the primary source of meeting any liabilities, whether they arose in contract or otherwise. The value of the ability to hold property in perpetuity became even more pronounced when the industrial revolution began to gain momentum and entrepreneurs began requiring increasingly greater amounts of capital. As a consequence, the capital-raising characteristic of the legal person came to the fore. These days, this characteristic is one of the most important justifications for weighing limited liability rules.

- Company internal rules: The right of separate property ownership and perpetual succession brought with it the need for some ongoing administration, such as the collection and employment of earnings from corporate property. This was needed both for the achievement of the company purpose in the present as well as to ensure the continued existence of the corporation beyond the current generation of owners and managers. In the absence of legal requirements in this area, founders of corporations were free to establish appropriate roles and responsibilities to facilitate the meeting of the company purpose.

[160] Id.
[161] Williston 116-121.
[162] Confirmed by case law, e.g. Child v. Hudson's Bay Company, 2 P. Wms 207.

- Limited liability of company shareholders: This was one possible element in a limited number of external rules which attempted to define a corporation's relationships with parties outside it by means of the petition for incorporation. Limited liability was not an automatic feature of corporations, though some promoters specifically sought limited liability protection when pursuing a corporate charter. These charters may also have contained rules regarding internal responsibility and liability, e.g. for existing debts or capital needs. The early English law only refers to the normal ability of a corporation to sue or be sued, just like any natural legal person. Partly for this reason, a corporation had to have a legal name. It would be over two centuries before the topic of limited liability would become the subject of specific attention by both the public and the legislature, at which point the politics of the issue had changed dramatically.

The importance of the individual characteristics varied over time. For example, failure to get the corporate name exactly right in litigation pleadings may have meant losing the chance to pursue one's claims in the early periods. Pleading requirements later became more flexible so that clerical errors or honest mistakes could be corrected. Similarly, the "place" requirement of a location has undergone dramatic change in the period between the Case of Sutton's Hospital and Blackstone's *Commentaries*. Early on a physical structure (e.g. hospital, university, church) was closely tied to the central purpose of the company being created. As businesses began to use the company form, a central meeting place was not the central purpose of the company, but was deemed necessary for the centralized coordination of activities. A fixed location as a prerequisite for company formation began to evolve from a firm requirement of a business office, to a minimalist approach involving registered agents. In the 20th century the envelope was pushed even further with purely web-based companies, which do not maintain fixed premises. Similarly, the requirement of a corporate seal has almost vanished in practice. The nature of the law underpinning legal persons, such as companies, has evolved and changed to reflect the needs of society at different periods.

There are two important points worth highlighting here because of their importance to a main argument of this dissertation, namely that change has been a frequent visitor to the corporate legal form such that any claims that certain elements are "essential" deserve close scrutiny. The fact that elements of the corporation fluctuated, both in composition and in weighting, show that change or revision is possible without destroying the overall purpose and functioning of corporations. The above tracing of the evolution of the corporate form showed that evolution within the English legal system was definite, albeit slow. Following the split of the Colonies from England, further evolution and divergence within the common law legal family cast further doubt on the later claims of particular elements, such as limited liability, being essential to the corporate legal form.

As discussed in the next section, the divergent paths taken by the English and US "branches" of the common law tree call into question just how "absolute" certain rules were (e.g. prohibition against corporations owning shares in each other). Similarly, the varied treatment of specific corporate characteristics (i.e. limited liability) over the course of evolution of domestic English and American company respectively corporate law casts some doubt on the claimed "essential" nature of such characteristics. The fact that individual characteristics of the corporation varied over time and within different branches of the same legal family tree are also important for the consideration of legal reform efforts in the final section of this dissertation. The table on the following page highlights the evolution of the corporate liability rules over the evolution of the corporate form.

Company purpose (and broad time period)	Company purpose	Operating environ-ment (e.g. market)	Primary means of financing/ capital raising	Externalities of pursuing company purpose	Liability regime(s) for company engaged in activity	Comment
Municipal & ecclesiastical (from Middle Ages through 19th century)	Community administra-tion, charitable or public service	Local community	Self-funded	Level of success or failure of purpose	Unlimited	Non-economic public benefits generally a key factor in granting corporate status
Trade & crafts guilds and livery companies (mainly from 13th to 19th centuries)	Create physical products	Local community	Self-funded	Utility and quality of products; possible injuries to members from production process	Unlimited (with some exceptions for chartered businesses)	Economic public benefits generally a key factor in granting corporate status
Trading (mainly from 16th to 20th centuries)	Trade physical products	Local and foreign markets	Self-funded & third party financing	Utility and quality of products; possible injuries to those involved in trading; net effects on foreign buyers	Unlimited (with some exceptions for chartered businesses)	Economic public benefits generally a key factor in granting corporate status
Manufacturing (mainly from 19th century)	Create and sell physical products	Local and foreign markets	Self-funded & third party financing	Utility and quality of products; possible injuries to workers as well as buyers and users of goods	Generally unlimited until 18th century, with limited liability gradually becoming the norm	Economic and employment public benefits generally a key factor in granting corporate status, limited liability at first discretionary
Services (incl. financial) (mainly from 19th century)	Offer services	Local and foreign markets	Self-funded & third party financing	Generally no direct physical externalities, though possible indirect ones	Generally limited	Limited liability the norm by the time services predominate

Table One Key Factors and Liability Regimes across Company Purposes and Periods

E. The Nature of Liability Exposure of Legal Persons at the Time of the American Revolution

English company law as it stood in the late 18th century sowed the seeds of what would become the law of corporations in the United States. Much of the flavor, reasoning, historical tradition, and so forth was sewn into the legal fabric of colonial law prior to independence. This provided the basis of the emerging American legal system following the Revolution. In the words of one commentator: "Exercising only what seemed to savour of oligarchy, those who had defied King George retained with marvelous tenacity the law of their forefathers.[163]"

This legacy extended to the characteristics of the legal person itself, and in particular to the nowadays much-touted "essential element" of limited liability. Thus it is worth distilling from the above historical coverage just how limited the liability of the owners of legal persons, whether livery companies, regulated trading companies, or other, really were over time.

The topic of liability limitation as it relates to non-contractual liability is a relatively recent one.. Throughout this period the liability of corporations and legal persons in general related almost exclusively to financial arrangements, generally debt. The cases against the early municipal corporations in England suggested that the property of such corporations, mainly land and other chattels utilized by the citizenry, was subject to "distraint" (i.e. attachment or levy in order to satisfy outstanding debts)[164]. If that did not suffice, creditors could have recourse upon the lands and chattels of the "burgesses" as well.

Placing limits on liability did not seem to be a major concern for early English companies, as witnessed by the absence of any discussion of such a characteristic in the leading treatises of the early period. From Coke in the late 16th century, to Blackstone in the 18th century, the writers of the leading legal treatises were "expressively silent" in relation to limited liability[165]. One issue with considerable relevance to liability is discussed in such treaties, however, namely the distinction between property belonging to the corporation and property belonging to the owners of the corporation. This may be more of a reference to the order or priority in terms of recourse by creditors and a delineation of which property is genuinely "off limits" versus "at risk" in relation to non-creditor third parties.

The famed legal historians Maitland and Pollock, investigating the liability issue over an extended period of early English legal history, concluded that the case law did not reveal "*the non-liability of individual corporators for the debts of the corporation… as of the essence of a corporation[166]*." The fifteenth century began to see examples of limited liability arising in practice, but not as an inherent part of the corporate form[167]. Generally extra effort and additional steps were required to secure limited liability protection. The main motivator behind such specific arrangements was the management of debt exposure (i.e. credit risk).

Similarly, there was discussion surrounding the related issue of division of corporate property upon its dissolution, e.g. when the term of the corporation had been set as definite. These were generally pro rata schemes defined at the outset, or by practice. They related almost exclusively to the shareholder participants in a venture as opposed to third parties like creditors or persons dealing with the company. This reflects the intertwined nature of company and insolvency law as well as the debt-centric nature of the economy and company liability. All in all, the liability question in the early period of the corporation was almost a non-issue, with a presumption of an obligation of the shareholders to make third parties whole in the event the assets of the corporation did not suffice. According to one commentator:

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[163] See Chapter V, History of English Law, in Selected Historical Essays of F.W. Maitland, Cambridge University Press (Selden Society) 1987 at pgs. 116-17.
[164] Williston. at 11 (referencing legal analyses of Madox).
[165] Id. at 12.
[166] Id.
[167] Id., in particular note 54.

"*In England the concept that limitation was inherent in corporateness was foreshadowed earlier, but even after the turn of the 19th century it had not yet emerged completely from its fuzzy chrysalis.*[168]"

This "fuzzy chrysalis" may have later contributed to, if not necessitated, the "mists of metaphor" later required to deal with the challenges of what would eventually become the other end of the doctrinal continuum, an entity law regime which had limited liability as its underlying premise. One suggestion for better understanding the reluctance to commit to a doctrine of limited corporate liability early on relates to the operational nature of how such entities were financed and operated at the time. Shareholder contributions were made by means of assessments[169]. There was an initial assessment based upon the estimated capital needs of the company in the startup period. But there was also an expectation that further assessments could be made of the shareholders in periods in which the corporations were not able to finance themselves completely from their current activities (i.e. out of profits earned).

Absent a clear rule regarding such assessments, conceivably shareholders could be "assessed" multiple times, with no clear legal limits. The only clearly viable option for a person wishing to avoid such assessments was to sell his stake in a particular corporation, and hope that a plaintiff did not come after him later for assessments from a stakeholding no longer held. Over a considerable period many legal rules even made former shareholders subject to assessment demands, at least for a certain period of time. The only foolproof method to avoid such assessments was thus not to acquire a shareholding in the first place. In the age before a defined bankruptcy law, the corporations themselves could not simply decide to dissolve and go through a well-defined statutory insolvency process if faced with overwhelming debts.

The nature of the shareholder risk was greater than that facing today's shareholders. The larger investment risk was that the administrators in charge of managing a company's affairs would not make assessments against the members, thus forcing the creditors to bring suit. One case brought against one of the early trading companies clarified that in the event a company's assets did not suffice to cover its debts, recourse could be had against the assets of the shareholders[170].

Similar cases confirmed the rule applied to "domestic" companies as well, confirming equitable relief in the form of an assessment against the individual members of a corporation whose assets did not suffice to cover its debts[171]. The liability exposure of companies related to the financing of their operations in the form of contractual lending arrangements with individuals or financial institutions. In summary, the bulk of the historical evidence appears to point to a general rule of unlimited liability in English common law at the time of the creation of the United States. As discussed below, the lines of reasoning applied to those early English cases served as the basis for the jurisprudence which would develop in the American colonies and later the independent United States.

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[168] Id.

[169] Id. at 13.

[170] See Order for the Creditors of the Muscovy Company, House of Lords Journal Volume 3: 19 June 1628, Journal of the House of Lords: volume 3: 1620-1628 (1767-1830), pp. 863-867. Available at: http://www.british-history.ac.uk/report.aspx?compid=30622

[171] Salmon v. Hamborough Co., 1 Ch. Cas. 204, 22 Eng. Rep. 763 (H.L. 1671).

F. Political and Industrial Revolution and Divergence in the Common Law World

The next distinguishable milestone in the evolution of the law of corporations in the common law world was the increasing political divide between Great Britain and its American colonies leading up to the American Revolution. That split would provide even greater opportunity for experimentation with the rules related to business in general and corporations in particular. Divergent paths of legal regimes addressing the same or similar areas are of particular relevance to this dissertation in that they provide an additional line of argument for how certain characteristics of the corporation may not be as "essential" as frequently claimed. For if the overarching principle of the common law is convergence of judicial decisions and consistency of legal norms, at least in relation to fundamental issues, then divergence related to specific issues suggests that the respective subject matter may not rise to the level of being fundamental, or "essential." It is worth keeping this in mind when tracing the further evolution of rules of liability related to corporate activity.

1. Normative Congruence as Starting Point

Before making the transition from England to what would become the United States of America, it is helpful to recall the situation in England in the mid-18th century, in particular the nature of liability exposure to those engaged in commerce, whether in relation to natural or legal persons. As outlined above, non-contractual liability was not a key element in addressing the rights and obligations of legal persons, and those responsible for their creation and operation. This was mainly due to three factors:

1) the nature of economic activity at the time (agriculture, handicraft, and trading),
2) the nature of financing of both commercial and non-commercial activity (mostly private debt contracts), and
3) the administration of litigation through the public courts. Each of these factors is dealt with below.

Because of the different levels of economic activity, the earliest attempts at forming corporations in the American colonies generally related to educational and religious organizations. For example, the Massachusetts colonial assembly approved the "incorporation" of Harvard College in 1635, during the interregnum years in England when there was uncertainty around the continued requirement of royal approval[172]. It paid a heavy price for its boldness after the restoration, when its colonial charter was revoked[173]. Subsequent promoters of incorporation had to walk a fine line in exercising rights of local self-government without appearing to encroach on the power of the British sovereign.[174]

Before the English colonies separated from the mother country, their economic and legal systems had already been diverging for several decades. The debates around who had the ultimate authority for approving company charters is a fundamental example. Given the distance and cumbersome nature of an incorporation process directed out from London, at a time when ships needed weeks to cross the Atlantic, the American colonists had to either find workarounds or make do with the extremely slow and tedious transatlantic incorporation process. As the American colonies themselves operated under Royal charters or letters patent, there was an argument that the general right to local self-government under English law included approving the creation of local associations. The uncertainty and resulting frustration around such basic issues of communal government administration became part of the overall momentum for formal separation.

Particularly for large enterprises needing considerable capital, the preferred organizational form became voluntary partnerships, often operating under a separate company name[175]. According to the

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[172] See Simeon Eben Baldwin, History of the Law of Private Corporations in the Colonies and States, in Selected Essays in Anglo-American Legal History, Vol. 3 (American Association of Law Schools and Lawbook Exchange Ltd. New York City, 1992), at pgs. 241-243.
[173] Id.
[174] Id. (describing the caution exercised by the original trustees of Yale University).
[175] Id. at 243.

colonial records of the period, full partners were deemed personally liable to creditors[176]. Very few sought a formal charter approved by the Crown, with only three business charters identified in the entire pre-independence period[177].

The British Parliament's express ban on colonial assemblies' granting of corporate privileges in 1741 only further stifled the development of the American business corporation until after the American Revolution[178]. One of the triggers for the ban was the creation of the joint-stock Massachusetts Manufacturing Company, which issued circulating bills as a form of finance[179]. The Act of 1741 prohibited the creation of or business by unincorporated joint-stock companies with transferable shares and more than six members[180]. It represented increasing efforts by the British Crown to maintain control over its American colonies, which were growing increasingly restless and resentful of interference in their economic and private affairs. It is worth recalling that this was the era in England of the hysteria around speculative investments as epitomized by the Bubble Act.

The financing of English enterprise was directly impacted by the South Sea Bubble and the ensuing legislation. The background behind that legislation was the enormous growth in the use of the joint-stock organization to house all manner of business ventures in the early 1700's[181]. The economies, and in particular the nascent markets for capital, in the American colonies did not provide the same breeding grounds for speculators and fraudsters in London which led up to the financial disasters there in the early 18th century. If anything, the American and other British colonies often represented the storyline of investment schemes. They were not (yet) the starting point for further, locally-financed, expansion projects. There was enough work to be done solidifying and maintaining the English settlements which had been set up over the past century and a half or so. As such, the attempted application of the Bubble Act to the American colonies was misplaced and ignored the realities on the ground.

In the 18th century, given the relative immaturity of the economy in North America, liability risks primarily revolved around lending relationships. The American Colonies were still mainly agrarian economies, and the level of social stratification was high. A relatively small circle of landowners and merchants controlled much of the societal wealth of the day. This was also the group with the means to provide for credit to the rest of the population. Any disputes related to commercial enterprises- whatever the legal form- mainly arose in contract.

Credit took a number of forms in colonial times. Simple loan agreements set out the parties to a lending transaction, the amount loaned, any interest to be paid, and sometimes a specified term. During colonial times a term of six to twelve months was common[182]. Some agreements, however, left the term open. In fact, for the well-to-do, lending was considered an important means of saving, given the relatively underdeveloped and unregulated banking system at the time[183]. Some lenders were able to secure their debts at the time of lending by having the borrower create a charge against specified property. Creditors could have the specified property seized or attached, and sold to pay off a due debt. But though this may have worked well for certain collateral (e.g. land), extending loans secured by personal property in the British colonies was still relatively underdeveloped and risky.

The Colonial credit systems of the 18th century were characterized by two significant drawbacks. First, a lack of transparency about a borrower's financial situation put the burden on lenders to ascertain relevant information. Such informational gaps would become particularly dangerous when a

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[176] Id.
[177] Id. at 242.
[178] Id.
[179] Id. at 246.
[180] Id.
[181] For a full discussion of this era, see "Capital" on pgs. 347-357 of A.H. Manchester's Modern Legal History (Butterworth Publishing) [hereinafter "Capital"].
[182] Id. at 2432.
[183] Id. at 2412-13.

borrower was undergoing financial difficulties. This led to interesting phenomena, such as "court days":

> "*…court sessions were widely attended, and indeed, 'Court days' were regional, popular events, in part because they were the best time for creditors to see 'who was recovering against whom and what their roles might be at any given moment.' Outside of court days, creditors wanted to keep negative information about debtors' financial status secret… because 'every creditor hoped to be able to collect his debts before the insolvency of the debtor became generally known*.' [184]"

The second key element is the nature of the litigation system at specific times. On the whole, in both England and the American colonies, the procedural rules were relatively formalistic and the costs of pursuing a claim rather expensive. Given the spread of the population and the paucity of judges at the time, it was common for a small group of magistrates or judges to travel around to different parts of the country, hearing disputes within a particular time frame. This was the origin of the term "circuit court", with judges and court administrators travelling the circuit of local courts. This aspect of the litigation system was even more pronounced in the Colonies than in relatively densely-populated England.

Indeed, disputes over debt relationships were the primary form of litigation in colonial courts. One empirical study revealed that in the 50-year run-up to the American Revolution, almost three-quarters of the litigation in one major colonial jurisdiction related to debt cases[185]. During this period "*the judiciary affected economic development principally through its enforcement of credit relationships*[186]." Some have even opined that the early American litigation system was partly used in order to publicly "record" debt relationships, and thus obtain priority over later creditors. By suing to enforce a debt arrangement shortly after its creation, a lender would better know where he stood vis-à-vis other lenders in relation to the same debtor[187]. In fact, so the theory, such a practice could have even facilitated overall lending, by introducing additional information into the overall credit market, and at the same time providing some certainty in relation to the (chronological) priority of debts[188]. Proponents of this hypothesis pointed to the fact that an overwhelming majority of debt cases were won by default judgments[189].

The lack of transparency and formality of procedure in the colonial litigation system are believed to have impacted its overall function in society. Some legal historians view the colonial period as one in which the court system was also used as an integral part of private financing[190]. By filing a suit for the collection of a debt, even a recently-created one, a creditor would be able to improve his or her relative position in the event that the debtor ran into financial difficulties[191]. By suing upon a debt, a creditor could thus establish a priority of later debts, something deemed important given the lack of a clear debt recording system as we have today[192].

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[184] Id. at 2449, in particular footnotes 150 and 151 (citing two other legal historians, A.G. Roeber and Virginia D. Harrington).
[185] Id. at 2416, in particular footnote 13.
[186] Id.
[187] Id. at 2419-22. This theory is sometimes referred to as the „debt recording interpretation of colonial litigation."
[188] Id.
[189] Id. at 2419 (citing the research of Bruce Mann, which revealed that about 90% of debt litigation in colonial Connecticut was resolved by default judgment. Moreover, in many of the remaining cases the debts were confessed by the debtors).
[190] See Claire Priest, *Colonial Courts and Secured Credit: Early American Commercial Litigation and Shay's Rebellion*, Yale Faculty Scholarship Series, Paper 1304, pgs. 2413-2450 (1999).
[191] Id. at 2419-2422.
[192] Id. Eventually the modern debt-recording system, such as that encompassed by the Uniform Commercial Code Article 9, would replace litigation as a vehicle for having private debts publicly recognized. See also Id. at 2448.

The theory that the litigation system proved an effective means of recording debt relationships was empirically tested by one legal historian, in an analysis which covered both the pre-independence and post-independence periods[193]. In that study, additional factors, such as the various costs of litigating disputes, were taken into account. The results cast some doubt the debt-recording interpretation of colonial litigation by showing that in general, creditors did not rush to have their credit arrangements publicized by means of filing a lawsuit[194].

On the contrary, given the high costs of litigation at the time, creditors often waited until they learned that a particular debtor may have been experiencing financial difficulties before turning to the courts as a last resort. Even then, they often pursued pre-litigation alternatives such as deferred payments[195]. Given the English law principle of "loser pays", which the colonial courts inherited, forcing a debtor into the courtroom often would have jeopardized a creditor's ability to recover at least part of any debt owed. Adding an additional debt (i.e. litigation costs) to a debtor on the verge of insolvency would further deplete the limited resources for the recovery which the plaintiff was seeking. Whichever of the two competing schools of thought is more accurate, they have one thing in common. They both accentuate the central importance of credit relationships in commerce, and thus in relation to litigation and limited liability rules.

The above description of the nature of the Colonial and early post-independence litigation system serves as a good segue to the evolution of company law in the United States. Legislatures in the newly-independent United States of America had to address the same societal and economic dynamics in relation to debt law as it began to increasingly be applied to legal persons, as opposed to natural ones. The nuances of the legal person, with the general legal separation of the entity from its founders and operators, would have to be taken into account as more and more economic activity began to be undertaken on a larger scale and within the context of companies. Though some of the vestiges of English law continued to influence the direction of such legal efforts, increasingly the US states began to chart their own courses.

2. The English Inheritance and Dispersion of Authority[196]

Prior to gaining independence, the British colonies in America followed the English model of company charters being procured directly from the King of England[197]. Eventually limited authority was delegated to the colonial assemblies in relation to religious and municipal corporations, but even here the assemblies were deemed to be acting with the implicit authority of the King[198]. This tradition of centralized authority residing at the highest governmental levels continued after the 13 newly-independent US states began assuming direct control of economic and legal matters. From then on it was the individual state legislatures, as opposed to a single institution in the case of Britain, which began making decisions related to corporate charter petitions. This fragmentation of authority over company law would, over time, provide an opportunity for experimentation and the pursuance of different policies and approaches.

Initially the approach to incorporation in the United States was a cautious one. In the words of one commentator:

> "*But as soon as the courts set themselves to constructing an American theory of corporate personality, the judicial position became antagonistic to what had been the common position before the Revolution. All our circumstances were changed. It had been our interest to make the most and claim the most of whatever franchises we had obtained from the Crown or*

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[193] Id. at 2422-2439.
[194] Id.
[195] Id. at 2437.
[196] This section relies on the following sources in particular:
[197] See Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations*, 49 American Univ. L. Rev. 1 (Oct. 1999), 80, at 88-89 (hereinafter Hamill, *Special Privilege*).
[198] Id.

agents of the Crown. Americans had been only recipients of corporate privileges. Now they began to be givers, also. They had been but too glad to repeat the doctrine of the English Judges that corporations possessed power to do anything which they had not been expressly or by fair implication forbidden to do. Their own Judges began to assert that corporations could do nothing which they were not expressly or by fair implication authorized to do.[199]"

This attitude had two main influences on the further development of US corporate law. First, since there was less to fear from the grant of corporate privileges (given their narrow and scrutinized purpose), states could more readily grant them. This facilitated the gradual move towards general incorporation, described in more detail below. Second, this willingness to grant corporate charters more easily came with a price, that of the narrow interpretation of both the corporate purpose and actions normally incident thereto[200]. Whereas the more rigid process in England indicated a heightened trust in both the incorporators and the artificial person they sought to create, in the US the corporate vehicle was more generally available, but the scope of permissible activities including any incidental powers was relatively narrow and subject to more scrutiny.

In the early years of the United States, the federalism debate also impacted the law of incorporation. The drafters of the US Constitution considered empowering Congress with the authority to grant corporate charters at the federal level[201]. The proponents of such Congressional power saw great benefit in having federal authority, particularly in relation to enterprises with a strong "public good" component, such as financial institutions and infrastructure companies (e.g. roads, bridges, canals, aqueducts). But the voices for decentralized authority carried the day, and the proposal for express federal incorporation authority did not make it into the final version of the Constitution[202]. States introduced their own statutes, with the result that state law almost exclusively defined the framework for the creation, operation and internal affairs of corporations.

In certain specific areas, the federal government was occasionally active. For example, a few years after the passage of the Constitution, the Bank of the United States received a federal charter, despite legal uncertainty as to whether the federal government actually had the requisite authority[203]. The absence of an express delegation of authority to the federal government meant that corporate law in the United States evolved very much through the actual practice of states granting petitions for corporate charters. Though in sheer numbers the state-chartered companies quickly outweighed federally-chartered ones, the seed had been planted for some kind of federal role in the creation and governance of legal persons in the United States. It would take almost a century for that latent, and implicit, authority to be fully utilized with the introduction of the US securities laws and other New Deal legislation.

In the initial decades post-independence, the United States remained primarily an agrarian economy. When promoters of an enterprise sought the benefits of incorporation, it was mainly in relation to municipal corporations, infrastructure projects, and entities with a core civic purpose, like religious and educational organizations[204]. The benefits which the promoters sought were generally not identical to those generally touted today. The abovementioned characteristics of extended life, capital-pooling, and the collective ownership of property were the main attractions in both the colonial and early post-independence periods[205]. The ability to limit the liability of the shareholders was not yet a central element of the incorporation process or debate.

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[199] See Simeon Eben Baldwin, History of the Law of Private Corporations in the Colonies and States, in Selected Essays in Anglo-American Legal History, Vol. 3 (American Association of Law Schools and Lawbook Exchange Ltd. New York City, 1992), at pgs. 254-55.
[200] Id.
[201] Id. at 89-90.
[202] Id.
[203] Id.
[204] Id. at 91-93.
[205] Id. at 91.

Although the federal government was not deeply involved in the economic sphere in the early days of the Union, some practical aspects of state-level incorporation occasionally forced debate regarding the appropriateness of a federal role in certain instances. Corporate charter petitions related to infrastructure projects in particular revealed some of the inefficiencies inherent in state-level regulation. Trade and traffic routes, both natural and man-made, traversed state boundaries such that coordination of certain projects made practical sense. For that to happen, the legal framework and corporate underpinning would have to be coordinated as well, something which often proved difficult in practice.

During this period, the trade and travel routes of the new American nation began to take on clearer shape. This led to the need for cooperation between state-level actors in improving the transportation infrastructure, such as in relation to eminent domain, rights of way, and so on. The early debate surrounding the appropriate level of infrastructure enterprise regulation culminated in a controversial piece of federal legislation, the so-called Bonus Bill, which was aimed at creating a national transportation system coordinated at the federal level[206]. It passed Congress by a narrow margin, but was vetoed by then President Madison[207]. The politicians of the day were unable to reach agreement on when federal exercise of authority in the economic sphere was appropriate. The federal government itself often seemed indecisive or unable to develop a consistent, concerted view in relation to infrastructure development.

The courts were also asked to consider issues of federalism with respect to legal persons such as corporations. For example, when the US Supreme Court was asked to opine on the issue of where the authority for incorporation lay, it held that it was concurrent between the federal and state governments[208]. As a result, the status quo continued to prevail. The ruling set the stage for the the precedence of state over federal regulation of corporations for the next century or so.

Another way in which history appeared to favor the states over the federal government in terms of enterprise regulation was the “forced” acceleration of pre-industrial trade in the newly-independent states[209]. The trade embargos which preceded and accompanied the War of 1812 forced the former British subjects to abandon their traditional reliance on trade with Britain for most manufactured goods (e.g. textiles, furniture, tools, light machinery). Home-grown enterprises thus developed at a quicker rate than they otherwise might have. This raised the question of what might be the best legal form to house such businesses. This laid the groundwork for what would become a boom in enterprise and corporate creation during the industrialization period.

These developments at the executive and judicial levels provided the states with almost free reign in relation to the development of corporate law, something of which many states took ready advantage. To a large extent this may have been influenced by the nature of the corporate purposes of the day. Public administration, religious institutions, promotion and provision of education, and similar functions were deeply connected to the welfare of the people. Combined with inactivity at the federal level, this may have led to a natural preference for decentralized, or state, authority in relation to corporate charter petitions related to such activities or services. Had industrialization happened earlier, or the gaining of independence occurred later, there may have been more emphasis on federal regulation of corporations, at least those impacting interstate commerce. The failure of the Bonus Bill initiative and early decisions of the US Supreme Court seemed to put a nail in the coffin of the federal-state corporate jurisdictional debate for almost a century.

As the states began to solidify their hold on the incorporation authority and process over the next few decades, the corporate form itself increasingly became a topic of political discussion. President Andrew Jackson refused to re-issue the charter of the Bank of the United States, while state-chartered

[206] Id. at 94-96.
[207] Id.
[208] See e.g. Gibbons v. Ogden, 22 U.S. (9. Wheaton) 264, 380-90.
[209] Hamill, *Special Privilege* at 97-100.

financial institutions proliferated[210]. The estimated number of state-authorized banks rose from over 200 in 1815 to over 300 in 1820, expanding to 506 by 1834 and 901 by 1840[211]. Because these institutions were not closely regulated, they were often at the center of financial debacles at the local level. Somewhat ironically, the anger at financial collapses of state-chartered banks was often directed at the federal level.

The blame for bank or other corporate debacles was not laid at the corporate form itself, however, but more at the nature of the incorporation process, with its need for special legislative approval of charter petitions. In many citizens' minds there was something inherently suspicious about a process which was not very transparent and required support of a small political class. From a political standpoint, it became important for the corporate institution to be made accessible to the general public[212]. This led to a push favoring devolution of the incorporation authority to the citizen level in the form of general-incorporation regimes.

3. Experimentation with the Incorporation Process

Until the introduction of general incorporation statutes, the legislative branch of US states maintained a monopoly on the granting of approval to enterprises as legally separate and distinct persons. Up until the 19th century, granting an incorporation petition was a relatively rare event, and the goals and objectives of the petition were historically tied to some public need. This monopoly kept a lid on the growth in number of enterprises which enjoyed the corporate form. The early processes in place for having the separate legal existence of an enterprise officially sanctioned were complicated, cumbersome, and often completely at the discretion of the governing public institutions. It was not until the process for incorporation - or sanctifying the separate legal existence of a corporate enterprise - began to be routinized, that the legal ground became fertile for the uncomplicated creation of enterprises.

The US states generally always maintained some role in this process. At first, the state reserved an exclusive right, held at the highest levels, to review, analyze, and accept or reject an application for the creation of a new corporation. By the mid-19th century, the process began to move towards one of the state defining the basic requirements for the creation of a legally distinct corporation. As long as these basic requirements were met, an application for creating a new enterprise could generally not be rejected. Discretion disappeared with the introduction of a standard process accessible to all. Given this demoted function, responsibility for reviewing the adherence of an application to these basic requirements was pushed further down in the state apparatus. Explaining the detail of this evolution will aid understanding what happened with the "essential" characteristics of the corporate form as the incorporation process became democratized.

New York was the first state to experiment with this in 1811[213] by its allowance of the corporate form without a legislative charter for the production of "woolen, cotton or linen goods." This may have been partly a reaction to address supply disruptions caused by the trade embargos with Britain. The significance of this development was threefold:

1) it represented a clear break from past practice (and a divergence from the historical English approach),
2) it ushered in the gradual commodification of the incorporation process, which directly impacted the importance of the "essential" characteristic, and
3) it opened the door to certain default positions, in particular in relation to limited liability treatment.

[210] Id.
[211] Id.
[212] Id. at 102-04.
[213] Act of Mar. 22, 1811, ch. LXVII, §1, 1811 N.Y. Laws 111 (discussed in Hamill, *Special Privilege* at 100-102).

If limited liability was deemed the starting point in a state's general incorporation statute, this basically removed the issue from any debate surrounding whether that was desirable from a societal standpoint or not. As it turned out, general incorporation statutes were silent on this key question.

The general incorporation trend accelerated during and following the Jacksonian Presidency, with Pennsylvania and Connecticut passing general incorporation statutes in 1836 and 1837, respectively. Pennsylvania's statute was initially limited to companies "making or manufacturing iron from the raw material, with coke or mineral coal.[214]" In the following decade six more states added general incorporation statutes. The trend spread rapidly so that by the end of the Civil War, most US states had one. By 1875, 44 of the then 47 US states had implemented general incorporation statutes.[215]

The introduction of self-incorporation - creating a legal person or company without specific legislative or royal approval - accentuated the importance of process in the debates surrounding companies and liability. It is worth remembering that process extends beyond just the formation of the corporation. It also deals with the operation of the company and the ongoing relationship with and obligations to the state. These in turn impact the treatment of the participants in the litigation context, and even the handling of corporate assets in the event of dissolution. The fact that the procedural dimension of incorporation had now been shifted from the states to the general public was a major milestone. The significance of the self-incorporation development cannot be underestimated.

All in all, the state's involvement in the incorporation process, as it was to become known, became much more indirect, as opposed to direct. By shifting their involvement from prerogative (i.e. negotiating the specifics of the charter creating a given enterprise) to process (i.e. setting out a standard procedure which essentially removed any discretionary approval element provided the requisite steps were taken), states set the stage for the dramatic growth in the number of enterprises in the post-industrial period. These factors combined to produce a proliferation of enterprises, which eventually became the basic unit for private, as well as public, activity.

Despite the proliferation of general incorporation statutes, there were still a number of restrictions or limitations that would come to play a significant role in the evolution of corporate law as applicable to later groups. First, certain activities were still off limits to a company aiming to be chartered through the general incorporation process. These were mainly large scale activities with a strong public dimension to them, such as banks and transportation, as well as those whose function was clearly a public one, such as running a municipality[216]. For these, the legislative charter path was still mandatory. Such limitations directly impacted the legal scope of activity of state-chartered corporations.

Second, and perhaps even more important, there was a legacy of restrictions on several operational aspects of the corporate form, including: maximum capitalization and/or asset size, share issuance and assessments, source and use of company dividends, voting rights of shareholders. [217] If promoters wanted more control or special treatment in any of these areas, they would have to seek a special charter from the state legislature.

Many of the limitations promoted a dispersion of economic activity, forcing business to be conducted by more entities than objectively might be desirable. For example, limits on capitalization or the number of shareholders in relation to the capital needs of a business could force the promoters to create multiple entities to cover the primary (e.g. manufacturing) and any necessary incidental (e.g. marketing, transport and distribution) operations. They thus provided the seeds for some of the attempts to work around the restrictions when the scale and complexity of economic activity conducted by an enterprise outgrew them. This also may partly explain why despite the introduction of general incorporation, entrepreneurs continued to pursue special legislative corporate charters in

[214] Act of June 16, 1836, ch. CCCLX, 1836 Pa. Laws 746 (discussed in Hamill, *Special Privilege* at 100-102).
[215] See Hamill, *Special Privilege* at 101-104.
[216] Id. at 105-07.
[217] Id.

certain cases. Some rights and privileges (e.g. eminent domain to acquire needed property, right to collect tolls) could still only be granted by state legislatures. Because of this, the so-called dual-incorporation (the option to incorporate under a general incorporation statute or via a special legislative charter) regime continued right into the early 20th century[218].

The reasons behind the maintenance of a dual-track incorporation process are not entirely clear. In some cases it may have been legislative oversight. In some states, it may have been too cumbersome to formally eliminate special charter legality, since this generally required an amendment to the State constitution. In the early days of the general incorporation statutes, only about a quarter of the enacting states went the extra step of expressly prohibiting the special charter route through constitutional amendment[219].

In most states both alternatives would continue to exist side by side for almost half a century[220]. Other states, such as New York, had a general prohibition on special charters, but still reserved the option of creating a corporation by this route "[if] the objects of the corporation cannot be obtained.[221]" Such provisions reflected the uncertainty surrounding this area of the law as well as the reluctance on the part of legislatures to shut the door for good on the special charter mechanism. State legislatures preferred to follow an incremental approach to an issue of such fundamental importance to economic policy.

So why did the special charter modality linger on for decades, despite the apparent lack of real need for it? One school of thought points to general legal system inertia as a possible explanation. Additionally, the legacy restrictions on certain operational and/or legal aspects outlined above affecting corporations created by general incorporation statutes triggered the need, or at least the desire, for some businesspersons to continue to prefer this more complicated process. Indeed, there may have been some genuine benefits in such cases, as evidenced by the nature of special charter applications sought and approved.

In addition to avoiding some of the restrictions contained in the general incorporation statutes (e.g. capital-raising, company borrowing), promoters seeking special charters often did so to procure some special advantage. These included gaining exclusive or monopoly rights over certain activities or areas, exemptions from tax provisions otherwise applicable, obtaining real estate outright, or exclusive use rights related thereto.[222] Moreover, special charters could be sought which were not subject to the same reporting requirements contained in the general incorporation statutes[223].

Interestingly, adding limitations on liability to third parties did not appear to feature largely in business's attempts to procure special charters. This would seem to have been an ideal opportunity to request such treatment at a time when limited liability was not a big topic of discussion by the general public. Yet this did not happen. Even with the objective potential for increased risk of tort liability following wide-scale mechanization, litigation risks were still relatively benign from the industrialists' perspective. Until that changed, the external liability question remained of secondary importance in the grand scheme of corporate America into the 20th century.

The fact that special charters lingered on into the 20th century was not without controversy. Indeed special treatment was often the main reason promoters sought incorporation via the special charter route. The appearance of favoritism continued to impact the political debates surrounding the corporate form in general. In addition to the favoritism issue, there was the practical effect that dealing with applications for special charters took legislative time away from other issues[224]. Over

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[218] Id. at 122-166.
[219] Id. at 122-128.
[220] Id.
[221] See 180 N.Y. Constitution of 1846, art. VIII, §1 (also discussed in Hamill, *Special Privilege* at 125-26).
[222] Id.
[223] Id. at 124.
[224] Id., in particular the discussion in footnote 191.

time this led to more and more states going the extra step and introducing constitutional prohibitions on seeking special corporate charters[225]. But not all states blocked the avenue completely. Following sometimes heated political discussions, by the late 19th century the states landed in one of three general categories[226]:

1. Constitutional prohibition with no exceptions- 23 states
2. Constitutional prohibition with exceptions for "publicly oriented activities[227]"- 21 states
3. No Constitutional prohibitions- 7 states[228]

Though not completely gone from the scene, special charters have become very much the exception in the 21st century as opposed to the role they represented in the 19th and early 20th centuries. Analysis of special charters from the Reconstruction period through the 20th century reveals the nature of the corporate purposes where special charters were sought: 54% public corporations (e.g. municipalities, utilities, nonprofits, educational institutions, etc.), 20% transport and telecommunications, 15% banks and other financial institutions, and only 11% general private enterprises (e.g. manufacturing, mining, real estate, publishing, timber, and so on)[229]. These were corporations with a strong public component to them. The large majority of the corporations was created under the general incorporation statutes, which would eventually be introduced in every US state.

For municipalities, special charters were still deemed better suited for establishing detailed governance procedures[230]. This continued to impact corporate creation well into the 20th century. Empirical research covering most of 20th century reveals that approximately 70% of special charters dealt with public corporations[231]. Moreover, most of the remainder had some public component to them, e.g. the establishment of railroads or other transport infrastructure, communications companies, or financial institutions. Eventually these sectors would become increasingly subject to federal regulation, but in terms the incorporation process, the state level continued to be the one that mattered most.

4. Experimentation with the Substantive Law of Corporations

In addition to experiments with self-incorporation privileges, US states began to debate variations in approach to some of the fundamental characteristics of corporations. The work of jurists such as Blackstone had been instrumental for the early development of American corporate law. The principles outlined in such treatises became the seeds of the body of law which American legislatures developed post-independence. Yet despite this common heritage, in some areas company law in the early United States began to diverge from that in England as early as the 18th century.

For example, enterprises for the creation of turnpikes or river navigation companies typically took on the corporate form in the United States, while England continued to favor the trust[232]. Similarly, certain financial services (i.e. underwriting, life insurance) remained as unincorporated enterprises in England, while in the newly independent United States such activities were increasingly conducted through the corporate form[233]. It is estimated that in the whole of the 18th century, England only chartered six corporations dedicated to manufacturing activities[234]. Meanwhile, the relatively underdeveloped economy of the United States created about 350 business corporations between 1783

[225] Id. at 122-126.
[226] Id. at 123 in particular the discussion in footnote 169.
[227] Id. These include things like municipalities, charities, educational institutions, and the like.
[228] These were primarily the New England states, which even approved special charters into the 1990's. Id.
[229] Id. at 137-39.
[230] Id. at 139-40.
[231] Id. at 141-143.
[232] See Oscar and Mary F. Handlin, Origin of the American Business Corporation, Vol. 5 Journal of Economic History No. 1 (May 1945) 1, at 2-4 [hereinafter, Handlins, "American Business Corporation"].
[233] Id.
[234] Id. at 3.

and the dawn of the 19th century. With 13 colonies, now 13 states within a Union, the sheer number might be expected to have been higher.

It is not exactly clear why the US was quicker to embrace the corporate form. The divergence may have partly been due to the economic structure of the time, combined with the relatively greater freedom of businesspersons to initiate an enterprise without a complicated "supreme sanctioning", by the royalty and Parliament in England's case, and by the respective legislature in the case of the United States. The Bubble Act is believed by many legal historians to have acted as a drag on company creation in England, in particular on the corporate form[235].

The Commonwealth of Massachusetts provides an excellent example for analyzing the evolution of the corporate form in the United States. First, it was at the forefront of legal developments following the independence of the American colonies. Second, it was at the center of the industrial revolution as played out in the US, particularly in the textile industry. Third, there has been considerable research of issues related to those of this dissertation which shed light on some of the legal issues considered herein. Tracing the role of limited liability for legal persons throughout key periods in Massachusetts legal history will set the stage for the later review of this issue in the multi-entity corporate form throughout the United States.

The legal-historical situation of owners of companies in the US with respect to claims by third parties is not completely clear. One school of thought holds that limited liability was inherent in the chartering process. Shareholders were not personally liable beyond the amount of their contribution to the enterprise[236]. The fact that some applicants for charters nonetheless requested an express provision regarding the limitation of liability casts some doubt on that presumption, though perhaps they were simply seeking additional clarity and another layer of protection.

Another school of thought sees the liability issue not as one of direct personal liability but as one of indirect liability in the event of action taken by the company against an individual shareholder. The classic example of this was an assessment made by the company for the payment of an initial contribution, or more controversially, an additional assessment to cover some unanticipated debt of the enterprise. English case law, which initially controlled and even today still influences US common law, did seem to support the practice of indirect assessments against the personal assets of a shareholder[237].

All in all, however, the lack of sufficient evidence does not permit a definitive answer to this question of legal history. For the purposes of this dissertation, however, the key points are that even in early 19th century, incorporators and owners were increasingly concerned about their liability risk. This concern, however, was primarily focused on the risk of liability for debts to creditors who had financed the operations of the enterprise. Rarely if ever did it center around the other forms of liability risk such as to third party tort claimants.

At the beginning of the 19th century, Massachusetts, like the other US states, permitted corporations to be created only through the grant of a legislative charter. Such charters were generally readily granted. The proponents of an application could request the special privilege of limitation of liability in one form or another. In the early stages of post-independence Massachusetts, however, such special requests were generally not granted[238].

The purported rationale for rejecting most requests for any limitation on liability was a very practical one: the protection of creditors[239]. Without initial creditors to provide financing to establish a

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[235] Handlins, American Business Corporation, at 3-4, in particular footnote 16.
[236] Id. at 1356-57.
[237] Id. See discussion of the Salmon case at 1357.
[238] See E. Merrick Dodd, The Evolution of Limited Liability in American Industry: Massachusetts, 61 Harv. L. Rev. 1351, 1352-53 (Sept. 1948).
[239] Id.

commercial enterprise, there would be no need for an application for a corporate charter in the first place. Similarly, without sufficient legal protections for ongoing creditors following the establishment of an enterprise as a separate legal person, it would be difficult to ensure the continued and sustainable existence of the respective enterprise. Interestingly, throughout much of this period, liability in relation to non-creditor claimants against the enterprise did not play a significant role in either the public or the legislative discourse.

When the United States was primarily an agrarian economy, there was not a tremendous need for the benefits of the legal person such as those provided by the corporation. Similar to the origins of the legal person discussed above in relation to England, the initial driver was more the need for an efficient form of public administration and delivery of public goods. Most of the early charters in Massachusetts and other states related to infrastructure projects (e.g. canals, turnpikes, toll-bridges, water supply) and financial enterprises (i.e. banks and insurance companies).

Manufactured goods came primarily from Europe, especially England. That changed dramatically with two nearly parallel developments: the English embargos of 1807, and the War of 1812, which extended their impact. These tended to accelerate the push towards economic self-reliance and with it domestic industrialization in the US.

The year 1809 is seen as a watershed year. In that year Massachusetts chartered 11 manufacturing companies, more than it had done over the past 20 years[240]. The flood of applications for corporate charters forced the Massachusetts legislature to consider a new approach. All these developments culminated in the Manufacturing Corporation Act[241]. Perhaps in response to the legal uncertainty under the common law, the Massachusetts legislature made a policy decision in 1809 of expressly making shareholders in all manufacturing companies directly liable to their creditors. One has to cut through the legalese of the time to pinpoint the provision related to shareholder liability:

> "*… whenever any action shall be commenced against any corporation that may hereafter be created, or whenever any execution may issue against such corporation, on any judgment rendered in any civil action, and the said corporation shall not within fourteen days after demand thereon made, upon the president, treasurer, or clerk of such corporation, by the officer, to whom the writ or execution, against such corporation, has been committed to be served, shew to the same officer sufficient real or personal property to satisfy any judgment, that may be rendered upon such writ, or to satisfy and pay the creditor the sums due upon such executions, then and upon such neglect and default, the officer, to whom the writ or execution may have been committed for service, shall serve and levy the same writ or execution upon the body or bodies, and real and personal estate or estates of any member or members of such corporation*.[242]"

The underlined portion highlights the statutory liability of the members of the corporation in the event that the corporation itself was unable to meet claims successfully made against it. Remarkably, there was no interim procedural step required in order to levy against the personal property of one or more members in the event of nonpayment by the corporation. Instead, aggrieved creditors could proceed directly against one or more of the members. Naturally, knowledge regarding the financial wherewithal of such members would be a key piece of information for a judgment creditor seeking enforcement.

That is not to suggest, however, that personal liability concerns did not play any role in the economic decision-making of this period. In fact, where promoters had particular concerns about their personal liability exposure, they would often go the extra step to secure additional protection. For example, in

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240 Id. at 1356. Eight of these eleven companies were in the textile industry.
241 An Act defining the general powers and duties of Manufacturing Corporations of March 3rd, 1809, Mass. Laws 1806-09, c. 65 p. 464.
242 Id. at section 6.

1807 the Exchange Coffee House received a corporate charter from the Massachusetts legislature[243]. This charter followed the standard liability allocation in place at the time, namely that the promoters were individually liable[244]. When it came to initially financing the enterprise, however, the promoters expressly sought additional protection in relation to registration of a debt instrument (mortgage) with the notation "*without personal responsibility*."[245]

It was also around this time that the textile industry began to expand, especially in New England. The War of 1812, with its preceding embargo on trade between the US and the United Kingdom, also acted as a catalyst to drive the industrialization process forward. By 1815, the tally in Massachusetts was up to 115 chartered textile companies and many other manufacturing companies[246]. The Massachusetts legislature readily granted corporate charters for manufacturing corporations. The charters generally included an express provision regarding direct shareholder liability, which reflected the Incorporation Statute. Charters for banks and insurance companies, on the other hand, generally did not contain direct liability provisions, presumably on account of the the role of such institutions in supporting the financial dealings of their respective communities[247]. Legislators had the challenge of creating a legal environment which would support the establishment and functioning of banks. The states had to strike the right balance between incentivizing the creation of financial institutions, which required significant trust to attract deposits, and protecting depositors. The US banking system was still in its infancy.

In contrast to the treatment of banks, charters for the more traditional public-works type activities did not contain a direct liability provision[248]. Perhaps the Massachusetts legislature, and legislatures in other US states, needed a period to become familiar with the nature of manufacturing in general, and its legal regulation in particular, before taking a chance on providing any limited liability protection to manufacturers. As the public, and the Massachusetts government, became more comfortable with the risks and opportunities presented by the manufacturing corporations, a debate began about extending limited liability to these enterprises as well. The debate really gained momentum in 1825, when the Governor of Massachusetts, Levi Lincoln, encouraged the legislature to revise Massachusetts law to permit limited liability for manufacturing corporations as well[249]. It is worth focusing on these developments as they tend to exhibit how a change in law was necessary to make the attribute of limited liability part of the corporate law framework. There was growing sentiment that such a change was necessary in order for the United States to meet its true economic potential.

Two neighboring states (Maine and New Hampshire) had already begun offering such treatment. As states begin to compete for investments by touting the attractiveness of locations for direct investment, there began a public discussion around the relative benefits and costs.[250] In addition, the proponents of more liberal treatment pointed out an odd aspect of the then current legal situation, namely that a debtor who paid any assessment levied against him thus achieved the status as creditor, enabling him to then go after other members for contribution. This led to strange dynamics in practice when an enterprise encountered financial difficulties, with owners often chasing each other for reimbursement or contributions.

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[243] Mass. St. 1807 ch. 32 (June 20th, 1807) (discussed in Handlin & Handlin on pg. 10 and in footnote 49 in particular).
[244] Id. at section 7.
[245] Mass. St. 1807 ch. 78
[246] Dodd, at 1356-58
[247] Id., at 1364-66. It is worth noting that while relatively far-reaching, the provisions related to bank shareholder liability were not as open-ended as those initially applied to shareholders of manufacturing companies. Generally such additional liability was capped at the respective shareholding of the member.
[248] Id.
[249] Id.
[250] Id. at 1366-72. This was similar to the "race-to-the-bottom" debate which ensued following the introduction of corporation statutes which permitted the holding of other company's shares.

The groundswell of support for change amongst both businessmen and politicians is well-evidenced in a speech by Governor Lincoln to both houses of the Massachusetts senate in 1825. Lincoln led up to the specific corporate law topic by describing the tremendous infrastructure development needs of the young country[251]. The success of neighboring states in building canals, roadways, turnpikes and other essential means of moving people and goods had "*animated the people of Massachusetts… that some public effort should be made to secure a participation in the benefits*.[252]" In addition to this perceived increased public appetite for improvements, there was also apparently plenty of "unemployed capital" which could be put to use in this area. The only thing apparently holding things up, as the speech emphasized, was the state of the Massachusetts law of corporations, with its unlimited liability.

Lincoln went so far as to invoke the Revolutionary War hero General Henry Knox, who in 1792 had managed to procure a corporate charter from the Massachusetts legislature to make a navigable canal connecting Boston to the Connecticut river, thus opening up the entire transport system of the region[253]. The project never came to fruition, however, because the term granted with the corporate charter was too short. Massachusetts would need to become more flexible in its regulation of corporations, the message seemed to say, or capital would simply flow to other regions. He also pointed to the example of the English support for railroads, "affording a rapid and cheap mode of conveyance[254]." In the vernacular of the day, Lincoln reached out to the legislators' greater sense of purpose and destiny, saying:

> "*In a period of unexampled national prosperity, when there is a surplus of capital seeking investment, and a genuine spirit of competition in the cultivation of arts, and the development of the resources of society, a provident and wise people will avail themselves of the opportunity to lay deep the foundations of permanent power, and to make secure the foundations of future independence. This can only be done by a just estimate of physical advantages, and the application of great moral force to their highest improvement*[255]."

He then turned to the primary industry of the day, textiles, linking the ingenious use of the water power of the region to run the industrial mills. In addition to help the region meet its domestic needs, these developments had a geopolitical role, helping the young Union become independent of foreign suppliers[256]. His comments also addressed some of the main concerns of the day surrounding manufacturing, namely the risk of neglect of education by those working in factories, or the feared "consequent indifference to the restraints of social obligations[257]." The management of the "large manufacturing establishments", under the "well regulated tone of American sentiment", could be trusted to organize their activities in such a way as to avoid some of the societal concerns feared from parallel developments in England. For example, what today might be defined as worrisome child labor was described as exhibiting "a conscientious and praiseworthy regard to the instruction of children has mingled with provisions for their employment." The legislature was deemed capable of supervising these institutions so that they would never become "the nurseries of immorality and crime."

With a combination of patriotic appeal, economic imperative, and quelling of concerns, Lincoln then followed with a direct request for a change in the liability regime for corporations. The 1809 Corporations Law was causing Massachusetts to lose business to other states, and the unlimited liability was directly to blame:

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[251] See Speech of His Excellency Levi Lincoln to both branches of the Legislature of June 2nd, 1825 at pgs. 5-6 (Massachusetts State House Library, copy on file with author).
[252] Id.
[253] Id at 8.
[254] Id. at 10.
[255] Id.
[256] Id. at 12. It is worth recalling the recent embargoes with England and the War of 1812 in this context.
[257] Id. at 13.

"Not only the property and credit of the Corporations are made responsible, in the first instance, for the payment of debts, but the persons and private estates of the stockholders are holden ultimately liable, without limitation of time and to the full extent of the contracts, however small may be the proportion of stock, which the individual shall possess[258]."

The underlined portions of the quote highlight the contractual nature of any liability, consistent with the comments of the day on the topic. The phrase regarding the time element referred to the additional aggravating problem of shareholders being held accountable even though they had ceased to have that status (e.g. had sold their interests) before any contract leading to dispute had been entered into. In Lincoln's words: "*the jealousy of the law, not satisfied with devolving upon the purchaser the same liability, holds the seller, also, bound to the discharge of every precedent obligation.*[259]" This naturally led to a reluctance by investors to become financially involved in corporations, particularly those without an established track record.

Perhaps to not overly criticize the legislature's original (i.e. unlimited) approach, Lincoln noted that this role may have made sense when manufacturing was new and a "doubtful experiment… in the hands of rash and unskillful adventurers.[260]" But now manufacturing had come of age, and in the end, "the trust which is given a corporation is always voluntary." The practice, under the 1809 Manufacturing Law, of giving a creditor resort to the personal assets of a shareholder of a corporation was "questionable, at best[261]."

Lincoln pointed out that in dealing with corporations, the amount of capital stock, the management, and the success of the business, and the "apparent circumstances of solvency [could be] easily ascertained[262]." If a creditor still had any lingering doubts about dealing with a corporation, he could require some form of suretyship, or simply refuse credit[263]. In other words, there were better mechanisms than unlimited liability to deal with such financial exposure, and Massachusetts was losing out on account of its outmoded legal stance. Towards the end of his address, Lincoln hammered home the main message:

"*In a government professing a deep interest in the prosperity of domestic manufactures, and acting under this profession, in incorporating manufacturing associations, the policy of requiring that each proprietor of stock shall personally guarantee the responsibility of every other, and they severally, the credit of the corporation to the full extent of the debts which may be contracted, cannot be maintained.*[264]"

Interestingly, as the speech comes to its concluding recommendation, Lincoln points out that no additional securities to creditors are recognized in banking, turnpike, and other corporations. He also pointed out that many risks, such as destruction of corporate property by acts of nature, already put creditors at risk of financial loss. Granting them a liability regime tied to their actual investment would provide an additional incentive and stem the flow of the "immense amount of capital [which] has already been transferred from us to the neighboring states." The only appropriate way to address this issue would be for the Massachusetts legislature to change the law both the limit the scope of liability exposure to a stockholder's share in the capital[265]. In addition, the legislature should fix a period beyond which a bona fide seller of a share in a company would no longer be "responsible for corporation debts contracted during his membership."

[258] Id. at 14.
[259] Id.
[260] Id.
[261] Id.
[262] Id. at 15.
[263] Id.
[264] Id.
[265] Id.

The efforts of the Massachusetts political and economic elite began to pay off. An Act of 1827 went part of the way to resolve some of these operational deficiencies of the law, but did not address the basic question of liability. The debate continued throughout the decade, receiving increasing media attention as well as the attention of leading politicians[266]. Governor Lincoln continued to highlight the deleterious effects of unlimited liability on the financing of the textile industry, painting doomsday scenarios of the industry migrating to other states should the legislature not take action[267].

The discussions in the Senate on the Manufacturing Bill were equally as passionate and comprehensive in their analysis. One senator described the 1809 statute, with its provision for unlimited liability, as "a wide and essential departure from the common law.[268]" In his view the proposed Bill would restore the law to its correct order so that each corporation would "appropriate a certain, limited, and known fund, to the objects and purposes of their institution.[269]" The comments' focus on the debt obligation arising from borrowing shows that other sources of financial exposure, such as tort liability, were not even part of the discussion:

> "*Upon this fund alone should [corporations] be enabled to obtain credit; to this alone should recourse be had for payment*[270]."

Indeed, the proponents of the new Manufacturing Bill pointed to the lax rules regarding borrowing by non-incorporated manufacturers as responsible for the "ruinous debt" which such entrepreneurs had incurred. The introduction of limited liability for corporations would prevent or at least reduce the risk of that scenario. The disclosure and other safeguards would promote fiscal discipline in the corporations created under the new legislation:

> "*The unlimited and dangerous credit which these Corporations have had, resulted from the provisions of law, which extends the liability for corporate debts to private property. Limit this liability to corporate property, and you limit the credit of the Corporation to its corporate means of payment; you thereby abridge and diminish its capacity of incurring debts and of creating ruinous losses either to stockholders or creditors. Creditors will not then trust the Corporation beyond its means to pay; and the stockholders, if they will incur further expenses and make larger outlays, must consent to be assessed for that purpose; they will not be able to do it upon the corporate credit.*[271]"

The reasoning underpinning the above sentiments may have made sense in the simplistic financing context of the early 19th century, but would be questionable in today's context. Despite the higher risk of physical injury (and hence tort claims) in the manufacturing context compared to financial institutions, for example, the focus of the debate remained almost exclusively on overborrowing as the primary financial risk of the day. In addition, the competition from neighboring states was a key driver in the debate. There were claims of millions in lost investment revenue to other states in New England where limited liability was accepted for shareholders in corporations[272].

Some senators, not yet persuaded by the arguments, were concerned that the liability rule change would actually worsen the position of creditors vis-à-vis corporations experiencing financial difficulties by causing a panicked run against their assets, thus accelerating the risk of insolvency. To this another proponent of the Bill noted that if a borrower-whether an individual or a corporation- is

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[266] Id.
[267] Id. at 1368-69.
[268] See speech of Senator Hastings of Worcester in Remarks made in the Senate upon the Manufacturing Bill by the Hon. Messrs. Hastings & Pickering, pgs. 1-2, on file at the Massachusetts State House Library (copy on file with author).
[269] Id.
[270] Id. (emphasis added).
[271] Id. at 4.
[272] Id. at 6-10 (also highlighting the growth of New York as an economic powerhouse).

of doubtful credit, a lender can easily demand a surety[273]. In addition, he pointed out the voluntary nature of the creditor-borrower relationship and the fact that a lender unconvinced of the creditworthiness of the borrower could choose not to deal with that person at all. This particular element- the voluntary nature of the relationship- stands in stark contrast to persons who find themselves in an involuntary relationship with a corporation, such as a tort victim. It would be almost a century before this element and difference received heightened scrutiny in debates regarding liability rules.

The deliberations on the Manufacturing Bill went on for several days[274]. Both sides of the debate gained supporters, and the legislation which was produced in the end represented a compromise. The legislative changes limited the liability exposure of members to the whole amount of the capital stock, for which they were jointly and severally liable[275]. As a control, the members had to record the amount of capital stock at the first meeting, and make this fact public by filing notice with the Registry of Deeds[276]. Following incorporation, the members were obligated to publish an annual statement which reflected all of the assessments made, and any dividends to be paid out of capital[277].

Failure to follow these procedures would lead to personal liability of the members for the debts then due[278]. But provided the members followed these establishment and monitoring procedures, they would enjoy liability limited as described. In short, a tradeoff of increased transparency in return for limited liability protection. This background helps elucidate the historical importance of procedural elements in the liability analysis, something which would continue to be central in the further evolution of corporate law in the US[279] including in the creation of multi-corporate entities.

Within a decade the Massachusetts legislature was having second thoughts about the limited liability experiment, an indication of the closeness of the debate and lingering concerns about the appropriateness of the new limited liability provisions. The House of Representatives commissioned a committee to investigate a possible tweaking of the rules- something between limited and full, unlimited liability. In 1840 a proposal was considered to extend stockholder liability beyond the capital paid in to a corporation to any dividends received over a certain period (e.g. 10 years)[280]. This was deemed to be fairer than holding stockholders accountable to the full extent of their personal property, a practice noted as "not in accordance with the principles of justice" which would also gravely harm the state's manufacturing interests[281].

The attempt reinforced the guiding principles behind corporation law as it was developing in the 19th century. The House Committee concluded that the current law- the Manufacturing Act of 1830- was "well calculated to secure the public against loss from such corporations.[282]" Non-financial losses, such as those suffered by tort victims or other aggrieved parties, are conspicuous by their absence in the reasoning of the decision not to adopt broader stockholder liability rules:

[273] Id. at 11. Remarks of Senator Pickering.
[274] Id. at 10. Important clarifications were made during this process, such as that the new rules would only apply prospectively.
[275] Act of Feb. 23rd, 1830, section 6.
[276] Id. at sections 2, and 4-6, respectively.
[277] Id. at section 7.
[278] Id.
[279] See in particular the discussion of „piercing" jurisprudence and the importance of adherence to corporate formalities thereto.
[280] See Report on the Liabilities of Stockholders, Massachusetts House of Representatives Report of Feb. 21st, 1840. The proposed Bill would have applied to manufacturing companies as well as banks and insurance companies. Id. at 6-7.
[281] Id.
[282] Id. at 3

These laws are designed mainly to prevent fraud and mismanagement, and to secure the community against any damage which may come from this source[283].

The development highlighted how rules around liability were intertwined with those regulating the incorporation process. In theory, a general rule of limited liability would have reduced the need for special charters. Though somewhat of a breakthrough, the possibility of limited liability, conditional upon the observance of certain requirements, was sometimes still at the discretion of the state legislature (e.g. if the proposed corporate activity required additional or specific privileges). In such cases a special charter was still often required.

While legal historians believe that such petitions were readily granted[284], the historical picture may be incomplete. Statutory records only reflect charters which had been approved, but not those which had been rejected. Some secondary sources, such as press articles, hint at the possible role of politics in relation to petitions for corporate charters[285]. Interestingly, the opening of the door to limited liability in a corporate charter did not appear to dramatically impact the number of charter petitions during this period[286]. And non-contractual (e.g. tort) liability was still not a major feature in the public debate.

As corporations increasingly began to entail private business enterprises, there was heightened attention paid to any perceived favoritism or special treatment. Citizens did not have the same level of trust regarding manufacturing corporations compared to their historical, mainly community-focused, predecessors. This was perhaps due to the different objectives (profit compared to more socially-oriented), magnified by the frequent lack of transparency regarding the establishment of this new "class" of corporations. Even the appearance of potential political influence in the corporate chartering process did not sit well with many during the period of the Jacksonian democracy[287]. There arose an impression that the corporation was yet another tool of the powerful.

According to the populist mood of the times, whatever benefits that corporate chartering might have had should be made available to all, and not just the well-connected industrialist elite. This led to increasing pressure to establish a general incorporation statute[288]. Though not limited to Massachusetts, the debate took on particular urgency there.

Despite receiving considerable support from both the legislature and the voting public, a general incorporation right remained elusive for several more years. But in 1851, the Massachusetts legislature took this step by enacting a regime under which citizens could establish their own corporations without making a special petition to the legislature, provided they followed a specific procedure and assumed certain obligations[289]. This avenue to incorporation was now available to any group of persons of three or more, and extended to "*manufacturing, mechanical, mining and quarrying*" businesses, but expressly excluded the "*distilling and manufacturing [of] intoxicating liquors.*[290]"

The price to be paid by incorporators for the general incorporation privilege was transparency. The founders of permissible businesses were to specify the purpose and location thereof in a document known as the articles of association. Those running the business could only direct the operations and

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[283] Id. (emphasis added).
[284] See, e.g. Dodd at 1370-1371.
[285] Id.
[286] Id. at 1371-1372.
[287] See detailed discussion in relation to the corporate chartering process in section III E. below.
[288] Some commentators point out that Massachusetts had a general incorporation law by 1799, if not earlier, though this was limited to aqueduct companies. See Mass. St. 1798, ch. 59 (Feb. 21, 1799). See also Handlin & Handlin at 4 (in particular footnote 20).
[289] An Act relating to Joint Stock Companies of May 15th, 1851, Mass. General Laws ch. 133 pgs. 633-636.
[290] Id. at section 1.

funds of such corporation for that specified purpose[291]. Anything going beyond that risked being deemed to be void by law. The founders had to inform the public about the creation and operation of such corporations through a public filing which specified the following:

1) Corporate name
2) Corporate purpose
3) Amount of capital stock
4) Amount of capital stock paid in
5) The par value of such shares
6) Names and residence of the shareholders
7) Number of shares owned by each stockholder[292]

A certificate containing all of the above information was to be signed by the president, treasurer, and a majority of the corporation's directors, and filed with the Secretary of State[293]. Following incorporation, the company had to make an annual filing which contained the following information:

1) Amount of capital stock paid in
2) Amount of capital invested in real estate
3) Amount of capital invested in personal property
4) The amount of property owned by the corporation
5) The amount of debts due to it on the next first of December
6) The amount of existing debts against the corporation "*as nearly as the same can be ascertained*"[294]
7) The name of each stockholder and the number of shares held[295]

The annual financial information filing requirement provided creditors with at least some basis for making any lending or financing decisions, albeit limited to a particular time frame. In the absence of real-time financial information, there was (and is) thus a heightened element of uncertainty and risk when dealing with a legal person who enjoyed limited liability. The legislatures tried to find the right balance in order to incentivize entrepreneurial activity without placing too much of the risk of externalities on the general public.

As long as the above requirements were observed, the corporation would have "all the powers and privileges, subject to all the duties, restrictions and liabilities" set forth in the statutes[296]. The liability of the officers for "all debts of the corporation" was to be joint and several[297] if they failed to meet their respective duties. An earlier complication was eliminated, in that as long as an individual stockholder's contribution was paid up, there was no liability because of a fellow shareholder's failure to meet their respective capital obligations[298].

Finally, breaking new legal ground, the Act expressly made stockholders personally liable for any debts related to unpaid wages for services provided on behalf of the corporation[299]. Here we see a reflection of the concerns of the day and an additional group (workers) added to the traditional category (contractual lenders) of persons protected by the law. Involuntary creditors such as tort victims did not fall into the group of legally protected persons. This has been interpreted in various ways by commentators ever since.

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[291] Id. at section 3.
[292] Id. at section 4.
[293] Id. The promoters also had to publish a notice of the incorporation in at least three local publications.
[294] This was the age before detailed rules regarding accounting treatment in financial statements.
[295] Id. at section 9.
[296] Id. at section 5.
[297] Id. at section 11.
[298] See Dodd at 1374-75. This was important to address the creditor-debtor "chasing" issue highlighted above.
[299] Id. at section 15.

This was one of the earliest examples of a US state legislature providing special protection to a specific group in relation to corporate law. But it was certainly not to be the last time that a legislature tinkered with the order of priorities of debts owed by corporations, and upon their unwillingness or inability to pay, by its stockholders. As corporate law evolved over the ensuing decades, legislatures struggled to find the right balance between often competing policy interests. But the 1851 Act is particularly noteworthy for its introduction, in a major industrial US state, of the right of self-incorporation. The implications of this development, focused as it was on the process of incorporation, were explored in more detail in the previous section. At this stage we must turn our attention once again to more substantive issues of corporate law.

i) *Case Study: the Textile Industry in New England*[300]

The presentation above of the evolution of the legal framework related to corporations aids in understanding the policy issues which drove that evolution. But the presentation of a legal framework limits such an understanding to a more abstract level. To fully appreciate the significance of the legal developments summarized above, it is helpful to trace them in relation to a specific industry. The textile industry is a particularly good example, given its role at the heart of the industrialization wave in the United States. As Massachusetts was the center of the burgeoning textile industry in the US, it permits an ideal cross-referencing opportunity to the legislative experiments with corporate law. After all, it was the textile industry and related manufacturing industries which drove much of the debate and resulting legislative corporate law.

The New England colonists brought with them both their understanding of a legal system (as outlined above) as well as their general views regarding nature. The English settlers had a decidely economic approach to land and its fruits. Ownership, cultivation, and profit-making were cornerstones of the European settlers' relationship with the external world and their concept of societal organization.

As the New England colonies first began to develop, land use disputes highlighted the struggle between the traditional common law approach and the attempts at colonial legislatures to introduce a legal framework more hospitable towards development. Textile mills, for example, were at the forefront of these developments. The Massachusetts legislature had passed a statute in 1713 to provide an orderly procedure for claims to be brought against mill owners for any damage caused by the operation of their mills[301]. The idea was to replace the traditional common law approach whereby all affected parties could individually raise suits against the responsible mill owner, or even take direct action by sabotaging the offending dam. . Flooding was the typical cause of disputes, and in 1749 the mill dam statute was put to the test when a Natick mill owner by the name of Hastings was sued by several farmers for damages to their fields. Hastings won at the trial court level, but the petitioners appealed. The appeals court interpreted the Mill Act in a way that the traditional common law recourse of individual suits was tolerated. The right to peaceful enjoyment of one's land and property was still preserved, but not for long.

In 1796 the (post-independence) Massachusetts legislature strengthened the legal position of mill owners by clarifying that the statute represented the exclusive remedy for petitioners claiming damages resulting from mill operation[302]. Damages were assessed at the initial claim stage, and paid annually. They could be increased or decreased depending upon any petitions made by the mill owner or those claiming damages. Mill dam owners were required to post a bond for potential damages, which were capped at 4 pounds per year. This marked a shift away from the traditional common law of nuisance approach to one of statutory favoring of economic development, at least in relation to projects which were deemed to have some benefit to the general public.

[300] Much of this case study is based upon the book Nature Incorporated: Industrialization and the Waters of New England, by Theodore Steinberg (Cambridge University Press 1991), and the underlying research. The book maps the use of water in the age of industrialization and the key role played by the textile corporations in shaping both the economic and environmental course of the region.
[301] Id. at pg. 30 (citing Province Laws 1713-14, ch. 15).
[302] Id. at pg. 30 (citing the Act of 27 Feb. 1796, ch. 74 [1794-95] Mass. Acts & Resolves 443.

This shift from favoring agrarian interests to economic and manufacturing interests seeped into the incorporation process as well. As corporations increasingly began to relate to the creation of large-scale factories, one feature of the incorporation process gained in importance: special or incidental privileges. Applications for charters had often included requests for land grants (including condemnation of land to convert it to more productive means), operational privileges (such as the collection of tolls from users of turnpikes and canals), and even monopoly rights (effectively blocking future entrants). The grant of a mill privilege generally entailed the applicant receiving priority use of given water resources running through company land. This was a marked shift in the common law thinking regarding water as a resource, and reflected the importance of water in powering industrial machinery. Industrialization- and the employment it brought with it- was increasingly displacing agriculture in the list of societal priorities.

The incorporation of the Boston Manufacturing Company (BMC) in 1813 is seen as a turning point in the industrialization of the United States[303]. It also marked a turning point in corporate law development, embodying as it did the mindset shift described above regarding societal priorities, use of natural resources, and the direction of economic development. Two Boston merchants, Nathan Appleton and Francis Cabot Lowell, had been to Scotland and England and had seen the revolutionary developments in mill technology in operation there. The massive mills had revolutionized the chain of textile production, bringing previously separate manufacturing steps together under one roof, all powered by flowing water. Appelton and Lowell returned to Massachusetts committed to duplicating that success back home.

The Massachusetts legislature approved Lowell's petition for the charter of the BMC in 1813 and by the fall of that year the company's first mill was under construction. From its origins in the town of Waltham outside Boston, the company soon grew to control much of the waters of the Charles River. This it did through strategic land purchases as well as acquisitions of smaller, less efficient mills. The company's expansion was not always smooth, however, and on more than one occasion disputes ended up before the public courts. In general, the mood of the public and the judiciary was on the side of the large-scale enterprise, which had also become the greatest employer in many towns. The BMC mill system- both in terms of its legal structure and approach as well as its technical operation- became the model for other companies to emulate throughout the region and country.

The shift towards prioritizing economic development in an increasingly industrialized world contributed to a shift in the nature of the corporate purpose. Whereas up till now corporations had generally been established and operated as "quasi-public agencies", the advent of the modern mill corporation marked a shift towards the corporation as the embodiment of entrepreneurs pursuing private commercial interests. Mill owners and investors were quick to point out the job-providing role which the corporations presented, but even this purported benefit was not without its critics. In the words of one commentator:

> "*At the founding of the BMC... ambiguity surrounded the corporate form of ownership. Caught between a world in which corporations served public functions and one in which they operated on a more self-interested agenda, it was unclear what to expect. Many questions remained unanswered. ... In 1813, as the ink dried on the BMC's charter, such questions were obscured by the novelty of it all, by the prospect of a water-driven textile factory that some imagined would work for the general good of the community. But as New Englanders quested for further economic growth, the potential for conflict inherent in the corporate form became more apparent.*[304]"

That potential for conflict was increasingly manifested in real conflict as the corporate vehicle was used in innovative ways to expand the scope and power of the large mill enterprises. Given the importance of scale of production to the profitability of the enterprise, the mill boom in New England saw a hardnosed race for control over the means of production- water power and workers. At times

[303] Id. pgs. 22-23.
[304] Id. pgs. 45-46.

this was done surreptitiously. For example, the Merrimack Water Power Association (MWPA) made strategic purchases of land along the Merrimack River, with an eye towards constructing a major textile venture[305]. These companies were specialized corporations whose purpose had become the provision of water power to the growing mill industry[306]. Some had their origins in canal companies, and were able to convert existing, quasi-public privileges to more private uses during this transition in corporate purpose[307].

This transition somewhat masked a radical philosophical shift regarding legal rights to natural resources such as water. In the pre-Revolutionary period the American colonies followed the common law approach of water being deemed appurtenant to land[308]. Holders or riparian (i.e. land next to water sources such as rivers or ponds) had rights of use in water, but no legal ownership of the water as such. Water usage had historically been premised on use for agricultural purposes. With the advent of the large-scale textile mills, water's main purpose had become a means of powering great looms, part of a broader chain of production. This change in purpose was reflected in the way water rights were described in deeds and contracts.

Corporate owners of land (and the related water usage rights) made it available to the mill companies for a profitable fee. Deeds to land referred to specific amounts of water which could be used, which were tied to the size of the respective mills. The instrument of the mill-power, or mill privilege, was born and reflected in the underlying transactional documents[309]. Water companies received an annual rent for the water usage, but retained the legal ownership of the land along with the water use privileges accorded by the corporate charter. As part of such arrangements, they were obligated to maintain the dams and canals in operating condition so as to guarantee the contracted water flow to the mills. Eventually, water companies succeeded in separating the legal rights to water from the neighboring land tracts, with some deeds referring only to mill rates, i.e. the amount of drawings granted to a purchasing mill corporation.

Given the nature of corporate law in the US at the time, with narrow restrictions on corporate purpose, mill operations generally involved multiple corporations to cover all the elements of production. Often the investors and owners of these companies were the same persons, the political and economic elite of the respective societies. In the case of the New England mills around Lowell, for example, the Boston Associates company served as a type of controlling parent of the constituent mill and power corporations. The power and influence which flowed from that ownership paralleled the turbine power of the great rivers which permitted the New England mills to run. Despite the general admiration and appreciation for the technical progress and employment which the textile corporations brought with them, the latent potential for abuse surfaced periodically as a topic of public discourse. Concerns related to the concentration of economic and political power would continue to play a role in the evolution of US corporate law.

Somewhat overshadowed in the dramatic developments of the industrial period was the element of limited liability. As outlined above, the presence or absence of limited liability in the corporate law of a state did not seem to stem the tide of the corporate vehicle as the primary instrument for housing business. This is likely attributable to the fact that the traditional focus of liability exposure remained on contractual liability, in particular the liability of the corporation for debts incurred. Companies were generally able to manage those risks via appropriate clauses in lending agreements.

The introduction of the general incorporation right tended to further cloud the issue of non-contractual liability, as incorporation became a more process-driven act without the earlier level of scrutiny regarding corporate purpose. In other words, the shift from corporate privilege to corporate right may have masked the liability enquiry just at a time when the corporate object was shifting away

[305] Id. at pgs. 84-85.
[306] Id.
[307] Id.
[308] Id.
[309] Id. at 85.

from public purpose to private for-profit manufacturing and related activities. The underlying corporate activities brought with them the risk of harm both to persons with voluntary relationships with the corporation (e.g. workers) as well as others with involuntary relationships (e.g. neighbors). That dichotomy would gain in focus as the United States transitioned from a predominantly agricultural society to one very much driven by industry. As similar developments were occurring across the Atlantic, it is worth considering how English law was addressing these same challenges back in England.

The dramatic legal developments in the US paralleled trends in company law back in the legal "mother country." Though industrialization had its roots in England, the pace and scope of industrialization had taken on an entirely new scale in the former colonies. The federalist structure of the US may have allowed the US states to experiment a bit earlier with both the forms of business enterprises as well as with rules regarding liability for companies' actions. In the middle of the 19th century England experienced a period of heightened political and economic activity, as the legal and political institutions sought to keep up with the expanse and complexity of the British Empire.

ii) Role Reversal: Influence of US Legal Developments on English Company Law

Before diving into the Parliamentary debates which led up to the introduction of general limited liability for companies, it is worth reviewing the position of English law on the topic at the time. As outlined above, when corporations mainly entailed municipal and ecclesiastical organizations, limited liability was not at the forefront of Parliamentarians' or courts' ruminations on the nature of the legal person. Once commercial enterprises became the main object for new legal persons (e.g. corporations and joint stock companies in England), the politics of the limited liability privilege changed considerably[310].

As elsewhere, the issue of limited liability did not begin to take on central meaning in such debates until a number of external developments had taken place. These included the conduct of manufacturing and related economic activity on a massive scale, as opposed to the more traditional community-based trading and lending. In addition, the nature of enterprise financing became increasingly subject to intermediation, as providers of financing began to act more as investors as opposed to pure commercial lenders. The increasing transferability of such financial interests accelerated this trend and thus influenced both the nature of the stakeholders in the debate as well as the nature of the arguments for and against limited liability.

The British Parliament enacted a general incorporation statute in 1844.[311] Interestingly, the statute foresaw unlimited liability of the members for unsatisfied corporate judgments[312]. In the context of this era, such judgments would mainly refer to debt obligations as opposed to tort or other claims. As discussed below, it would take over a decade before various interest groups could succeed in getting Parliament to pass a bill granting limited liability to members.

At the introduction of general incorporation in 1844, the general stance of the law was still one by which responsibility for acts, and thus liability, was deemed to be a "personal attribute" of those "adventurers" engaging in the entrepreneurial pursuits of the day, one of which they could not simply divest themselves[313]. In the past, seekers of corporate charters had to gain the express approval of Parliament for the inclusion of any provisions regarding limited liability, and such approval was very selectively granted. The 1844 Act expressly prohibited the inclusion of limited liability provisions in corporate charters under the general incorporation process. That left the individual contracting process as the primary means for businesses to attempt to limit their liability vis-à-vis their trading parties. Even if successfully negotiated into contracts, however, such provisions were often not on as

[310] See discussion in Section III C. above for more detail on the period leading up to the Victorian statutes on company law covered in this section.
[311] Joint Stock Companies Registration and Regulation Act, 7 & 8 Vict. C. 110 (1844).
[312] Id.
[313] See discussion in Blumberg, §3.01 pgs. 3-14 through 3-16.

solid legal grounds as a charter provision. They also did not cover the increasingly important area of tort liability, which was beginning to expand in belated step with industrialization.

An important turning point in the debate around limited liability was its acceptance in relation to railroad companies. Railroads, with their revolutionary ability to move large amounts of people and goods across great distances, were deemed to have a large "public good" component to them. This facilitated arguments in favor of providing additional protection to the financers and owners of railroad companies, in order to provide sufficient incentive to keep adding to the growing network of railroads across the country. Once this evolved into an almost categorical exception, similar treatment began to be sought for other industries and sectors of the economy where the "public good" element was deemed significant (e.g. roads, canals, bridges, turnpikes). Over time pressure grew to make the exception into the general rule and grant all registered companies the benefit of limited liability.

The arguments for accelerating the introduction of a general limited liability, however, were not solely economic. Similar to the experience of the United States during the Jacksonian period, the British public also considered the whole chartering process prior to 1844 to be rather intransparent. Benefits such as limited liability treatment were also deemed to be available only to the well-connected and off limits to the "normal businessperson." There was considerable debate surrounding the wisdom of shifting from a system of discretionary grant of the privilege by the state, to a general right, contingent only upon the observance of a few organizational and operational conditions.

The year 1854 witnessed the failure of the attempt begun a year earlier to introduce limited liability into English partnership law[314]. This influenced the debate around the appropriateness of offering limited liability protection to joint-stock companies. There the argument for limited liability prevailed in the debate. Despite this disadvantageous environment, Parliament decided to take another bold step and embed limited liability protection in the English statutory legal framework. This was a break from the past- up to then the limited liability privilege had generally been preserved for businesses requiring considerable capital and delivering meaningful public benefits (such as transportation or utility companies).

The 1855 Limited Liability Act[315] permitted members of new or already existing joint stock associations and companies to register and thus automatically obtain the benefits of limited liability. To obtain this privilege companies had to comply with the following requirements:

1. Shares in capital were to be divisible in shares of at least £10
2. At least 25 shareholders had to subscribe to the deed of settlement (founding document)
3. These 25 shareholders must have held at least 75% of the company capital
4. Each shareholder must have paid in at least 20% of the value of their shares (with two promoters providing a declaration to that effect)
5. The corporate title had to include the word "Limited" in it.[316]

The minimum capital amount per share was considerable for that time, such that the universe of potential investors would have been limited to a rather small group of relatively wealthy persons. The minimum shareholder number was likely driven by a desire to only have companies of a certain size quality for the special liability protection under the Act. Similarly, the requirement of a core group of investors holding most of the company capital was likely motivated by a desire to have a certain profile (i.e. diversified but not at the "micro" level which exists today) and capital structure for such companies. The fourth requirement for a minimum paid in capital was and is common for most legal systems' treatment of corporate persons. Combined with the promoter declaration requirement, this

[314] See Colin Mackie, From Privilege to Right- Themes in the Emergence of Limited Liability, electronic copy available at: http://ssrn.com/abstract=1980681 A Mercantile Law Commission had recommended against the change, Id. at 294 [hereinafter "Mackie, From Privilege to Right"].
[315] Limited Liability Act, 18 & 19 Vict. c. 133 (1855) [hereinafter "English Limited Liability Act of 1855"].
[316] Id. at section 1.

rule aimed to ensure a minimum level of working capital for a new company organizing- or existing company reorganizing- under the Act.

Finally, the requirement for a reference to the extent of liability deriving from the company form had both a public informational function as well as a distinguishing categorical dimension to it. Not only would the traditional "essential" name characteristic of the common law be met, but it would be met in a way that would designate a category of businesses with a key common characteristic. Considered against the backdrop of the prior century's South Sea Company debacle, this formal requirement entailed an important signaling function to providers of both debt and equity capital. Conspicuous by its absence is the historical element of some advantage to the public before a privilege like limited liability would be granted in a company charter (via a Private Act of Parliament) or letters patent[317].

There are four main factors which contributed to the dramatic shift in favor of limited liability for businesses under English law. First, certain geopolitical entanglements (the debating and introducing of the Limited Liability Act occurred right around the time of the Crimean War) which had ravaged the Exchequer were seen as contributing to a rush to passage by Parliament[318]. There was a widely-held belief that extending limited liability across the broader economy would invigorate the English economy and improve the miserable state finances through increased taxes.[319]

Second, the political winds were shifting in Victorian England, with deep suspicion that the ruling aristocracy had an unfair privilege compared to the growing mercantilist and small business community[320]. A look at the general process for such grants reveals the source of such skepticism. The rules applied by the Board of Trade required the identification of such a general public advantage, as could generally be shown in the case of infrastructure companies (canals, bridges, transportation systems, water supply, etc.)[321]. Yet in practice applications for similar projects were not treated consistently, with some rejections relating to projects which had been approved in other cases. Such inconsistency smacked of favoritism, and led to suspicion that the cards were stacked against the growing middle class[322]. The introduction of a general privilege went a long way to address the perceived favoritism of the aristocracy.

In addition to the societal and political changes described above, there was a general change in regulatory approach to dealing with legal persons such as corporations. The enterprise financing model had shifted dramatically by the mid-19th century, with passive investors assuming a greater role than ever before[323]. In order to encourage such individuals to part with their excess savings, it was deemed essential to limit their liability (i.e. to their capital contribution)[324]. The statutory disclosure requirements were deemed a sufficient alternative to unlimited liability, as they would allow both creditors and investors to assess the financial condition and prospects of a company before making a lending or investing decision[325]. English law had come a long way from the stringent restrictions of the Bubble Act of the prior century.

A third key factor was the fact that limited liability was already becoming a standard part of many business dealings, not by virtue of the company form, but through express provisions included in the underlying contracts. The practice had originated in the insurance industry, and had begun to spread to general trading companies[326]. Rather than relegate this important factor to individual business

[317] Mackie, From Privilege to Right, at 302.
[318] Mackie, From Privilege to Right, at 296-98.
[319] Id.
[320] Id. at 298.
[321] Id. at 301-02.
[322] Id.
[323] See discussion of similar trend in the United States in Section IV.
[324] Mackie, From Privilege to Right, at 303-04.
[325] Id.
[326] Mackie, From Privilege to Right, at 305

negotiations, the Act introduced a general rule tied to the status of the company as one which had completed the required steps to incorporate.

It is important to note the emphasis on the contractual context of claimants who might find themselves stymied in their efforts to seek recovery because of the limited liability status of the respondent. Several commentators have argued that the absence of any discussion in the Parliamentary debates suggests that tort claimants- as involuntary claimholders against a company- were not impacted by the limited liability status created under the Act[327]. In fact, the case law of the time seemed to hold that limited liability- with its roots in contract or in the status of a company- did not extend to tort plaintiffs, whose contact with the company had been anything but voluntary[328]. Yet somehow the overall process, and the term "limited" in the company name, began to muddle even these kinds of cases. This has become a key point in the debates surrounding the appropriate scope of limited liability to this day[329].

Fourthly and finally, one cannot underestimate the impact of the industrial revolution on the debates and their outcome. Whereas land had historically been the principal generator of economic wealth and subject of legal rules and protection, now new assets were becoming more important, such as machinery and factories[330]. Whereas land was available for economic exploitation as is, machinery and factories first had to be created, requiring financing which exceeded the risk appetite of even the wealthiest industrialists of the day[331]. This led to increased cooperative financing and the development of a more formal banking infrastructure in all jurisdictions undergoing the industrialization process. In the words of one commentator: "*The law had, therefore, to consider all the complicated relationships which were being created through the machinery of credit and joint enterprise.*[332]" This process emphasized the focus on contractual liability in relation to property. There was minimal consideration of the byproducts of industrialization such as the risk of physical injuries to both laborers and bystanders.

The debates around liability rules at this time focused much more on the need for rapid and efficient accumulation and allocation of existing capital. By expanding limited liability beyond the traditional railway and utility companies, investors would be able to improve their lot in life by having a broader set of opportunities for earning from their savings[333]. The average size of the shares in capital, along with the increasingly passive nature of- at least small- investors, would help accelerate the growth of the middle class[334]. On top of this, there was great concern that if English law did not keep up with trends elsewhere, capital would leave the country, to the detriment both of the English companies and the working classes[335]. With the United States and countries on the Continent (e.g. France) having introduced limited liability, there was a real perceived risk of capital flight unless English law adopted the same approach.[336]

Within a year the Limited Liability Act of 1855 was overhauled and incorporated into the Joint Stock Companies Act of 1856[337]. This lends support to the theory that the prior act was somewhat of a rushed effort. The revision introduced a number of important changes, including replacing the "deeds of settlement" with the memorandum and articles of association to describe the purpose, structure,

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[327] Mackie, From Privilege to Right, at 307-08.
[328] Id.
[329] See discussions below in Sections V through VII.
[330] See discussion of the legal consequences of the Industrial Revolution in Plucknett, A Concise History of the Common Law, at pgs. 68-69.
[331] Id. at 68.
[332] Id.
[333] Id Mackie, From Privilege to Right, at 308-09.
[334] Id.
[335] Id. at 310.
[336] Id. Interestingly, this same dynamic influenced the development within the federalist system of the US, see discussion of the Massachusetts example in Section III 3..
[337] Joint Stock Companies Act of 1856, 19 & 20 Vict. c. 47. See Palmer, A Guide to Companies Legislation Past and Present, pgs. 1009-1011, in Palmer's Company Law.

governance and operational management of the company. In the words of one commentator, this statute introduced "*the modern conception of the joint-stock company, with limited liability capable of being established without any special Act of the Crown or legislature*[338]." This was a milestone in terms of limited liability, particularly in light of the judicial ruling two years earlier that limited liability clauses in deeds of settlement were not enforceable against external parties[339]. The limited liability feature was increasingly becoming an intrinsic part of the modern company by becoming anchored in statute.

The 1856 Act also added rules regarding the dissolution of the company in the event of insolvency, a key issue for claimholders[340]. By defining who has priority in relation to the remaining assets of an insolvent company, such rules directly impacted the allocation of risk between those persons having contact with a company, whether voluntarily or involuntarily. Banks and financial institutions were originally excluded from coverage under the Act, and were left with the traditional special request route in the chartering process. But after a few years' experience with the limited liability regime, Parliament also extended the general limited liability protection to them as well[341]. The final stage in the development of modern company law in England was the passage of the 1862 Companies Act[342], which consolidated the separate statutes related to bank and non-bank companies[343]. It also introduced a standard set of articles of association (so-called "Table A") with default provisions which incorporators were free to modify, which facilitated the incorporation process and brought broad consistency to corporate structures and operation[344].

The company purpose remained a key element in the articles of association and incorporation process. Courts continued to closely scrutinize such provisions in relation to disputes about the permissible scope of company activities. Shareholders could not legally ratify a contract which entailed activities going beyond the defined permissible scope[345]. Judicial decisions invalidating contracts whose subject matter was ruled outside the scope of permissible activities served as a reminder that the Companies Act legislation aims to protect not only entrepreneurs and owners, but also the financers of the company, as well as the general public. This it partly does by ensuring some minimum level of scrutiny to business activities to be conducted under the corporate veneer.[346]

As in the US, however, the stringent application of *ultra vires* jurisprudence eventually gave way to "catch-all" provisions in company articles, in effect broadening the scope of the business to any lawful activity. This was another example of the increasingly pro-commerce sentiment in legislatures on both sides of the Atlantic. The political and social debates which accompanied the introduction of the limited liability regime in Britain are worth keeping in mind for comparative purposes. Also, many of the points (competing interests, participation in legislative process, allocation of risk) debated in that period echo in modern discussions of regarding the appropriate scope of limited liability, discussed in more detail below.

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338 Napier, cited in A.H. Manchester's Modern Legal History [Butterworth] at pg. 358.
339 *Greenwood's Case* (1854) 3 De G.M. & G. 459.
340 Id. Similar developments had taken place in the United States, with bankruptcy or insolvency law remaining an intrinsic part of corporate resp. company law before becoming legal fields in their own right.
341 The Joint Stock Banking Companies Act, 20 &. 21 Vict. 49 (1857) extended the registration and general incorporation option to banks and financial institutions. A year later the The Joint Stock Banking Companies Limited Liability Act, 25 & 26 Vict. 91 (1858) provided registered banks with similar limited liability protection as that enjoyed by non-bank companies.
342 Companies Act 1862, 25 & 26 Vict. c.89.
343 Palmer, Companies Law, at pgs. 1010-1011.
344 Id.
345 See, e.g. *Ashbury Railway Carriage Co. vs. Richie*, House of Lords (1875), cited in in A.H. Manchester's Modern Legal History [Butterworth] at pg. 358.
346 Id.

5. The Judicial Treatment of Limited Liability

After the legislative activity surrounding liability rules for corporations, it was soon the courts' turn to apply those rules in various contexts. As outlined in the prior section, by the 19th century limited liability was firmly anchored in English company law. But just how solid were the boundaries of the legal person under the new statutory legislation? Courts were increasingly called upon to address questions regarding the solidity of those very boundaries. Perhaps one of the most famous discussions of the limited liability of companies in the "modern" age was that contained in the *Salomon v. A. Salomon & Co. Ltd.*[347] case. The case is one of the earliest to thoroughly examine the relevant principles applicable to small businesses which choose the corporate form. Mr. Salomon was a producer of leather shoes and boots, and had run his business in London for about 30 years. He later decided to set up a corporation both in order to prepare for the succession of the business, as well as to seek financing alternatives which may have been more available to a formal company.

Relying on the applicable company law in effect at the time, Salomon created a separate corporation, in which he held the overwhelming majority of the shares, and his wife and child each received one share each. The dispute which led to the court cases arose from debentures which a third party lender had purchased, part of an external financing which Salomon sought to shore up the internal company financing during a difficult period. Eventually the company defaulted on the debentures, and was forced into liquidation[348].

Much of the legal literature regarding the case focuses on the House of Lords decision. But the two lower court decisions highlight the types of issues with which courts struggled, and continued to struggle with, when considering the sanctity of the separateness of the legal person. The court of first instance, focusing on the proximity of the majority shareholder to the running of the business, decided in favor of the debenture holder (i.e. did not uphold limited liability). The reasoning of the court relied heavily on the fact that the same person had signed the memorandum of association as had become the majority shareholder, with the holders of the single shares seen as mere token or dummy shareholders to give the appearance of a more disperse shareholder structure. As such, ruled the court, A. Salomon & Co. Ltd. was in reality little more than an agent of Mr. Salomon the businessman and principal. This analogy to principal-agent law is an element which has underpinned the thinking around the extent of inviolability of the corporate form right up to the present.

The Court of Appeal used even stronger language in affirming the decision of the trial court[349]. Justice Lindley described the incorporation of A. Salomon & Co. Ltd. as an abuse of the incorporation process. Any protection which the relevant statute (Companies Act 1862) provided was only for "*bona fide shareholders*" and not "*mere puppets… [without a] will and mind of their own*[350]." In this Court's view, Salomon's wife and children did not belong in the category of genuine shareholders[351]. Though the Court found that Salomon followed all the proper procedures in creating A. Salomon & Co. Ltd., such that the company constituted a corporation, it described it as a "corporation created for an illegitimate purpose[352]." The Court highlighted the method of financing chosen by Salomon as calling the legitimacy of the overall incorporation into question, noting in particular:

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347 Salomon v. A. Salomon & Co. Ltd., [1897] AC 22.
348 See the discussion of a similar scenario in relation to Massachusetts in section III C. 3, in which the company in question took additional measures to add limited liability status confirmations into its contractual finance documents above.
349 Broderip v. Salomon, Ct. Appeal 1893 B. 4793, 1895 2 Ch. 323.
350 Id. at 341 (J. Lay's opinion).
351 This conclusion was apparently reached despite the fact that some of Salomon's sons were actively involved in the business, and there may have been plans for them to take over the family business upon the retirement of its founder.
352 Id. at 337 (L.J. Lope's opinion). This purpose discussion has been echoed in court decisions regarding piercing the corporate veil ever since. See discussion in section V below.

"A person may carry on business as a principal and incur debts and liabilities as such, and yet be entitled to be indemnified against those debts and liabilities by the person for whose benefit he carries on the business. The company in this case has been regarded by Vaughan Williams J. as the agent of Aron Salomon. I should rather liken the company to a trustee for him - a trustee improperly brought into existence by him to enable him to do what the statute prohibits. It is manifest that the other members of the company have practically no interest in it, and their names have merely been used by Mr. Aron Salomon to enable him to form a company, and to use its name in order to screen himself from liability[353] (emphasis added).

Thus it was not the fact that Mr. Salomon held almost all of the shares of the company which swayed the appeal court's decision. Instead, the Court seemed to place considerable emphasis on the timing of Salomon's decision to incorporate, after having run the business for many years without the corporate form:

"I do not go so far as to say that the creditors of the company could sue him. In my opinion, they can only reach him through the company. Moreover, Mr. Aron Salomon's liability to indemnify the company in this case is, in my view, the legal consequence of the formation of the company in order to attain a result not permitted by law. The liability does not arise simply from the fact that he holds nearly all the shares in the company. A man may do that and yet be under no such liability as Mr. Aron Salomon has come under. His liability rests on the purpose for which he formed the company, on the way he formed it, and on the use which he made of it. There are many small companies which will be quite unaffected by this decision. But there may possibly be some which, like this, are mere devices to enable a man to carry on trade with limited liability, to incur debts in the name of a registered company, and to sweep off the company's assets by means of debentures which he has caused to be issued to himself in order to defeat the claims of those who have been incautious enough to trade with the company without perceiving the trap which he has laid for them.[354]" (emphasis added)

A further appeal brought the case to the House of Lords. In a landmark decision for English company law, the Lords unanimously overturned the lower courts' rulings. The House of Lords saw nothing fraudulent about a businessperson deciding to incorporate a business, even in times of financial difficulty. As long as there was sufficient transparency about the business, including its financial health, it was difficult to allege any fraudulent conduct. More importantly, according to the Lords, the burden of ascertaining the financial health of a company rested with its contracting parties. Those operating the company, even if shareholders, were only required to provide the level of information called for by statute, if any. Lenders in particular should supplement that baseline data with any information they deem to be important:

"The unsecured creditors of A. Salomon and Company, Limited, may be entitled to sympathy, but they have only themselves to blame for their misfortunes. They trusted the company, I suppose, because they had long dealt with Mr. Salomon, and he had always paid his way; but they had full notice that they were no longer dealing with an individual, and they must be taken to have been cognisant of the memorandum and of the articles of association[355]."

Lord Herschell echoed the above sentiments by noting that anyone dealing with a company is aware of its nature, and can and should learn about the shareholder structure by inspecting the register of shareholders. In terms of timing, Lord Macnaghten emphasized that any legal protections afforded by

[353] Id. at 338 (L.J. Lope's opinion).
[354] Id. (emphasis added).
[355] Id. Here the court emphasized the burden of information-gathering between lenders and borrowers. Under the Company Act legislation, the filing and approval of the memorandum and articles of association were prerequisites to the company coming into existence as a legal person separate from its owner(s).

the incorporation process began at the instant that process is complete and a separate legal person is created:

> *"The company attains maturity on its birth. There is no period of minority - no interval of incapacity. I cannot understand how a body corporate thus made "capable" by statute can lose its individuality by issuing the bulk of its capital to one person, whether he be a subscriber to the memorandum or not. The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.[356]"*

The House of Lords made clear that there was no presumption of anything untoward related to the intention to and actual implementation of incorporation unless the moving party in litigation could provide affirmative proof. As we will see later, many common law courts since have taken a more scrutinizing approach to the timing and motivation behind the incorporation of a business experiencing financial difficulties[357]. Finally, the House of Lords seemed to clarify once and for all the idea that the protections of the corporate form are available to all businesses, regardless of size:

> *"It has become the fashion to call companies of this class "one man companies." That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of creditors. If the shares are fully paid up, it cannot matter whether they are in the hands of one or many[358]."*

In the end the sanctity of the corporate form, and the incorporation process in effect at the time, was upheld by the House of Lords. The *Salomon* case is important for its comprehensive discussion of the factors which leading English judges deemed relevant or not relevant when considering whether to uphold the existence of a legal person (i.e. to decide against disregarding the separate legal form of a corporation). The relevant factors include:

1. The observance of formalities both at incorporation (e.g. actual payment of required capital) and thereafter (e.g. periodic reporting)
2. The importance of a clear delineation of individuals acting on behalf of the corporation as opposed to in their personal capacity
3. The importance of not commingling or dealing with company property in a manner which overlaps with personal property or interests
4. A presumption that the corporate form will be generally respected, with exceptions based only on fraud or "misuse.

On the other hand, the court found it essentially irrelevant that family members could have the status as shareholder and/or be in the management of the company. The mere fact that participants in a company shared a blood relationship did not by itself lead to a presumption of something untoward

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[356] Aron Salomon (Pauper) Appellant; v A. Salomon and Company, Limited, Respondents, House of Lords, 16 November 1896, [1897] A.C. 22, at 51 (Lord McNaughten's opinion).
[357] See discussion below regarding private action veil-piercing jurisprudence in Section V.
[358] Aron Salomon (Pauper) Appellant; v A. Salomon and Company, Limited, Respondents, House of Lords, 16 November 1896, [1897] A.C. 22, at 53 (Lord McNaughten's opinion). The underlined sections highlight specific issues with which courts would soon struggle in the parent-subsidiary scenario. See discussion below in Section V.

in the arrangement. In an era where many smaller businesses were still run by families, this was an important clarification. The decision solidified the common law jurisprudence regarding the equal treatment of liability rules to corporations irrespective of the particular size.

The ruling also removed any doubt concerning where the burdens for information-gathering lay in relation to external parties dealing with a company. The law foresaw a minimum level of transparency regarding the structure and operation of an incorporated company. Periodic disclosure requirements provided some element of currency to some of that information. If a party desired more comfort or information regarding a particular issue, then there were various mechanisms (e.g. contractual provisions, enquiries) available to it. But it was up to such parties, such as lenders, to take affirmative action in satisfying such informational or other needs. Once again, the focus of the court's ruminations was on creditors and claims originating in contract.

Equally important, the case clarified that though size considerations could make important practical differences to both the corporations and third parties dealing with them, in the eyes of the law size did not make a difference. In fact, even an individual was able to incorporate a business, play an active role in its financing and management, and still enjoy the benefits which corporations comprised of dozens or hundreds of shareholders might enjoy. These include limited liability protection.

This particular aspect, and the holding as a whole, has been subjected to criticism since then. But the essence of the decision still underpins much of English company law. Its main value lies in its discussion of which factors a court will consider when deciding whether or not to respect or disregard the separate legal existence of a corporation. Cases like *Salomon* considerably influenced the development of American corporate law, which by the early 20th century increasingly began to look at these factors not only in the individual-corporation context but in the corporation-corporation context as well. The same issues examined in the sole-shareholder context would prove equally relevant in relation to the examination of parent and subsidiary relationships, discussed in more detail below.

IV. A New Frontier- The Multi-Corporate Enterprise

As outlined above, by the end of the 19th century, company law in general, and limited liability treatment in particular, had become relatively well settled in the common law legal systems on both sides of the Atlantic. The different approaches taken during different periods, even within a given US state, accentuate the ambiguous nature of the issue. More importantly, they also show that several models- unlimited, limited, or limited with conditions- can work in practice. The preferred approach at any time thus reflects decisions about competing social objectives and policy choices.

The next crossroads for company law was the development of liability rules applicable to multi-entity enterprises. Here as well the US legal system followed a rather different path than that adopted in England. Various factors including the federalist system meant that a major debate was necessary in the US before it became clear that one corporation could legally own another. Indeed, legislation was even necessary. Once that issue was resolved and such ownership sanctified, the major remaining question was how to apply liability rules across multiple entities connected by equity ownership or in some other form. The issues in this debate are important for understanding subsequent legal reform efforts of liability rules, as they involve significant questions of social policy. As such, the next section goes into considerable detail to describe both the evolutionary process and the relevant issues regarding the liability of corporate groups.

A. Pluralistic Purpose- Cooperative Economic Activity and the Origins of the Corporate Group

A good starting point for analyzing the evolution of business from a single company to multi-entity enterprises is the underlying corporate purpose. For a considerable period the corporate purpose had to be defined with a high degree of specificity. The extent of the state approval of the corporate form- with its attendant benefits- was directly linked to that narrowly-defined purpose or purposes. Any activities falling outside the defined scope risked being deemed invalidwhen challenged. This was the concept of *ultra vires*, which traced its origins to Roman and English law. It had the practical effect of causing some enterprises to be operated through multiple entities in the early days of the United States.

Scope limitations such as those rooted in concepts like ultra vires may have induced some of the growth in corporations, particularly where the natural scope of business operations had outgrown those specified in a specific corporate charter. Moreover, vertical integration, the process by which companies established- or acquired- business operations at other levels in the supply chain, also contributed to the growth of the multi-entity enterprise. As discussed below in more detail, in the US at least, there were some legal hurdles to overcome before such growth could take place by means of outright corporate acquisition.

Ironically, legacy constraints on business conducted through the corporate form - such as those related to permissible scope of activity- may in the long run have contributed to a proliferation of its numbers. The federalist system in the United States, with each state reserving authority for company creation, combined with a narrow interpretation of the corporate purpose was an important driver in the incorporation dynamic. In the words of one commentator:

> *Our federal system making every corporation created in one state foreign to every other state often renders it advisable to organize corporations in many different states which are simply branches of the same concern*[359].

Once states had become more familiar, and thus more comfortable, with business conducted through the corporate form, they began to loosen the strict requirements of narrowly-defined corporate purposes. Perhaps the best example of this was when states began permitting corporate charters to

[359] See Henry W. Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Cal. Law Rev. 12, at 14 (1928).

include a “catch-all” or general provision. Connecticut’s self-incorporation statute of 1837 was one of the earliest, with its formulation of “any kind of manufacturing or mechanical or mining or quarrying or *any other lawful business*[360].” These four small words opened the door to all kinds of new businesses to enjoy the corporate form without triggering additional approval processes.

Such statutes gave the shareholders free reign to conduct a variety of economic activities through a single entity. There remained the need to have a central purpose or focus of the corporation, but no longer were the shareholders hands tied in terms of the lines of business in which they preferred to operate through a single entity. Size limitations, however, continued to restrict the amount of activity which could be driven through a single corporation. By adding the formulation “… *and any other lawful business…*” to corporate charters, the promoters could essentially create a placeholder for other business activities to be started later, if at all. This was very convenient, for example, for manufacturing companies which needed ancillary activities (e.g. raw material supply, transport of finished and semi-finished goods) in order for their primary business to succeed. Often the same group of people became involved in the diversified business activities of such companies. The legal foundation was being laid, perhaps unwittingly, for the later growth of the integrated polycorporate enterprise.

Once again, commercial practice began to heavily impact the evolution of the law. The increasing acceptance of such “catch-all” provisions eventually meant the death knell of the traditional “*ultra vires*” concept. Instead of the business purpose being defined narrowly, with everything outside that scope deemed off limits for that corporation, the law evolved to a position of “anything goes.” Naturally the general restrictions of such activities needing to be lawful and not against public policy provided something of a buffer. But the default rule had essentially been reversed. Instead of the traditional need for a carefully crafted corporate purpose, whatever was not forbidden was permitted. Over time, statutory law would further impact the areas which were restricted to corporations unless they obtained a specific license from a regulatory authority[361].

There remained, however, other constraints on the corporate form which continued to impact the structure of economic activity in the US states. For example, many early corporate charters were approved only for a particular term or period. This could vary from a few years to several decades. This practice of fixed-term charters hearkened back to the days when business ventures were often project-based, or tied to the lifespan of a particular group of persons promoting and managing the venture. Whatever the approved duration, a predefined term left the businesspersons with three basic options:

1. Complete the particular project or business within the approved term (with practical limitations as to how realistic this might be in a given situation)
2. Seek an extension or re-grant of the approved term from the state (which would generally add an additional political dimension to the venture)[362]
3. Transition the underlying project or business to a new entity with a term going beyond that which had been approved for the prior entity (to the extent legally permissible)[363]

Eventually charters began to be granted with unlimited durations, but this was generally not automatic. A third constraint on the development of a particular business activity was the permissible level of capital or assets which a corporation could own or control. In the early days of the United States, the charters generally provided sufficient financial substance to cover the anticipated scale of the underlying enterprise, including growth. As one set of commentators put it:

[360] Act of June 10, 1837, titl. XIV, ch. LXII, §1 Conn. Gen. Stat. §1 (1837) (discussed in Hamill, *Special Privilege* at 100-102).
[361] This is discussed in more detail in Section VI.
[362] A good example of this was the experience of the US Bank, which originally received a federal corporate charter of limited duration. When that period had past, the bank’s application for an extension was refused.
[363] Such attempts ran the risk of being deemed invalid as a workaround or circumvention of the relevant legal restrictions.

"Factories were small; $10,000 was a substantial investment for building and equipment. Even in banking, which needed substantial sums to begin with, the number of participants and the amounts involved were not significantly larger than in other enterprises[364]."

It is also worth distinguishing between limitations on capital levels versus those on assets which a corporation was permitted to own or control. Early acts often placed limits on the maximum value of property a corporation could hold, but not necessarily on the amount of capital stock[365] A relatively small investment could suffice to create and grow an enterprise with assets worth several multiples of that capital stock.It became increasingly difficult to determine who had exactly what level of control over connected businesses. These facts would all impact the development of the corporate group and the application of liability principles to it.

B. Relevance and Prevalence of Limited Liability at the Introduction of Corporate-Corporate Ownership in the United States

For much of the early period of the United States, limited liability was not a central feature of the debate surrounding corporations, neither by the legislature nor as an issue litigated before the courts. For example, one of the leading cases dealing with the nature of the corporation focused on many aspects of the corporate form, but found it unnecessary to even refer to limited liability[366]. This is in some respects a reflection of the nature and level of the liability and litigation threat which corporations of the time faced.

As described in more detail above[367], the fact that state legislatures were able to switch back and forth between corporate law regimes without and then with limited liability with relative legislative ease provides additional evidence as to the level of importance of this factor, at least through the 19th century[368]. In the words of one commentator:

"... in the United States, limited liability was not perceived as an essential attribute of the corporation and was far from inevitable. It emerged after the initial period of industrialization and came as a political response to economic and political pressures, rather than as a necessary consequence of the entity concept.[369]"

As general incorporation statutes began to proliferate, many states included a provision for double liability of the shareholders (i.e. the amount of the par value of their shares) either in that statute or in the state constitution. For anyone asserting a claim against a corporation, essentially all of the assets of the enterprise were available for payment of outstanding liabilities. It is worth noting that at this time there was no federal bankruptcy law. The regime for distribution of assets of an insolvent company was generally contained in the respective state incorporation statute. At times, this could lead to a race for the courthouse in situations in which a company was facing financial difficulties. The later a party asserted a claim, the lower in the order of priority any resulting judgment would be[370]. If the total amount of claims exceeded the value of the assets available for paying, those who came too late would receive only a fraction of their claim, or possibly nothing at all.

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[364] *Id.* at 7-8.
[365] Id. at 7. Footnote 27 provides an example of how an $8000 cumulative investment secured a corporate charter for a company which could own up to $150,000 in property.
[366] See *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 636-637, 657-658 (1819).
[367] See sections III D. 2. and 3.
[368] See in particular the discussion of the Massachusetts legislature's experimentation with various corporate liability models in section III D. 3. above.
[369] See Blumberg on Corporate Groups Chapter 4 (2nd ed., Wolters Kluwer), hereinafter "Blumberg, Corporate Groups". Prof. Blumberg, of the Univ. of Connecticut Law School, is perhaps the most prolific scholar on the topic of corporate groups in general, and veil-piercing in particular. See individual references *infra*.
[370] The federal bankruptcy law later changed this situation by introducing a specific order of priority of categories of claims. See Section VI A. 2. for more detail.

As most claimholders over this period were creditors, issues of fairness or broader public policy did not feature in the debates to the same extent as they would in the 20th century. The greater concern at the time were the perceived dangers that the concentration of economic activity, particularly through corporations, brought with it. The issues surrounding the liability of the shareholders of such corporations for individual debts and claims were overshadowed by these broader concerns. The average US citizen at this time, generally not a lender to corporations and thus not directly impacted by the liability question, did not give the issue much thought. They were more worried about the impact that the concentration of economic power had on the prices of goods and services and the availability of jobs which could sustain a decent standard of living. These were the topics which news outlets of competing political and social orientation focused on in attempting to drive the broader debate around what should be done with these new, all-powerful, economic behemoths.

C. A Legal Milestone- The Elimination of Restrictions on Corporations Owning Other Corporations

To appreciate the extent of the legal breakthrough described in this section, namely the ownership by one corporation of another, it is helpful to quickly review the state of affairs shortly before New Jersey began permitting corporations to own each other. As outlined above, English law did not appear to restrict the ownership of one legal person by another[371]. To the contrary, this option was always available, implicitly if not expressly, to those setting up corporations under English law, whether pursuing municipal, charitable, economic, or some combination of these objectives.

> *English law had no comparable doctrine to the then-prevalent American philosophy of strict construction of company powers under which such powers in the charter were restricted to those authorized, expressly or impliedly, by the statute. In England, the company power to acquire and own the shares of another company could arise from provisions inserted in the memorandum of association, notwithstanding the omission of such power in the statute*[372].

Thus the departure in US company law seems to be attributable more to historical evolution as opposed to by intentional design of the legislatures or courts. First of all, the federalist structure in the US meant that many businesses ended up creating corporations in each state where they had significant activity. Often this seemed simpler than going through cumbersome procedures to gain formal authorization to do business in other states. Local incorporation proved to be only marginally more burdensome, and brought with it greater operating certainty.

This federalist dimension, combined with other legal legacies in US corporation law, tended to promote enterprises conducted across multiple entities in multiple jurisdictions. As outlined above, the strict interpretation of the scope of authority of early US corporations represented a departure from the more flexible approach followed in England. As a result, the *ultra vires* and corporate-corporate ownership were not central issues in the evolution of English company law around the time of the Industrial Revolution.

The situation was just the opposite in the United States. Unless there was an express provision in a statute or charter, it was generally settled law in the US that the acquisition of shares of one corporation by another was beyond the scope of legal corporate activity, or *ultra vires*, such that any attempts to do so were void by law. This directly impacted the ability of corporations to own one another. In the words of the US Supreme Court opinion tracing the evolution of corporation law in the early history of the United States: "*The power to hold stock in other corporations was not conferred or implied. The holding company was impossible.*[373]"

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[371] See discussion of the *Sutton's Hospital* case above.
[372] See "Blumberg, Corporate Groups", in particular Part II (Common Law Veil-Piercing Theory).
[373] See the dissenting opinion of Justice Brandeis in *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 541, 589 (1933).

Certain activities, such as railroads or other services with a significant public component, may have been exempted on a case-by-case basis[374]. But such exemptions were almost unheard of in relation to general manufacturing companies. At the end of the 19th century, manufacturing made up an increasingly larger portion of the US economy. Following some legal entrepreneurialism initiated by the legislatures in states like New Jersey, even they would soon enjoy a general right to acquire other corporations. According to historians, the relatively liberal policies towards legal persons in New Jersey had a long tradition. According to one commentator, "*from the moment the family of states was formed the fathers have gone there to do things they dared not do at home*…[375]" One of the early proponents of business development was Alexander Hamilton, a New York native. Hamilton was described as "*the founder of the first great Jersey corporations, … [whose] charters initiated the liberal policy of the state toward business*.[376]"

Businesspersons from the neighboring states of New York and Pennsylvania apparently saw the attractions of a company established in New Jersey early on. When they contemplated the formation of a company for a wide range of activities, New Jersey became the state of choice[377]. Hamilton played a leading role in the effort, and the result was the grant of a charter to the Contributors to the Society for the Establishment of Useful Manufactures[378]. The company was authorized to conduct activities ranging from digging navigable canals, deepening rivers, collecting tolls, and more[379].

Many of these activities entailed a public or quasi-public function. This was also evidenced by the company's authority to condemn and take lands for its purposes[380]. Perhaps even more dramatic, the Society had the authority to incorporate the inhabitants of a district centered around its activities[381]. Thus was created the town of Paterson, named after the New Jersey lawyer and politician instrumental in framing both the state and federal constitutions, complete with mayor and alderman[382]. There was a direct intertwining of the traditional municipal enterprise with a profit-making commercial enterprise.

The interaction between the state and economic enterprise was also evident in the financial structure of the Society. Of the one million dollars in authorized capital of the company, up to 10% was allocated to the state and could be subscribed by the Governor[383]. Half of the capital was already subscribed at formation, and a lottery was approved which would open up subscriptions to additional investors[384]. In some historians views such arrangements were tantamount to overreaching by the well-connected into what were primarily public affairs:

> "*The great Federalist from New York and the leading citizens of New Jersey combined to have and hold 'the gateway of the Continent' as private property, and Hamilton's charter not only gave this company governmental powers and rights and privileges, troublesome to the commonwealth down to to-day, it taught 'the best people' to rule and, ruling, to use the state for private business purposes*[385]."

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374 Id.
375 See Lincoln Steffens, *New Jersey: The Traitor State, Part I- The Conquest*, at 649, (hereinafter "Steffens I"), available at unz.org Steffens also wrote about the legal innovation in New Jersey which opened the door to the creation of the modern, multi-corporate enterprise in the United States.
376 Id. at 650.
377 See Edward Q. Keasbey, New Jersey and the Great Corporations, 13 Harv. L. Rev. 198 (Nov. 1899), 198, at 202-203.
378 Id.
379 Id.
380 Id.
381 Id.
382 See Keasbey, at 203.
383 Id.
384 Id.
385 See Steffens I, at 650.

Thus were sown the seeds for the experimentation with the corporate vehicle shortly after independence. This chapter also highlights the roots of some of the public perception problems which the corporate form has had ever since. About a century later New Jersey would also lead the way in the area of corporate law providing the underpinning for the development of corporate groups. This latent potential existed in the legal framework and the political traditions of the state. Though generally always pursuing a business-friendly environment over the ensuing decades, New Jersey tracked many of the traditional corporate mechanisms of the 19th century, including mirroring other states in terms of maintaining certain constraints on the growth potential of chartered companies.

In the mid-19th century, New Jersey was roughly similar in its treatment of corporations to the other US states. The applicable statute[386] required a minimum level of capital stock ($10,000.00), as well as a minimum amount "to commence business" ($6,000.00)[387]. There was a maximum term fixed at 50 years[388], though the legislature could dissolve the corporation earlier[389]. The corporate purpose had to be set out in the company certificate, which had to include the standard disclosure of the day (e.g. names and residences of stockholders, number of shares held by each)[390]. Following incorporation, broader disclosure (e.g. county where business conducted, amount of stock paid in, amount of debts, amount of "good" assets) was required on an annual basis[391].

This disclosure requirement provided some information regarding the financial condition of the company to those who had, or were considering, dealings with it. Failure to make such periodic disclosure rendered the presidents and directors "*jointly and severally liable for all of the debts of the company then existing*.[392]" Such liability also applied to their responsibility regarding the sound financial management of the corporation. Thus the president and directors should ensure that all due company debts were paid up before withdrawing or refunding any of the capital stock[393]. Similarly, directors were deemed jointly and severally liable for the payment of dividends in a period where the company was either unable to pay its debts, or where the payment of the declared dividends would put the company in that position[394]. General fiscal discipline was called for, with directors held jointly and severally liable for the discrepancy any time that the amount of debt exceeded the amount of capital stock paid in[395]. Thus in this period conservative financial management was the order of the day and models based on heavy leveraging were inconsistent with most state corporate statutory frameworks.

The procedural rules for seeking recourse against the company were broadly favorable to legitimate claimholders. Plaintiffs were permitted to proceed both against the company as well as against the officers and stockholders personally, "*and both of the said actions may be prosecuted, until the plaintiff shall obtain payment of his debt and the costs of both actions*.[396]" Aside from the actions set out in the statute, petitioners could also seek a remedy in the chancery court[397]. At times this could prove preferable in practice given the broader discretion such courts had in making rulings driven by equitable considerations.

The statutory scheme reflected the emphasis on contractual creditors as plaintiffs. Throughout this century it was the owners of debt granted to the company who were most likely to press a claim, with

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[386] An Act to authorize the establishment, and to prescribe the duties of companies for manufacturing and other purposes, N.J. Sessions of 1849 pgs. 300-323 (Feb. 28, 1849).
[387] Id. section 1. Third.
[388] Id. section 1. Fifth.
[389] Id. section 3.
[390] Id. section 1. Fourth.
[391] Id. section 24.
[392] Id.
[393] Id. section 23.
[394] Id. section 25.
[395] Id. section 27.
[396] Id. section 31.
[397] Id. section 32.

tort plaintiffs still relatively rare. The statute also contained a crude scheme for dealing with insolvent corporations, calling upon the receiver to cover all debts in full, if possible, otherwise to pay each proven debt "*ratably*", i.e. proportionate to the amount available for this category of debt[398]. As in other states[399], laborers were given preferential treatment. The statute gave them a lien against any company property[400]. The lien was enforceable before the payment of any creditors[401].

A later supplement to the above-described Act evidences the foresight which New Jersey legislators had in addressing the growing area of interstate trade. The state's location sandwiched between the major trading states of New York and Pennsylvania provided a somewhat unique perspective on the economic trends of the day. The 1865 supplement[402] expressly authorized New Jersey companies to do business outside of New Jersey[403]. To take advantage of this provision, a company merely needed to provide additional disclosure as to where it was conducting business, what portion was to be carried out locally, as well as where the "principal part" of the business was deemed to be[404].

A majority of the persons "associated in the organization of such company" had to be citizens and residents of New Jersey[405]. The general rule of liability for stockholders capped their exposure at the amount of their respective share[406]. If the indebtedness of the company exceeded the amount of capital stock at any time, then the trustees who assented to such an excess were held "*personally and individually liable for such excess to the creditors of the company*[407]." This tied the liability rule to the voting decisions of those responsible for the financial management of the corporation.

A few years later, however, New Jersey made it more cumbersome for stockholders to ascertain the financial health of a company based upon public disclosure. Previously companies were required to annually publish a statement outlining, among other things, the amount of capital actually paid in, the amount of existing debts, and the amount of assets. The 1873 revisions to the 1846 Act removed this express requirement, but required companies to make all records available to stockholders upon demand[408]. This procedural change shifted the information-gathering burden from the management of the corporation to the individual stockholder. On the other hand, for those making the extra effort, the information they were able to access was arguably more current and more detailed than that contained in any statement tied to a particular date (e.g. year end). One commentator summed up the revision as follows:

> "*... in New Jersey, where the purpose [of corporate law] is the protection of shareholders and creditors, it was considered that the publication of such a statement might, under many circumstances, be disastrous to the business, and that such a requirement would not be tolerated with respect to the business of individuals. Provision was, therefore, made that stockholders should have access at all reasonable times to the books of the company... but no compulsion was laid upon the company to make known to the public, or to its rivals, the precise condition of its affairs*[409]."

In addition, a key change was made to the permissible financial structuring of corporations. Companies could now incur debt in an amount greater than the capital stock. This thus opened the door to different corporate leveraging models which were soon to become commonplace. By

[398] Id. section 41
[399] See discussion on Massachusetts above in Section III.
[400] Id. section 42.
[401] Id.
[402] A Supplement to the act entitled "An Act to authorize the establishment, and to prescribe the duties of companies for manufacturing and other purposes" N.J. Sessions of 1865, ch. 201 (March 16, 1865).
[403] Id. section 1.
[404] Id. section 2.
[405] Id. section 1.
[406] Id. section 4.
[407] Id. section 5.
[408] See discussion in Keasbey, at 205-206.
[409] Id.

removing the statutory cap, this amendment shifted more of the overall risk of nonpayment of debt to the lenders. At the same time, the liability exposure of directors for violation of the capital stock payment disclosure rules was substantively changed[410].

Another relatively novel feature of the 1875 Act was the introduction of a provision permitting directors to purchase property by issuing company stock[411]. This opened up a new and important alternative to corporate financing besides traditional debt financing. Though both debt and equity financing of property acquisition entail an element of "selling the future" of the company today, equity financing has unique valuation aspects. The intrinsic value of a debt instrument- with its clearly defined elements of principal and interest rate- is directly tied to the ability of the company to generate sufficient earnings to meet its repayment plan. With an equity instrument, by contrast, the value of the acquired property (e.g. land, machinery, equipment, other businesses) represented by the share is driven by the capital markets. That value may grow or shrink due to factors quite unrelated to the success of the company, such as the perceived outlook for a given industry or the economy as a whole. More and more company directors began taking advantage of equity financing, with the risk of undervalued, or "watered" stock resting primarily with the external contracting parties to such financing agreements.

The 1875 Act also introduced changes to the administrative aspects of corporate law which made New Jersey particularly attractive to corporations from other states. For example, companies could write their by-laws such that much of the operational side of corporate administration (holding company meetings, maintaining company books and offices) could take place outside New Jersey[412]. The main exceptions to this were the requirement that the stock and transfer books be kept, and the annual stockholder meetings held, within the state[413]. Thus overall a corporation only needed to maintain a minimal nexus to New Jersey.

Though each corporation was still required to maintain a "principal office" in the state, in practice such an "office" could be little more than a postal address at a physical location used by countless other corporations, without any local employees or physical assets. A registered agent was also required, but even here New Jersey was happy to provide this service at a reasonable fee. The "place" requirement of the corporation hearkens back to the earliest common law jurisprudence regarding corporations[414]. Even the legal innovations introduced at this time could or would not overcome the staying power which such historic requirements held. The requirement was thus retained, albeit more in form than in substance. This is yet another example of the malleability of some of the "essential" characteristics of the legal person.

Another area where New Jersey unshackled the growth potential of corporations setting up shop there was the elimination of any cap on the amount of capital stock. Initially New Jersey did not even tax the capital stock, and applied the same, generally lower, tax rate to the real and personal property as applied to individuals. In 1883 a fee for incorporation was introduced, and a year later an annual tax which came to be known as the franchise tax. Competition from other states kept these fees and rates relatively low. Given the volume of corporations choosing New Jersey, however, the corporate regime proved to be a major revenue-generator for the state. The approach of the state to corporations was summed up by one commentator as follows:

[410] See Keasby at 206.
[411] An act concerning corporations in the state of New Jersey, approved April 7, 1875.
[412] Id.
[413] Id.
[414] See discussion of Sutton's Hospital case above, in particular the discussion in Section III A. See also the treatment of the seal requirement in the Salomon case, discussed above in Section III C 4.

"*Corporations were not considered as being hostile in any way to the public interests, and the regulations were intended for the protection of the persons interested in the companies rather than of the public.*[415]"

During this period, states were actively competing for the "business of business." This included in particular making a given state an attractive place to set up, and operate, their business activities. At the close of the 19th century, the winner of this competition appeared to be the state of New Jersey. New Jersey did so not just by legislating conditions favorable for the pursuance of business, but also by innovating in an area which had long been off limits to corporations- the ability to own each other.

There were specific examples of corporations owning the stock of one another as early as the 18th century[416]. Banks and insurance companies in particular had historically favored the corporate form primarily because of the capital-raising feature[417]. Both depended on large amounts of capital to function, and insurance companies often used bank stocks as a medium for their own investments. Thus from an early stage of US corporate existence, mutual ownership of shares was possible, albeit limited to certain activities and generally with the prior express approval of the body granting the corporate charter. The targeted success of the practice in the financial services area made entrepreneurs and policymakers wonder whether expansion to other fields would also make sense. In the words of one commentator:

The privilege was found advantageous in both banks and insurance companies as a medium for the investment of surplus funds. Other types of corporations adopted this stock-owning attribute of banks and insurance companies as well as their other aspects. They wished to employ their surplus funds at an increment, following exactly the procedure of the banks and insurance companies. Then, having established their right of stock ownership for purely investment purposes, they were able to see in this stock-holding privilege a means to further their own strength and position by so purchasing stock as to control at strategic points. In other words, from these early beginnings developed the "holding company" idea by steps of natural growth.[418].

Like financial institutions, corporations active in certain branches of the economy lent themselves readily to such experimentation. Infrastructure (canals, bridges, roadways, turnpikes) and transportation (ferry, steamboat, railroad) companies by their very nature connected different regions and operated across state lines. Linking the underlying corporations in a legal sense facilitated the operation and growth of regional and national commerce. Cross-corporation stockholding privileges became a standard part in the application process for special charters. These charters generally stated that their shares were to be open to subscription by other corporations[419]. Manufacturing companies which wished this same privilege still had to seek express permission via the special charter. Many states still retained restrictions on engaging in or acquiring businesses other than those specified within the express corporate purpose of the company charter.

The next stage of evolution of US corporate law was to extend the stock-owning privilege to other, unrelated businesses[420]. The railroad corporations were true pioneers in this area, succeeding in

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[415] Keasbey at 206-07.
[416] See discussion on pages 125-126 in William Randall Compton, Early History of Stock Ownership by Corporations, 9 George Washington Law Rev. 2 (1940).
[417] Id. at 126. Limited liability was also an important feature, though not uniform to all institutions. In some states a special provision along these lines had to be approved by the state legislature, which was not always forthcoming.
[418] Id. This ties into the concerns around industry dominance which drove the introduction of the antitrust laws, discussed in more detail below.
[419] Id at 127. Including many examples from several states. The railroad industry was the leader in terms of seeking this specific privilege in corporate charters.
[420] Id. at 128. The examples highlight early corporate experiments in extending the legal boundaries of the enterprise to other parts of the chains of production and distribution.

gaining approval for extremely broad corporate purposes in their charters. The Carroll Company[421] is especially noteworthy for an additional innovation in this area, namely a charter provision expressly permitting the use of the company's own stock in acquiring all manner of assets, including real estate, and not just the stock of other companies[422]. In addition, the charter sanctioned the creation of additional corporations without additional involvement by the state with the following provision:

> "*whenever said corporation shall become possessed of more than one mine, property, or estate, said corporation may, if they so elect, make a distinct concern of each, and organize the same under a suitable designation…*[423]"

Amazingly, the corporation was authorized at its creation to establish subsidiary corporations to operate and manage separate parts of the enterprise without any further involvement by the state (e.g. in the form of an additional legislative approval). In essence, the corporation could grow and multiply by having the stockholders vote to set up specially organized subsidiary corporations[424]. This was a far cry from the common law origins of the corporation requiring express approval of the King[425].

The judiciary also had its say in the debate, often striking down corporate-corporate ownership unless there was an express provision in the respective charters[426]. In addition to strict charter interpretations, courts also pointed to risk and fairness concerns, as well general public policy arguments against the creep of corporate powers[427]. Such sentiments were increasingly reflected by the public towards the end of the 19th century. But with each pullback, there appeared to be a state legislature willing to push the corporate envelope further forward.

It is worth noting that this development was taking place against the backdrop of a new era in US corporate law, namely the age of general incorporation statutes. From the viewpoint of business, ideally these privileges could even become part of the general incorporation statutes, thus saving them the often tedious step of seeking express permission in an initial special corporate charter. A general corporate stock-ownership privilege was about to become engrained in US corporate law.

That development required changes in the existing law in many states before the practice of stock ownership by corporations could become widespread in the US. Not surprisingly, the first experiments began in the economic heart of the young country, the mid-Atlantic states. This region had begun to overtake the industrial heartland in the Northeast, particularly when foreign trade led to the development of the largest ports on the eastern seaboard. Some states, in particular New Jersey, were particularly well-suited to push the "holding" experiment further in light of its traditional liberal approach to economic development and regulation.

Before outlining the steps taken by New Jersey to make its corporate law more hospitable to the 19th century kings of industry, it is worth noting that the state's "title" to being the first to permit corporations to invest in or even own each other is not uncontested[428]. Similarly, New Jersey's claim to fame as the creator and developer of the holding company mechanism is questioned by some legal historians[429]. But whatever the objective truth behind which state, depending on whichever definition

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[421] The company bears no connection to the author or his ancestors, despite the identical name and geographic overlap (i.e. the Carroll Company was a New Hampshire company).
[422] Id. at 129.
[423] Id. citing the company charter at Laws of New Hampshire, 1853, pg. 1403.
[424] Id. at 130.
[425] See discussion of early corporate development in Blackstone's commentaries above in Section III .
[426] William Randall Compton, Early History of Stock Ownership by Corporations, 9 George Washington Law Rev. 2 (1940) 125, 130-31.
[427] Id.
[428] See, e.g. Fred Freedland, *History of Holding Company Legislation in New York State: Some Doubts as to the 'New Jersey First' Tradition*, 24 Fordham Law Rev. 369 (1955).
[429] Id. at 372-377, 398-409.

one chooses[430], was "first" in this area is not of consequence to the topics covered in this dissertation. The relevance of the underlying development is twofold: 1) it highlights the nuances of historical evolution of law within branches of the common law family, and 2) the intensity of the debates around the introduction of the legal changes reflected the growing apprehension around these multi-corporate economic behemoths. Given the number and nature of developments which the New Jersey legislature pushed during key periods of industrialization in the United States, it remains an excellent case study for understanding the "birth" and growth of the modern multi-corporate enterprise.

The story of New Jersey's legal entrepreneurialism is captured in a colorful, albeit rather critical, article from the period. In *New Jersey: A Traitor State*[431], author Lincoln Steffens describes the background of the persons who drove and events which led to the legal milestone of state-sanctioned corporate-corporate ownership. Though the article may have a degree of embellishment, it is fairly clear in its overall negative view of the developments. It provides useful background to understanding the legislation which would dramatically impact the entire US corporate landscape.

According to Mr. Steffens, the main protagonist in the New Jersey corporate drama was a New York lawyer by the name of James B. Dill[432]. Mr. Dill had been observing the evolution of company law in England, in particular the rise of the joint-stock company as an alternative to the historically prevalent partnership form for conducting business[433]. Steffens describes James Dill as „*a young American lawyer out for business, [who] realized that the lawyer who had a hand in drafting laws favoring corporations could hardly fail to become an authority on corporation law- with a large practice*[434]."

Dill reviewed the existing state of corporate law in New York, where most of the major US companies were headquartered at the time, and identified several deficiencies. Not only were the statutory provisions arcane and complex, but the whole process of incorporation left much room for improvement. Despite an application process neutral on its face, there was an intrinsic opportunity for graft and corruption on account of the role played by bureaucrats in moving applications forward[435]. By refocusing the "reward" component to the state away from the application fee to the corporate tax element, Dill hoped to realign the incentives in a way to better favor the state enacting his proposed scheme.

Originally Dill proposed his corporate law regime to the state of New York. But the key powers of the day were unable to fully see the advantages of the new framework compared to the status quo[436]. It was a decision which New York was soon to regret. Dill did not give up after his attempt with the New York government and business leaders. Instead, he revised his approach to better emphasize how the business leaders could benefit from a revised corporate law regime[437]. New Jersey, as described by Steffen, was uniquely positioned to appreciate the benefits of the proposal given its historical approach to legislation. Critics might call this "self-centered", but fans would see it as innovative:

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[430] Id. For example, several early incorporation statutes where corporation-corporation ownership was permitted limited this to certain industries, or placed restrictions on the purpose of such equity investments. Other statutes placed monetary limits on the amount of such equity investments by one corporation in another, or prohibited the acquisition of equity stakes which would constitute "control" over that corporation. Freedland provides excellent examples of such limitations and restrictions to support his overall argument that New York, and not New Jersey, was actually the first and more innovative player in the legislative "competition" for establishing legal frameworks which were friendly to corporations.
[431] Lincoln Steffens, New Jersey: A Traitor State, Part II- How She Sold Out the United States, available at www.unz.org
[432] Id. at 41.
[433] Id.
[434] Id.
[435] Id. at 42.
[436] Id.
[437] Id.

"With the United States as a nation of men and women up in arms against trusts, there was need of a state where public opinion was conservative. With demagogic legislators in Congress, and in most states, passing laws expressive of the public will, there was a demand for a state legislature that would enact the will of the corporations. With businessmen everywhere forming pools, and trusts, and gentlemen's agreements to break the law or to get around it, and failing because, though there were trustees there was no trust, and while there were agreements there were so few gentlemen- with all these difficulties abounding in the Union, there was money in it for the state that would throw down her sister states and give license to do business just as business pleased: lawfully, widely, with a legislature to defeat the general public will, and courts to compel private, corporate good faith.[438]"

Dill's proposal received a much warmer reception across the Hudson River. In keeping with its traditions, the leading New Jersey politicians, in particular Governor Abbett, quickly saw how the state could profit from the proposed legal framework. The fact that this might come at the expense of other states was not a concern, indeed it may have even been an attraction[439]. The objective shaped up to one of making the state "*the easiest, safest, and best shop for limited-liability charters*[440]." The reference to the element of limited liability is noteworthy. The business world had begun to place increasing importance on this aspect of the investment vehicle decision.

To whatever extent the above journalistic coverage might be tinged with hyperbole, the long term significance of the legislative changes cannot be understated. At the time of the passage of the provision, few probably could have anticipated that within a very short time these few words would permit the building of huge corporate empires spanning multiple industries and several continents. On its face, the proposal for a new incorporation process appeared fairly innocuous. The provision itself, in terms of size, was rather humble, with a total of 94 words in two sections:

1. *"Be it enacted by the Senate and General Assembly of the State of New Jersey, That it shall be lawful for any corporation of this state, or any other state, doing business in this state and authorized by law to own and hold shares of stocks and bonds of corporations of other states, to own and hold and dispose thereof in the same manner and with all the rights, powers and privileges of individual owners of shares of the capital stock and bonds or other evidences of indebtedness of corporations of this state.*

2. *And it be enacted, That this shall take effect immediately*[441]."

The wording charted new legal ground in the United States by expressly authorizing corporations to own and deal in the financial instruments of other corporations. By so doing, corporations could build up majority control over other corporations, thus granting them influence greater than that of the original, now minority, shareholders. From the individual company's perspective, this ushered in an era where growth was not only possible organically (i.e. by reinvesting profits back into the enterprise), but inorganically as well (i.e. by raising financing to purchase other companies). This brought with it a great acceleration in the potential for growth of enterprises. That potential would be shown in a mere matter of years. The holding company quickly became a standard player on the US business scene.

The corporate acquisition legislation of 1888 was tied to the original incorporation statutes of the 1840's, and thus generally applicable to most areas of the economy at the time. Because certain activities were still regulated, at least in part, by other relevant statutes, the experiment had to be

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[438] Id. at 42-43. Steffens admits that this is his personal view, not represented by those leading figures he interviewed for his article, including James Dill. Id.

[439] Id. at 43.

[440] Id.

[441] An Act concerning corporations of this state, and of other states, doing business in this state, N.J. Session of 1888, ch. 269 pgs. 385-86 (April 4th, 1888).

expressly extended to such areas. So, for example, the ability to acquire and hold stock in companies involved in hoteling, or the transportation of goods or people, was authorized just 13 days later[442].

In passing the legislation, New Jersey was taking full advantage of the principle of interstate commerce concurrent jurisdiction. With the first part of section 1 New Jersey was essentially sanctifying cross-shareholdings of corporations in any state, provided that such "owning" and "holding" was "authorized by law." Thus the Act was effectively opening a door for merger and acquisition (M&A) activity related to corporations where such ownership was not legally prohibited.

In some cases, there were still lingering restrictions on acquisitions. For example, at this time many states had not yet relaxed the rules regarding corporate purpose. In these situations, corporate-corporate acquisition was only permissible if the activity of the acquired company fell within the scope of the activities as set out in the charter of the acquiring company[443]. Soon even these restrictions would fall into the dustbin of US legal history.

The use of "shelf" or "dormant" corporations as vehicles for such corporate acquisitions facilitated and expedited the whole process[444]. These terms referred to the practice of creating a corporation by completing the incorporation process, but not operationalizing the business until those involved were prepared to do so. This had the advantage of being able to expedite corporate mergers and acquisitions, with ownership and control changes taking place almost instantaneously. The Act also had the effect of encouraging corporate migration to the state, if corporate-corporate acquisitions were not lawful in the state of a company's original establishment. This act of "legal trumping" (if something is not legal elsewhere, come to New Jersey, where it is) became a source of friction and critique[445] as well as praise. One commentator sums up the impact of the change as follows:

> "*It was this power to acquire and hold the stock of other corporations that made it possible for corporations to be incorporated in New Jersey for the purpose of acquiring the stock of other companies of a similar character, and so to control their property and business, and to bring about under the form of corporate ownership the great combinations which, when produced by means of contracts, had been declared illegal in other states to be in restraint of trade and contrary to the public policy*[446]."

In essence, arrangements which had become problematic under applicable contract law principles were now permissible by simply joining the individual legal persons under the umbrella of a holding company.The institution developed by Dill to accomplish the new regime was also rather innovative. Dill proposed the establishment of a state institution which would actively promote New Jersey as a location for incorporating businesses[447]. The company would facilitate such incorporations by "explain[ing] laws, vouch[ing] for [its] courts, attend[ing] to the incorporation of commercial companies, and look[ing] out for them at home while they were off doing business in other states[448]." Thus from the outset, the focus of New Jersey's efforts was directed well beyond its borders to all of the other US states.

To effectuate these promotion efforts, the Corporation Trust Company (CTC) of New Jersey was established. Leading figures from both government and business were directly involved in the

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[442] An Act concerning corporations of this state, and of other states, doing business in this state, N.J. Session of 1888, ch. 295 pgs. 445-46 (April 17th, 1888).
[443] See William O. Douglas and Carrol M. Shanks, Insulation from Liability through Subsidiary Corporations, 39 Yale Law Journal 193 at 194 (1929).
[444] This practice soon gained judicial sanction. A single economic purpose would suffice for such dormant companies, as long as they met the requirements of the incorporation statute. Id.
[445] See Steffens I and II.
[446] Keasbey at 208.
[447] Id. at 44.
[448] Id.

company, including acting as directors[449]. New Jersey's Secretary of State and the head of the Pennsylvania Railroad were counted as members of the Board; New Jersey Governor Abbett himself was a shareholder[450]. The promotional circular which accompanied the launch of the CTC boasted of the support which business could expect if they chose New Jersey for their corporate headquarters:

> *"Our location which places us in close touch with the state departments, having charge… will be of special benefit to those for whom we may act.*[451]*"*

In the establishment of the CTC, we see echoes of the *Sutton's Hospital Case*. The judiciary is being reluctant to let go of long-held doctrines and requirements, which reared their heads in the continuing demand for a local "physical" presence. The modern legal system, however, was stretching that requirement to the limit. By retaining the definite location requirement, albeit at a fairly minimal level, it paid homage to centuries of company law doctrine.

The CTC provided a proxy for the marketplace and church of the medieval guilds, the meeting hall of the livery companies, and the port of the fleets of the Great Trading Companies. Rather than require companies to organize these on their own, New Jersey introduced a simple and inexpensive model for many companies to meet this formal requirement of a local "home." By providing a ready-made solution of which promoters could avail themselves at a reasonable cost, it minimized the burden of meeting the requirement. Historic fidelity to tradition, combined with a pragmatic, business-friendly solution.

As outlined below, the success of New Jersey's liberal approach to corporations was quick and great. Other states, including the economic behemoth across the Hudson River, New York, began to emulate New Jersey's incorporation statute. But this was not the end of New Jersey's experimentation with its corporate law regime. The New Jersey legislature began tinkering with other elements of corporate creation and administration to make the state continually attractive for the captains of American enterprise.

The 1893 Act ushered in modern corporate finance by making clear that corporations could deal in the equity and debt of New Jersey corporations in the same way as individuals could. This essentially sanctified what had been happening in practice already. Before the turn of the century even more flexibility was added to the corporate law framework. As an alternative to the direct acquisition of equity, and thus control, over a company of interest, New Jersey corporations were expressly permitted to lease the property and franchises of other companies[452]. This opened up new opportunities to enterprise creation and management in situations where direct corporate acquisition was not possible, or deemed not sensible, for example, where the respective assets were only needed for a defined period.

In 1896 the Act of 1846 was revised to remove the 50-year limit on the term of a corporation[453]. Thus disappeared one of the traditional constraints on corporate planning, activity, and expansion. The corporate person was now closer to the concept of a genuine perpetual life. The statute also opened the door to the creation of multiple classes of stock, with different voting rights, thus granting the promoters of business with even more flexibility in terms of maintaining control while enjoying the benefits of external financing via the issuance of equity in the corporation.

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[449] Id.
[450] Id.
[451] Id. According to Steffens, this was essentially a shifting of the existing graft problem. "This Company was organized to graft upon the incorporating function of the state, and state officials were in on it." Id.
[452] General Corporation Act of New Jersey (1893). Such actions required the approval of two thirds of the stockholders. Railroad companies were expressly excluded.
[453] See The General Corporation Act of New Jersey: "An Act Concerning Corporations" (revision of 1896), including the amendments and supplements to the end of the legislative session of 1899: annotations and forms (James B. Dill).

Of particular relevance were the changes introduced in the Act of 1897 related to the personal liability of directors, officers, and stockholders[454]. The 1898 Act also introduced enhanced ability in the founders to set out the powers and responsibilities of corporate directors and officers. As such the corporate certificate became more of a living document charting the course of the underlying business. It defined the parameters within which its stewards were to act, as opposed to the simple static document of creation, with little more, which it had often been in the past.

D. The Impact of the "New Jersey Breakthrough"

Many argue that by charting a more liberal path in the treatment of corporations and opening the door to the formation of corporate groups, New Jersey ultimately forced a sort of lowest-common-denominator competition in terms of corporate regulation. Taking full advantage of the constitutional requirement of the constitutional principle of "full faith and credit"[455], New Jersey was able to attract corporations from other states with its liberal business environment. The end result was that what may have been impractical if not illegal in another state was most likely was possible under the new New Jersey corporate law regime.

Perhaps one of the most extreme examples of this phenomenon was the migration of New York businesses to New Jersey, at least from a legal standpoint. Certain trusts had been declared illegal in New York as impermissible combinations in restraint of trade[456]. By setting up (e.g. holding) corporations in New Jersey and transferring business property into such corporations, companies were able to "unite ... property and business of corporations in all parts of the country…under one management.[457]" This led to accusations that the sole or primary purpose of such efforts was to accomplish purposes in New Jersey which would have been otherwise illegal elsewhere[458]. Most frustrating to the regime's critics, the nexus requirement of the business to the state of New Jersey in terms of securing a corporate charter seemed to be minimal or even non-existent[459]. In extreme cases, business operations physically located in several states, but not including New Jersey, could be reorganized and coordinated through a newly-created New Jersey corporation[460].

Despite such critique and resistance from both within and without the state, the New Jersey legislation remained in place. Its impact on the corporate landscape was immediately felt, with several corporate groups being formed. In the final year before the start of the 20th century alone over 1336 corporations were chartered in New Jersey. Not all of them were huge players, but the initial success of the New Jersey experiment was quite clear. Within just a few years of sanctifying corporate-corporate acquisitions, New Jersey accounted for some of the largest industrial enterprises in the United States:

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454 General Corporation Act of New Jersey (1897).

455 This refers to the US constitutional requirement whereby the legal acts of one state are supposed to be recognized and respected by the other states, except perhaps in extreme cases of such acts being inconsistent with the public policy of a state.

456 Keasbey at 200-201.

457 Id.

458 Id.

459 Id.

460 Id. Keasbey cites a New York Senate Committee investigating the activities of Trusts, which complained about the ability of promoters to secure New Jersey corporate charters "*without any semblance of any [business] interest in New Jersey*." Id.

Name of company	Authorized Capital
Amalgamated Copper Company	$ 75 million
American Woolen Company	$65 million
American Hyde and Leather Company	$75 million
American Cycle Company	$80 million
National Tube Company	$80 million
American Steel and Wire Company	$70 million
National Steel Company	$59 million
American Smelting and Refining Company	$70 million
United States Worsted Company	$70 million
Rubber Goods Manufacturing Company	$50 million
American Ice Company	$60 million
Distilling Company of America	$125 million
Federal Steel Company	$200 million

The table above not only depicts the rapid migration of business enterprises to New Jersey, it also paints a picture of some of the major components of the economy of the period: textile and clothing-related (wool, worsted, hyde and leather), food and refrigeration (by means of ice in an "icebox" prior to the introduction of electric refrigerators), industrial processing (steel, smelting and refining), transportation (cycle, tube, rubber). The inclusion of a distilling company, an activity which historically in most states was off-limits to corporations, is also noteworthy[461]. More and more of the traditional taboos of corporate law were fading away in this period.

New Jersey was not the only jurisdiction active in this area. The states of West Virginia and Kentucky were early competitors for drawing in "the business of business," with Delaware not far behind[462]. Given the geographic concentration of trade at the time (the mid-Atlantic region having surpassed New England by this time), New Jersey had a geographic advantage beyond that presented by its flexibility and innovation in the corporate law area. Its greatest competition came from neighboring states, especially Delaware. Shortly after New Jersey's successful experiment, even New York changed its stance, copying to a large extent the approach of its neighbor state[463].

The ability of corporations to acquire equity and debt holdings in another corporation, however, arguably introduced an additional layer in terms of the transparency of business coordination. Whereas a trust generally revolved around a document which expressly set out the rights and obligations of the various members, a mere shareholding, by itself, did not permit the same level of insight into such business coordination. An interested party would generally have to dig deeper to uncover just how such equity or debt holdings were being utilized to benefit the equity or debt holder.

Over time, both types of financial instruments became much more complex, further masking any analysis of influence. This applied both to potential influence, such as by way of voting rights tied to ownership of equity or certain debt instruments, as well as actual influence, i.e. how such voting rights were actually exercised. In short, though still within the reach of government officials charged with enforcing antitrust laws, corporate-corporate linkages made the job of antitrust enforcement that much more difficult[464]. The more opaque those linkages, the more difficult it was to analyze

[461] See the discussion of experimentation with corporate law and limited liability rules in section III. C. 2.
[462] See Keasbey at 201-02.
[463] Id.
[464] Some early commentators went as far as to suggest that the new antitrust legislation „seem[ed] inapplicable" to combinations based upon actual corporate mergers or coordinated purchasing rights or goodwill. See Keasbey at 199.

which levers of intercorporate influence existed and how these were utilized by corporate decision-makers.[465]

Given limits on enforcement resources, both then and now, any additional elements of opaqueness to collective business operations brings with it the risk of heightened anticompetitive behavior which remains below the regulatory radar[466]. Rather than attempt to address such concerns through corporate law, however, the US politicians and legislators ended up creating a new field of commercial law to address these concerns.

E. The Broader Antitrust Debate and Its Impact on Corporate Law Development

At the end of the 19th century, the general topic of the concentration of economic power began to receive much public and political attention. On the one hand, the topic was not new, as the United States economy had historically been in the hands of a relatively few wealthy landowners. Following the industrialization period, however, the societal impact of such concentration began to be more broadly felt. Having fought a revolutionary war related to the monopoly on political power, the American electorate was pre-sensitized to the concentration of economic power as well. Though the initial focus of such concern was the negative consequences of restraints on trade, the underlying tenor, as well as the timing, of the debate would influence the related discussions surrounding the liability of the corporate vehicle. This period saw a reassertion of the federal government in rulemaking related to corporations and economic activity in general.

Following the industrial period and the Civil War, the individual States became more interlinked by a growing network of transport and communications networks. Railroads, roads (turnpikes), and canals, themselves often the object of corporations, served to connect people and markets to a degree unheard of at the birth of the nation. For industrialists and entrepreneurs, they also provided an infrastructure backbone which facilitated and incentivized greater coordination of economic activity. By permitting greater economies of scale, such coordination brought with it the potential for greater profits for business owners and lower prices for consumers of goods and users of services.

In some respects, however, the legal system of the day stood in the way of such seamless coordination. Corporations were still primarily creatures of state law. Coordinating economic activity across state lines often necessitated contracts between companies involved in the same industry or service. This process would then have to be replicated several times over until the desired scale and level of cooperation had been contractually secured. And even after such a contractual "heart" of an enterprise had been created, it was still necessary for each of the constituent parts to be actively involved in the implementation and monitoring of said cooperation. In short, the process, both at the creation and in terms of its maintenance, was relatively clunky from a legal perspective.

In order to address some of the drawbacks of the economic-coordination-by-contract approach, business owners increasingly turned to an institution of the common law heretofore utilized more by individuals and charitable entities, the trust. The trust proved to be an ideal legal vehicle for coordinating economic activity on a uniform basis, without the administrative complexity and cost of a series of contractual arrangements. By centralizing the decision-making and management authority over multiple businesses in the hands of trustees, business owners were able to ensure that all participants were following the same general "rules."

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[465] This same challenge faces litigants who bear the evidentiary burden of proving responsibility or attributing decisions or actions within a multi-entity corporate scenario.

[466] More important to the central discussion of this dissertation, the blurring of lines of responsibility also brings with it a heightened risk that plaintiffs in litigation against corporate groups may not obtain redress in the event that the particular part or parts with which they had direct dealings does not have the financial wherewithal to meet any successful claims.

Moreover, the role of the trustee, with the attendant fiduciary obligations, ensured that the conduct of the business would be carried out in the best collective interests of the participants. This structure thus helped mitigate the risk of contention within the group. Depending on the powers delegated to the trustee, it also brought with it a greater degree of medium and long term certainty to the conduct of the business compared with a "network-of-contracts" approach.

As simple as the above summary might sound, the success of a given trust was very much dependent upon the quality of the legal framework for cooperation envisaged by the trust agreements. In the early phase of this development, willing participants in a trust only became so if they were convinced that the benefits of joining the arrangement outweighed the drawbacks. The fiduciary nature of the trustee role went a long way in providing a level of comfort. Huge regional and national trusts began to arise on the US business landscape.

A genuine momentum for joining began to surface. Industrial trusts covering all or most of a particular economic activity became almost a self-fulfilling prophecy. The costs of being outside the group began to mount to a point where non-membership may have threatened the very economic existence of such outliers. Against the backdrop of an inherent distrust of the concentration of power, here economic power, in a few hands, the "trust phase" of US industrialization in the late 19th century increasingly became a cause for concern. A quote from a legal commentator of the day gives a feel for the widely-shared view that this wave of trust-building was anything but innocuous:

> "*We have heard much of the dangers of corporations in late years; but, while our publicists had hardly whetted their swords to meet this question, we are confronted with a new monster a thousand times more terrible. Every student knows how corporations have grown from a monastic institution to the predominance they now occupy in the business world; but American ingenuity has invented a legal machine which may swallow a hundred corporations or a hundred thousand individuals; and then, with all the corporate irresponsibility, their united power be stored, like a dynamo, in portable compass, and wielded by one or two men. Not even amenable to the restraints of corporation law, these "trusts" may realize the Satanic ambition,—infinite and irresponsible power free of check or conscience. Corporations are bad enough; it is one of the defects of the historical growth of law that the conditions which attend the birth of a legal idea so infinitely differ from those that make possible its greatest development; but the trust is to the corporation what the mitrailleuse is to a blunderbuss.*[467]"

Though there was frequently an element of hyperbole in the views expressed by critics of the trust usage, much of the public shared the general concerns which they raised. The debate began to take on a real populist flavor reminiscent of that surrounding the general incorporation movement a couple decades earlier. Interestingly, the concerns voiced were not very focused on the limited liability enjoyed by many corporations. There was a general suspicion surrounding the longer term consequences of having entire industries under the control of a very few. The initial result of this intense debate was the introduction of a new field of law to regulate the perceived negative aspects of concentrated economic power. This field drew its very name from the main target of its concern, and became known as Anti-Trust law. The first milestone in this legal field in the United States was the passage of the federal Sherman Anti-Trust Act of 1890[468].

Despite the harsh rhetoric from the critics of the New Jersey legislation, it is difficult to claim that this was an outright attempt to circumvent the newly-launched antitrust regime in the United States. After all, both of the key federal statutes directed at perceived anticompetitive behavior applied irrespective of form. In other words, on their face, they applied equally to anticompetitive efforts coordinated through corporate linkages as well as through trusts. The same was true of antitrust statutes enacted at the state level.

[467] See Frederic Jesup Stimson, "Trusts", 1 Harv. L. Rev. 3, 132-143 (1887), at 132-33.
[468] Sherman Antitrust Act of 1890, 15 U.S.C. §§ 1-38.

Antitrust enforcement has primarily focused on so-called "horizontal" integration, that is, the acquisition of companies which are direct competitors to a given corporation. But corporate acquisition also occurs "vertically", such as when a corporation acquires other companies in the so-called value-added chain. Rather than purchase raw materials on the open market, or transportation or distribution services, a corporation may elect to bring these activities "in-house" and thus directly control the entire chain of production and distribution. This is exactly what corporations began to do, and did so at an accelerated pace once inorganic growth- the acquisition and integration of previously separate businesses- had received a legal blessing.

The Sherman Act drew upon a long legal heritage in the common law related to prohibiting so-called restraints of trade. Recognizing the fast-changing nature of business, and the structures through which business was conducted, the US Congress kept the provisions of the new statute intentionally general. Section 1 of the Sherman Act declares restraints of trade- in whatever form they might come- to be illegal, and even punishable by imprisonment[469]. The open-ended nature of the statutory language means that the courts have considerable discretion in determining which factual situations constituted genuine "restraints" as opposed to normal attempts at operating efficiency. This discretion was key in courts' early fashioning of the boundaries of this new field of law, with its interrelationship with the emerging sciences of finance, economics, and management[470].

Section 2 of the Sherman Act criminalizes not only the monopolization of "*any part of the trade or commerce among the several States, or with foreign nations*", but even the mere attempt to do so[471]. By focusing not only on the actual result but also on the preliminary steps in striving towards a monopoly, Congress sought to discourage businesspeople from even thinking along these lines. Interestingly, some of the conduct (e.g. monopolization) made explicitly illegal under the statute had, in earlier times, been the very objects of corporate charters (e.g. seeking monopoly privileges). For example, the guilds and livery companies benefited from special monopoly privileges granted them in their respective charters. Similarly, the exclusive rights to a given part of foreign trade (e.g. with India or Russia) to the English trading companies of the 16th and 17th centuries was part and parcel of their corporate setup. Under the legal-economic rationale of the 20th century, both could have been deemed an improper aspiration under this new field of law.

The passage of the Sherman and Clayton Acts ushered in the era of legal monitoring of the concentration of economic power in most of the US economy. The regulation of anticompetitive activity, whether carried out through the legal instruments of the trust, or otherwise, did not extinguish the rapid growth in the US economy. Nor did it put much of a dent in the proliferation of the corporate form.

Applying the new law, with its requirement for an intimate understanding of economics and business, was not always an easy task for courts dealing with real disputes. For example, in one of the first prosecutions under the Act[472], the court nearly exempted the entire manufacturing sector where there was no direct restraint of trade clearly related to interstate commerce. That case involved the so-called Sugar Trust, which at the time had succeeded in building up control of almost 98% of the sugar refining capacity in the US. Perhaps sensitive to both the critics of the Sherman Act and federalism concerns related to state-based corporations, the Supreme Court initially ruled that restraints "merely" affecting manufacturing did not fall within the Act's scope absent a clear interstate

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469 The full text of the section reads: "*Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal*." 15 U.S.C.A. §1.

470 For example, right around this time the first university-level institution dedicated to teaching finance and management was created in Philadelphia, and known as the Wharton School of Business.

471 The full text of the section reads: "*Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony [. . .]*." 15 U.S.C.A. §2.

472 United States v. E.C. Knight Co., 156 U.S. 1, 15 S.Ct. 249, 39 L.Ed. 325 (1895).

commerce component. Given that the Sugar Trust's refining capacity was concentrated in a single state, the prosecution faltered on the latter component.

The Sugar Trust case was decided on rather narrow grounds. The ruling nearly brought to an end the legal experiment to reign in the power of large enterprises. As antitrust law matured over the ensuing decades, the courts became much more amenable to arguments regarding both the interstate component as well as the broader implications of business concentrations, regardless of where in the chain-of-production they are situated. In fact, the holding in E.C. Knight was overturned in 1948[473]. This period of "teething pains" for the field of antitrust coincided with the dramatic evolution of corporate law at the state level, as more and more states begin legalizing the acquisition of one corporation by another.

The public's perception of the potentially nefarious nature of industrial concentrations continued into the 20th century. Though the Sherman Act had gone some way towards satiating the public's need for action, the somewhat erratic nature of the early prosecution and judicial decisions kept the topic on the political agenda.

A few years later the Supreme Court directly addressed the question of whether the Sherman Act also applied to holding company structures[474]. Holding companies are corporations created to hold and manage equity interests in multiple corporations as a vehicle to operate multi-corporate enterprises. The directors at the top can use their decision-making and voting authority to coordinate the activities of the collective entities which make up the enterprise. As described above, these relatively new structures facilitated the concentration of business control in ways similar to the trust arrangements. In a blow to the railroad industry, and others contemplating similar arrangements, the Court held that holding companies were also subject to the Sherman Act, and any arrangements by which companies which would otherwise be competitors were placed under a single entity (e.g. a holding company) constituted an illegal restraint of trade[475].

The Supreme Court reiterated the ruling in E.C. Knight that the Act had "*no reference to the mere manufacture or production of articles or commodities within the limits of the several states.*[476]" Railroads, by their very nature less likely to be able to be "legally confined" to the borders of a single state, much more readily implicated interstate commerce concerns, and thus the Sherman Act. The Court thus held that any combination or conspiracy "which would extinguish competition between otherwise competing railroads" engaged in interstate commerce fell squarely under the remit of the Act. The Court also appeared to soften the standard of proof related to the potentially negative consequences of such combinations by formulating the applicable standard as follows:

> *"it need not be shown that such combination, in fact, results, or will result, in a total suppression of trade or in a complete monopoly, but it is only essential to show that, by its necessary operation, it tends to restrain interstate or international trade or commerce, or tends to create a monopoly in such trade or commerce, and to deprive the public of the advantages that flow from free competition.*[477]"

This prospective view of current or potential business conduct served to throw cold water on the unbridled efforts of industrialists to cooperate and combine. The federal government even seemed to be reasserting itself into the arena of corporate law, perhaps concerned that the states had had free reign for too long. In the Northern Securities case, the Supreme Court reemphasized the authority of the federal government to intervene in corporate activities:

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473 See Mandeville Island Farms v. American Crystal Sugar Co., 334 U.S. 219, 68 S. Ct. 2759, 111 L.Ed. 2d 94 (1990). See also discussion in pages 23-27 of Ernest Gellhorn and William Kovacic's Antitrust Law and Economics, West Publishing 1994.
474 Northern Securities Co. v. United States, 193 U.S. 197 (1904).
475 Id. The case involved profit-pooling arrangements between the companies.
476 Id. at 198.
477 Id. at 198-99.

"No State can, by merely creating a corporation, or in any other mode, project its authority into other States so as to prevent Congress from exerting the power it possesses under the Constitution over interstate and international commerce, or so as to exempt its corporation engaged in interstate commerce from obedience to any rule lawfully established by Congress for such commerce ... Every corporation created by a State is necessarily subject to the supreme law of the land.[478]*"*

The Court also reminded both businesspeople and the public that a corporation was "*an artificial person, created and existing only for the convenient transaction of business...[but] not endowed with the inalienable rights of a natural person*"[479]. Such reminders of the "unnatural" nature of the legal person, with rights granted, but also revocable, by the state, went over well in the populist mood of the times. The introduction of the antitrust laws showed the possibilities of federal intervention in the state-based corporate law sphere, and presaged the subsequent development of federal regulatory law[480]. Both of these developments relied upon the "legal fiction" element of the corporate person and chipped away at the solidity of corporate boundaries.

Antitrust issues would continue to hold the public's imagination during this period of dramatic social change. In 1911 antitrust enforcement reached its high point with the successful prosecution against the Standard Oil Company. In a dramatic move going considerably further than in the prosecution of the Sugar Trust, the Court ruled that the Standard Oil Company was to be dissolved into 33 individual companies, in an effort to restore some "natural" level of competition[481]. Antitrust also featured largely in the discussions around the proper role of government in the regulation of business during the 1912 Presidential election. This debate later culminated in the addition of the Clayton Act of 1914[482]. The Clayton Act supplemented the Sherman Act's provisions, while at the same time bringing more clarity and guidance to the delineation between the protection of healthy competition, but not of competitors.

The introduction of the antitrust statutes marked a resurgence of the federal government into the regulation of business in general and corporations in particular. Aware of the limits imposed by the concurrent jurisdiction which the federal government had in this area, Congress decided to focus on particular areas of regulation. This marked a trend which would continue over the next decades. With antitrust now in place to address potential abuses of economic concentration and market power, the federal government later turned its attention to the use of the corporation as an investment vehicle.

American business and corporate law in particular had evolved quite a bit by the beginning of the 20th century. This evolution paralleled significant changes in the underlying purpose of the corporate vehicle. There had been a dramatic shift to private enterprise from the corporation's early roots in social, communal, and religious organization. The scale of activity was like nothing ever seen before. The geographic spread and size of infrastructure and industrial projects brought the need for huge amounts of capital.

The early 20th century saw an unprecedented use of parent-subsidiary structures. These arrangements were particularly useful for

1. Avoiding complications of qualifying to do business in another state- by acquiring an already-incorporated entity, the purchasing corporation would then have a local entity for coordinating activities in the local market without the need of additional registration or authorization.

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[478] Id. at 200.
[479] Id.
[480] This topic is addressed in detail in Section VI with particular attention to Public Action Veil-Piercing.
[481] Standard Oil Co. of N.J. vs. US, 221 U.S. 1 (1910).
[482] Clayton Act, 15 U.S.C. § 12.

2. Simplifying the purchase of physical assets- the purchase of an existing corporation entailed purchasing the assets which belonged to it.
3. Retaining the goodwill of an established business- the purchased corporation would continue to exist and the purchasing corporation could leverage the existing goodwill built up, either retaining an existing brand or merging it into its own.
4. Lowering tax exposure through corporate structuring- multi-corporate enterprises offer opportunities for structuring income and expense flows in tax-optimizing ways not available to the single corporation.
5. Simplifying management structures- multi-corporate enterprises offer opportunities for streamlining management and operational structures.[483]

Interestingly, limited liability was not the key driver behind such structures[484]. Nonetheless, the creation of multi-corporate enterprises had a direct impact on the ability of plaintiffs to pursue claims against such enterprises. When plaintiffs attempted to pursue claims against these newly complex enterprises, often the information needed to prove an allegation was spread across multiple entities. This posed additional challenges in terms of obtaining the necessary documents and information to meet the burden of proof. Even when this was not the case, enforcing a successful judgment against the relevant entity was that much more difficult. To see the nature of these additional challenges, the following diagrams depict the nature of the procedural and evidentiary hurdles facing a plaintiff under different scenarios.

F. The Creation of Organized Capital Markets and the Impact of Securities Regulation[485]

The other major change of this period, which the multi-corporate enterprise tended to accelerate, was the explosion in the demand for investment capital. As a consequence, the capital-raising purpose of the corporation came to the fore. The supporters of corporate enterprises became more and more distanced from the actual business than their predecessors in prior centuries. They increasingly took on the role of passive investors, concerned more about the return on investment than on the details of the running of the business. Part and parcel of this investor mentality was the characteristic of limited liability of the corporate enterprise. With the advent and spread of the public marketing of securities, limited liability gained even further in importance[486].

Whereas in the prior two centuries, limited liability was either very much an exception, or even a non-issue, now a complete reversal was taking place. Limited liability was now a presumption of the corporate form and held up as one of its primary advantages. One leading jurist of the day, President Butler of Columbia University even went as far as calling it the most significant invention of the modern age, even more important than steam and electricity.[487] The attribute was seen as key in convincing wealthy individuals (and increasingly, wealthy corporations) to put more of their cash at risk by purchasing an interest in a particular corporation. By the 1920's, the public markets for the investments in such corporations, which became known as securities, were no longer just the province of the upper echelons of society. Buying equity shares in corporations had become a widespread phenomenon, involving the "average guy on the street."

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[483] See William O. Douglas and Carrol M. Shanks, Insulation from Liability through Subsidiary Corporations, 39 Yale Law Journal 193 at 193 (1929).
[484] Id.
[485] This section draws on the following sources in particular: Prof. Joel Seligman, The Transformation of Wall Street, A History of the Securities and Exchange Commission and Modern Corporate Finance (Aspen Publishers 3rd. ed. 2003).
[486] Id. This is discussed in further detail in Section VI.
[487] Nicholas Murray Butler, President of Columbia University, "Politics and Economics", 143rd Annual Banquet of the Chamber of Commerce of the State of New York 1911 (pp. 43-55), available through the HathiTrust Digital Library.

While a full discussion of the securities markets would go beyond the scope of this dissertation, it is worth considering the growing impact which the "tradeable investment" characteristic of corporations began to have on the overall corporate law development. Limited liability was universally seen as a prerequisite to winning collective capital investment, particularly from the masses. In fact, the role limited liability played in incentivizing investment made it perhaps the single most important characteristic of the corporation at the time. It soon joined the list of characteristics of the corporate form which were considered "essential.[488]" As the general public began to enjoy the growing prosperity of the times, there were more savings to put to use. The market for securities in public corporations arrived just in time to help individuals part with their capital. From their humble beginnings under a dogwood tree in Manhattan, the US securities markets had grown enormously.

By the 20th century, the utility of the corporation as a collective financing vehicle had taken on a whole new dimension. The corporation had proven its ability to act as a vehicle for excess savings, not only for a small circle of persons (e.g. wealthy landowners), but for the wider society. This broadening of the vested interests in the success of the corporate form may have contributed to swinging the legal pendulum away from unlimited liability to limited liability. It also likely contributed to the hardening of the legal boundaries associated with the corporate form, as self-incorporation and a default rule of limited liability made the corporate shield inviolate, barring unique circumstances.

The default rule for courts had been one of upholding the legal separateness of a duly-formed corporation. The legislative regime had become relatively static by this point, leaving it to the judiciary to fashion any solutions to deal with perceived harsh results in individual cases. As we will see in the next section, this the courts eventually did not by tinkering with the overall legal framework, but by bypassing it with a temporary fiction to cure the ills created by the original fiction of the entity concept, now endowed with a default presumption of limited liability.

The interplay of the above societal forces provided ample opportunity for lawyers and businesspeople to maximize the protection afforded by the shift in favor of the limited liability default rule. Now that corporations were permitted to own each other, and form groups of an unlimited number of corporations, each one often responsible for one or more aspects of the overall operations, attaching liability to a particular unit of a corporate group became more and more complex in the litigation context. From the aggrieved plaintiff's perspective, the same dynamics applied (interests of justice, hardship, voluntary versus involuntary nature of contact with the defendant(s)). But in the new era, corporate management had a whole new array of options which directly influenced the ability of plaintiffs to assert claims against parts of the multi-corporate business enterprise.

For courts, the multi-enterprise backdrop was now much more complex than that presented by the traditional individual-corporation scenario. Rather than evaluating the personal actions (or omissions) of one or more individuals, and comparing these to the persons' status in relation to the company (e.g. shareholder, manager, owner, or combination), courts were now called upon to fashion tests for evaluating the interrelationships between legal persons and corporate groups. This often entailed an exponentially more complex decision-making apparatus and process compared to classic natural persons as shareholders. The record of corporate decision-making in large, multi-corporate enterprises was often backed up by myriad documents created for the purpose of business practicality and/or to memorialize the legal separateness of the businesses.

Recall that in the court's discussion in *Sutton's Hospital*, the seal requirement for natural persons was deemed less crucial given the alternative of the human signature. Similarly, other traditional characteristics of the corporation waxed and waned in importance as a reflection of the economic and social conditions of the time.

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[488] See the discussion on this point in III. C. above.

V. Private Action Veil-Piercing - A Judicial Safety Valve

This temporary excursion into the field of antitrust law is not meant to be a comprehensive coverage of this complex and fast-changing field. Rather, the above summary of early events is meant to provide a better understanding for the mood of both the public and the politicians during this crucial phase of corporate law development. The general debate about corporate power increasingly overlapped with the topic of the liability of corporations and corporate groups. The opaqueness of the multi-entity corporate enterprise, whose activities were coordinated through devices such as the holding company, were as suspicious as the trust arrangements which preceded them. The public disclosure requirements which accompanied the incorporation process did not satisfy the public's desire to understand more of exactly what was going on behind such structures. In the view of early commentators, the ability of a few persons to amass great power while limiting liability was often seen in as negative a light:

> *"The defenders of the trust point to this as a justification both of the need of the invention and its practical success. In the Standard Oil case there were a few men who had acquired controlling interest in a few (at first) manufacturing or mining properties, situated in different States. How could they manage them all? Not personally, for they wished to avoid personal liability; not through corporations, for, as their acquisitions increased, it was seen that the whole time of these two or three men would be taken up by going about to corporate meetings, publishing notices, placating stockholders, and complying with the (to them) vexatious restrictions concerning corporate management of the several States wherein their business lay.[489]"*

Doubts and concerns around the legitimacy of limited corporate liability in the single-corporation context were only heightened now that corporations could join together to form groups through equity ownership. The could now enjoy the benefits of size, while generally keeping their liability exposure limited to the unit, or individual corporate, level. For the early critics of the corporate groups, however structured, the avoidance of the limited protections afforded by state corporation law was an equally troubling concern. Such critics also saw a dilution of the corporate capital safety net resulting from the trust-building process itself:

> *"Now, before turning to the law, let us take an example of the other and even more dangerous trusts,—corporate trusts. They are usually created for controlling the stock or management of the corporation in whose shares they consist; thus creating a sort of a machine upon a machine, one fictitious person within another. And the process may even be repeated indefinitely, one-half the trusted stock being sold, i.e., the certificates for it, and a new trust created of the other half, plus one share to ensure a majority; so that, as long as the public continue to accept these trust certificates for stock, we may, by a sort of system of Chinese boxes, one within the other, see finally the absolute control of a corporation vested in a sixteenth or a thirty-second interest in its actual capital. And the peculiar profit to the insiders in these is, that they require little expenditure of money to give enormous power. For the so-called trust-certificates, which carry no voting power, may be sold in the exchanges as readily as the stock they represent; and the trustees having sold half the company's actual stock, and trust-certificates representing the other half, have got back all their money, and are left with half the stock of the original corporation to ensure their own control, besides being parties-trustees to an irrevocable trust-deed.[490]"*

This distancing between the holders of capital compared to the holders of genuine control, however real or imagined in relation to a given case, proved to be a major element of the debate surrounding both corporate law and what was to become known as antitrust law. It is worth pointing out that these developments took place before there was an established body of law regulating securities in

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[489] Stimson, Trusts, at 133-34.
[490] Id. at 134-35.

public companies (which now requires detailed disclosure of ownership arrangements). While recognizing that the concern applied only to certain trust structures, there was a fairly widespread belief amongst the corporate trust's critics that such structures

> *"practically do away with the whole law regulating corporations, with all the safeguards regulating their corporate management, the control of their stock, and the exercise of their franchises, besides evading all the laws regulating their capitalization and consolidations...[491]"*

Another public irritant was the generally secretive nature of the trust arrangements themselves. In contrast to the public disclosure required under incorporation statutes, both at the creation stage as well as going forward, the details of corporate trust arrangements were generally known only to a select few. In fact, some commentators even questioned whether those parting with the control over often substantial assets even new the extent of control they were delegating[492]. Taken as a whole, such trusts were deemed by some to be technically legal.[493]" But that legality was tenuous, and in the view of one commentator in 1887 only valid "until new legislation [was implemented]." The introduction of the antitrust laws just a few years later added a new angle to the legal regulation of the corporate legal person, particularly when these attempted collective action deemed potentially harmful to the society.

Before delving into the application of limited liability rules as applied to corporate groups, it is worth reviewing the general status of such rules as they evolved through the time of the "New Jersey breakthrough" and the introduction of antitrust law. With the advent of corporate groups, issues of limited liability under US law began to play out against an entirely new legal backdrop. Meanwhile across the Atlantic, the highest court in the "legal mother country" was reconfirming basic principles regarding the inviolability of the boundaries of the properly-formed corporate entity with the decision in *Salomon*.

A. Doctrinal Origins and Early Application

While decisions like *Salomon* enhanced legal certainty regarding corporate boundaries, in practice courts struggled with the fairness of applying strict rules to specific facts. As a reminder of the legal backdrop, since the mid-19th century state incorporation statutes worked from the presumption of the preservation of the limited liability of duly-incorporated entities. The nature of the facts in many cases was putting stress and strain on the entity concept, which had by then become fairly established, when juxtaposed against higher concepts of judicial fairness and equity. The judiciary began to develop means to deal with the perceived harshness of a "binary" approach to shareholder liability. As the corporate separateness itself is in essence, a legal fiction created by the legislature, courts began to revisit that very fiction. In justified cases courts withdrew it entirely, at least for the resolution of the dispute at hand. That temporary withdrawing or disregarding of the corporate shield eventually came to be known as piercing.

It is difficult to say exactly where or when the concept, and the articulation thereof, of piercing or disregarding the separateness of the corporate entity began. Some leading commentators attribute the "piercing" term to a prominent jurist named I.M. Wormser at the start of the 20th century[494]. Wormser's writings on the topic[495] came at a time when many courts were increasingly struggling with cases brought against corporations, whose number had grown exponentially compared to the

[491] Id. at 136.
[492] Id. at 134-141.
[493] Id. at 140.
[494] See, e.g. Philip Blumberg, The Law of Corporate Groups, at 11-4 and footnote 4 in particular (noting that the "instrumentality" doctrine was "prominently identified" by Wormser).
[495] See, e.g. I.M. Wormser, Piercing the Corporate Veil, 12 Columbia Law Rev. 496 (1912), and Disregard of the Corporate Fiction, and Allied Corporate Problems (1927).

prior century. The courts were in search of a doctrine which would permit them to deal with tough cases, some kind of legal "safety valve."

In Wormser's view, corporations, as critical as they had become to the modern economy, were still artificial creations of the legal system. The law provided the corporation with a personality "for convenience", although in reality it had none[496]. Legal separateness was an "extraordinary privilege conferred by the law… involving a fiction which must be used for legitimate purposes and not perverted[497]." If intended or used for a "purpose not within its reason and policy" courts should disregard the separateness. This sort of sentiment was soon expressed by courts in their decisions including in the new field of antitrust:

> "*All fictions of law are introduced for the purpose of convenience and to serve the ends of justice. When they are urged to an intent and purpose not within the reason and policy of the fiction, they must be disregarded by the courts*.[498]"

Wormser recognized the challenge of applying such an approach to the specific facts of specific cases, as well as just how engrained the concept of the corporation's separate legal personality had become in American corporate law. He urged, in rather colorful terms, that courts look deeply into the underlying facts of each case in order to determine if those facts reflected in the pleadings before them represented situations where an exception should be made:

> "*Fiction(s) must be employed with common sense and applied to promote the ends of justice… [they] must not be worshipped in the way savages worship a red cow or an ornamental totem pole as the supposed incarnation of a sacred spirit. There is always a danger, when a fiction (whether corporation or otherwise) becomes so deeply rooted in the case law that judges no longer remember its object and purpose and apply the fiction to an extent where they refuse to consider and to penetrate into the actual facts behind it*.[499]"

The disregarding encouraged by Wormser began to take root in actual proceedings. Many courts did attempt to penetrate the facts before them and thus began a gradual distilling process of what would come to be known as the jurisprudence of "piercing." Some of the leading jurists of the day, such as Oliver Wendell Holmes, decided some of the early precedents in this area. These judges also contributed to the growing list of expressions used to describe this line of enquiry, such as trying to "see the man behind[500]" and consider whether a corporation was merely a "dummy[501]." Naturally, it was not always an easy task to discern the "interests of justice" from specific fact patterns. Commentators like Wormser encouraged courts to at least "look at the men (cause) and facts behind (effect) the corporate fiction when employed to" do any of the following:

1. Defraud creditors
2. Evade an existing obligation
3. Circumvent a statute
4. Achieve or perpetuate a monopoly
5. Protect knavery or crime

The first example highlights the historical focus on the lender-borrower relationship, generally based in contract. In the days before well-developed capital markets, credit was still the primary method for starting and operating a business. The second example is interesting in that in can relate to both an existing obligation of known size (such as a debt arising in contract), or an obligation that is

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[496] See Wormser, Disregard of the Corporate Fiction, at pg. 8
[497] Id.
[498] Id. (citing State vs. Standard Oil Co., 40 Oh. St. 137, 30 N.E. 279. Here we see an example of the linkage to the field of antitrust, with a high profile case focusing on the perceived misuse of the corporate form.
[499] Id. at 24.
[500] See Donnell, 208 U.S. 267, 273 (also cited by Wormser).
[501] See US v. Lehigh Valley RR, cite (also cited by Wormser).

contingent and of unknown magnitude. The latter category is of particular relevance to claims sounding in tort, especially given the ability of companies to insulate themselves from specific risks through tactical use of the corporate vehicle with its limited liability.

The third example is an interesting one in that it emphasizes the challenges business often face when attempting to operate an enterprise according to its “natural evolving state” and in the most efficient manner within the context of regulatory constraints which themselves are underpinned by public policy choices. Classic examples of businesses trying to avoid obligations or exposure as reflected in specific statutes include labor law (e.g. obligations related to the number of employees) or tax law (e.g. tax treatment based upon size). By spreading the business operations across multiple corporations, an enterprise is often able to circumvent the objectives of the statute in question by masking the connectedness of the legally separate corporations. This practice becomes particularly critical when done primarily as a means of insulating the collective enterprise from specific obligations or risks.[502]Within a few years federal administrative agencies would be applying novel legal concepts of control to address this circumvention risk[503].

The fourth example is curious given that the article was published after the implementation of the Sherman Act (though before the introduction of the Clayton Act). The manner in which the antitrust statutes were crafted permitted government agencies and courts applying them to look across corporate boundaries to see whether the enterprise as a whole tended to create or support a monopolistic position. Finally, the fifth category now reads rather outdated in relation to the former term (knavery), though the latter (criminal) terms remains relevant to this day. Under certain US statues, corporations can be found guilty of crimes, and individual corporations could be deemed participants in a conspiracy[504].

If courts came to the conclusion that any of the above were shown by the evidence, they should disregard the legal fiction, i.e. the legal separateness of the corporation[505]. Wormser recognized that in some cases, the facts could make the analysis difficult. In his view, as long as the courts recognize the general principle that the corporate form should not be used to evade the law or perpetrate frauds, it didn’t “make a vast difference how any particular case is decided.[506]” Thus he argued against trying to codify a piercing approach by statute, instead deeming the courts best situated to perform the analysis. One may wonder whether such commentators would have maintained that view had they known just how much, and how complex, litigation would be when dealing with this issue in the ensuing decades.

B. Distinguishing Procedural from Substantive Scenarios[507]

The term “piercing” is often used in different contexts thereby essentially describing different things. The question arises as to whether piercing, as a tool of the judiciary, relates to substantive law (i.e. corporate law and the legal persons created thereunder) or procedural law (i.e. suing two or more affiliated entities in an effort to maximize the chances of enforcing a successful judgment). From a plaintiff’s perspective, the main motivation behind seeking recourse against an entity other than the one with which there was direct contact is the desire to ensure that the full amount of any damages will be paid in enforcing a judgment. Plaintiffs are not necessarily interested in the higher societal goods of doctrinal purity or simplicity, or vague notions of ultimate truth and justice. They are

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[502] See the “taxicab cases” discussed in Lenz and Newman, Corporations- Stockholders’ Personal Liability- Application of Agency or Undercapitalization Theory to “Pierce the Corporate Veil”- Walkovszky v. Carlton, 8 Boston College Law Rev. 981 (1967).
[503] See the discussion of “public veil-piercing” in Section VI.
[504] See Lundmark and Carroll, The Company in Litigation, in The Law of Business Associations (LIT Verlag 2001), pages 116-119. .
[505] See Wormser, Disregard of the Corporate Fiction, at pg. 40.
[506] Id.
[507] The individual fields of regulatory law where such developments were prevalent are explored in more detail in Section VI.

generally driven by very practical concerns, such as covering medical bills in case of physical injury, or replacing or repairing damaged property.

Similarly, in relation to the enforcement of a statute by a government agency, the objective is to maximize the observance of the underlying policy (e.g. clean water or air, product or workplace safety) by any and all relevant entities which have some affiliation to one another. Here there is relative clarity and alignment between the goals (e.g. ensuring a clean and viable environment or safe working conditions) and the underlying rules as compared to broad ideas of deterrence or compensation. In other words, the general specificity of statutes affords less wiggle room when compared to the more general rules from tort or other areas of law. There is agreement- as expressed by the legislature- on the ultimate aim of the rule compared to a competition for a specific risk allocation between first-movers (i.e. entrepreneurs) and those impacted by their actions. From a technical standpoint, piercing thus relates primarily to the substantive aspect of a legal proceeding, namely the failure to meet a legal or statutory obligation.

Nonetheless, that second aspect is not discussed or ruled upon unless a plaintiff overcomes the initial hurdle in litigation, informing or convincing a court of law that is has jurisdiction to hear a case related to the defendants in question (e.g. parent and subsidiary corporation). In American constitutional parlance, this is known as personal jurisdiction, and is a necessary component along with subject matter jurisdiction to initiate any legal proceeding. Thus in that sense piercing may not really be the appropriate term in relation to a plaintiff's burden of satisfying the court that it has personal jurisdiction. At this initial, jurisdictional phase, the court is not addressing liability (e.g. tort) or responsibility (e.g. for compliance with a statute) questions. That said, a court's decision on this issue can determine whether the liability question- often factually intertwined with the jurisdictional one- is addressed at all.

The conclusions regarding potentially responsible persons defines the potential scope for liability in the litigation context. By accepting arguments for personal jurisdiction over multiple defendants, a court is simply defining the universe of potentially responsible parties related to a potential judgment in favor of a plaintiff. The actual "piercing", in terms of broadening the asset base for recovery, or expanding the circle of companies subject to a statutory requirement, is not addressed unless and until personal jurisdiction over the defendants is confirmed.

The above distinction is important because of the interplay between the elements of procedural and substantive law in any successful corporate piercing litigation. The two elements go hand in hand, yet are subject to different paths of evolution and legal rules. The law of civil procedure takes different policy considerations into account compared to the substantive bodies of law such as corporation law and tort law. The nature of this interplay is readily seen by examining some key decisions from procedural law over different periods. In those decisions, courts analyze some of the same factors as those relevant to the traditional substantive piercing decisions. A good starting point for this discussion is one of the leading cases decided just before the wave of New Deal legislation of the 1930's came into effect.

In 1925, the US Supreme Court preserved the traditional corporate boundaries in a case in which a plaintiff attempted to sue a parent company in a dispute related to its subsidiary[508]. Factually, the operations of the companies (the parent corporation in North Carolina, with corporate subsidiaries in Alabama and North Carolina) were intertwined to such a degree that later courts applying piercing jurisprudence may have come to a different conclusion. But the Supreme Court, applying the then prevalent "presence" requirement for asserting jurisdiction, rejected the plaintiff's attempt to involve the parent corporation in the litigation, stating:

[508] Cannon Mfg. Co. v. Cudahy Packing Co., 267 U.S. 333 (1925).

"The Alabama corporation, which has an office in North Carolina, is the instrumentality employed to market Cudahy products within the state; but it does not do so as defendant's agent. It buys from the defendant and sells to dealers. In fulfillment of such contracts to sell, goods packed by the defendant in Iowa are shipped direct to dealers, and from them the Alabama corporation collects the purchase price. Through ownership of the entire capital stock and otherwise, the defendant dominates the Alabama corporation, immediately and completely, and exerts its control both commercially and financially in substantially the same way, and mainly through the same individuals, as it does over those selling branches or departments of its business not separately incorporated which are established to market the Cudahy products in other states.

The Court continued:

The existence of the Alabama company as a distinct corporate entity is, however, in all respects observed. Its books are kept separate. All transactions between the two corporations are represented by appropriate entries in their respective books in the same way as if the two were wholly independent corporations. This corporate separation from the general Cudahy business was doubtless adopted solely to secure to the defendant some advantage under the local laws.[509]"

The level of domination cited by the court is generally that which suffices for a successful piercing petition. Strictly observing the procedural law applicable at the time, however, the Court placed greater emphasis on the formalistic aspects of the arrangements between the companies, allowing the administrative separation (e.g. separate books and accounting) to trump considerations of intertwined operations of the broader enterprise. The decision notes that the defendant could have chosen to act directly in the jurisdiction in its own corporate capacity, but instead made a calculated decision to "employ a subsidiary corporation." Congress had already decided that this was insufficient for making a corporation amenable to suit in another jurisdiction.[510] The court supported its findings by reference to existing case law of the day:

"In the case at bar, the identity of interest may have been more complete and the exercise of control over the subsidiary more intimate than in the three cases cited, but that fact has, in the absence of an applicable statute, no legal significance. The corporate separation, though perhaps merely formal, was real. It was not pure fiction. There is here no attempt to hold the defendant liable for an act or omission of its subsidiary or to enforce as against the latter a liability of the defendant."

The highlighted reference to the significance of the absence of applicable statutes is important to the subject matter of this dissertation. This decision, essentially upholding form over substance, later became known as the "*Cannon* doctrine" by legal commentators. It highlighted one of the controversial points of inherent limited liability of the corporate person, namely the dichotomy between privilege (i.e. of incorporation) and responsibility (i.e. the ability to avoid liability behind a corporate shield). Natural persons undertaking the exact same activity would most likely be found liable for any resulting injuries on general principles of agency law. But once a corporation was the actor, the fact that it was factually often acting as the agent of another was crowded out by a belief in the priority of corporate boundaries over corporate responsibility. The complaints about this dichotomy grew louder with the expanded scale of activity made possible through corporate groups. Within a few years of this decision, a wave of federal legislative activity would arguably change the landscape related to the entity versus enterprise debate[511].

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[509] Id. at 335.
[510] Id. at 336.
[511] See section VI. below.

C. Evolution of Piercing Jurisprudence- Application to Corporate Groups

By the early 20th century, the world was shaping up to be a much different place than even that which existed at the time of the *Salomon* case. During this period in which US corporate law was reaching several milestones, limited liability was hardening into the very fabric of the multi-corporate enterprise. This was the acme of the prevalence and dominance of the entity concept. In the words of the commentators:

> "*Limited liability [was] now accepted in theory and practice. It is ingrained in our economic and legal systems. The social and economic order is arranged accordingly. Our philosophy accepts it. It is legitimate for a man or group of men to take only a part of their fortune on an enterprise. Legislatures, courts and business usage have made it so.*[512]"

The jurisprudence of *Salomon* and its progeny was essentially bootstrapped onto the corporate group scenario without much specific debate or attention given to whether that was appropriate. The fundamentals of corporate law from the simple corporation-human shareholder context were simply carried over to the corporation- corporate shareholder context. The general low priority of shareholder liability issues similarly carried over to the new multi-corporate enterprise reality. The carry-over of the existing corporate liability regime to the group context was thus in some respects an historical accident. It had its roots in the natural person conducting business through the vehicle of a legal person such as a corporation. When self-incorporation became possible, it was taken as the default rule for situations falling within the statutory framework for a single-entity enterprise. In the age of the multi-entity corporate enterprises those default treatments simply carried over without much legislative or public scrutiny. That "accident" has been questioned ever since by legal commentators:

> *"The parent's shareholders already had limited liability, and insulation of the parent created a second layer of protection. In addition, the parent's economic relationship to the subsidiary was often quite different from the corporation's relationship to its investors, for the subsidiary was often part of the parent's business enterprise. Despite these real economic differences, the rule of the limited liability of the shareholder was automatically applied to the parent corporation. This extension of limited liability took place apparently without realization that the relation of the parent to its subsidiary where the two corporations collectively comprised the enterprise was markedly different from the relation of the ultimate investor to the enterprise and that it would make possible layer on layer of insulation from liability in the multi-tiered corporate group.[513]"*

The judiciary, of course, had to apply the law as it then stood to the fact patterns before them. The toleration of corporate-corporate acquisition introduced at the end of the 19th century meant that courts increasingly had to analyze cases in which the shareholders were not one or more natural persons, but shareholders which themselves were corporations. This introduced an additional layer of complexity to the analysis performed by courts addressing claims for redress which went beyond a given corporate defendant with whom the plaintiff may have had contact. It also forced them to be creative in justifying holdings in which the traditional corporate boundaries- as defined by the acts of incorporation and any corporate-corporate purchases of equity- were not upheld.

In those early days, many courts were hard-pressed to articulate the reasons why they were, or were not, holding one corporation responsible for the acts of another. When they did so, the general explanation given was that there was no real separation between the two, the one being essentially an extension of the other despite the appearance of pro forma separation. General principles of justice called for certain cases to be handled as a whole, with the assets of both being made available to a

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[512] See William O. Douglas and Carrol M. Shanks, Insulation from Liability through Subsidiary Corporations, 39 Yale Law Journal 193 at 194 (1929).

[513] Blumberg, Corporate Groups, see in particular Part II (Common Law Veil-Piercing Theory) and Part III (Jurisdiction, Practice and Procedure).

plaintiff seeking redress for injuries. One of the most famous critiques of this apparent "decision-by-nomenclature" technique came in 1927:

> *"The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an 'alias' or a 'dummy.' All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation. Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice (Ballantine, Parent & Subsidiary Corporations, 14 Calif. Law Review, 12, 18, 19, 20).*
>
> *The logical consistency of a juridical conception will indeed be sacrificed at times when the sacrifice is essential to the end that some accepted public policy may be defended or upheld. This is so, for illustration, though agency in any proper sense is lacking, where the attempted separation between parent and subsidiary will work a fraud upon the law (Chicago, etc., Ry. Co. v. Minn. Civic Assn., 247 U.S. 490, 62 L. Ed. 1229, 38 S. Ct. 553; United States v. Reading Company, 253 U.S. 26, 61, 63, 64 L. Ed. 760, 40 S. Ct. 425).*
>
> *At such times unity is ascribed to parts which, at least for many purposes, retain an independent life, for the reason that only thus can we overcome a perversion of the privilege to do business in a corporate form. We find in the case at hand neither agency on the one hand, nor on the other abuse to be corrected by the implication of a merger. On the contrary, merger might beget more abuses than if stifled. Statutes carefully framed for the protection, not merely of creditors, but of all who travel upon railroads, forbid the confusion of liabilities by extending operation over one route to operation over another. In such circumstances, we thwart the public policy of the state instead of defending or upholding it, when we ignore the separation between subsidiary and parent, and treat the two as one.[514]"*

Deciphering the key ruling in the above citation, the "juridical conception" referred to is the inviolability of the separateness of the legal person (e.g. a corporation). This is further strengthened by the federalist issue of the respective public policies followed by the states. The potential "sacrifice" refers to the creation of an exception to what is otherwise a legal fiction to begin with, namely the identity of the legal person as a separate "being." It is worth pointing out that the "sacrifice" is limited to the facts at hand, and even then only when a weighing of public policy interests leads the decision-maker to favor turning a blind eye to a legally incorporated entity's separate existence under the law.

Many of the early cases originated in relation to accidents in the transport (e.g. railroads) sector which led to injuries of passengers or bystanders. Courts deciding such cases were hard-pressed to find for plaintiffs given the traditional favoritism accorded to the transport sector in its early days. Such favoritism was simply a form of balancing the societal advantages introduced by this new means of travel across the young country against the isolated and individual harms to persons injured by its existence and operation. But the conceptual door had been opened, and that opening was becoming wider, especially in cases where the societal benefits of the industry or activity in question were less clear.

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[514] *Berkey v. Third Avenue Railway Co* 244 N.Y. 602 (1927) (Justice Benjamin Cardozo). The underlined section highlights the growing trend by courts to consider a broader group potentially worthy of redress beyond the traditional creditor group, whose claims were rooted in contract. In the case at hand, however, the balancing of the competing legislative interests still favored a decision not to view the separate legal entities collectively despite their intertwined operations. But the group of potential tort victims (here those travelling on the railroad) was on the judicial radar, and within a few short years would be increasingly subject to protection by the growing field of federal regulatory law.

The judicial articulations in piercing cases began to look like the entry of a thesaurus dealing with the term "domination" as applied to one corporate entity in relation to another. Commentators quickly criticized the "vague and illusory" grounds by which the default rule of shareholder immunity might be disregarded[515]. One research team identified no less than 37 terms which had apparently been used to describe situations of such complete "domination:"

> "*mere adjunct, agent, alias, alter ego, alter, idem, arm, blind, branch, buffer, cloak, coat, corporate double, cover, creature, curious reminiscence, delusion, department, dry shell, dummy, fiction, form, formality, fraud on the law, instrumentality, mouth piece, name, nominal identity, phrase, puppet, screen, sham, simulacrum, snare, stooge, subterfuge, and tool*[516]"

Though often classified as "piercing" this simplified approach generally entailed treating two or more legal entities as one for the purposes of the dispute at hand. Their separate identities became merged in the eyes of the court or other body. Such decisions relied heavily on the common law of agency. As pointed out early on, such terms themselves needed definition to be of any use, as they merely "stated results."[517] They failed to describe the standard of conduct required to avoid attribution of liability, nor did they even suggest the relevant factors which might come into play[518]. For the purposes of this dissertation, such decisions are referred to herein as "conclusory piercing."

Against the backdrop of national, and even international, corporate groups, courts struggled to develop a fair and consistent approach which took into account the nuances of corporate group constituent parts as defendants. Legal observers were appreciative of the challenges facing decision-makers in the more complex business environment of the 20th century. There was broad recognition that it was not possible to formulate a mechanical rule "based on objective facts of control or connection which [might] furnish a certain test" for when the "acts, obligations and property" of one entity (e.g. a subsidiary) should be attributable to another (e.g. a parent)[519].

Judges trained in the law, but not necessarily in business, are often called upon to make conclusions about how corporate relationships in a particular setting are actually "lived." This they must do based upon whatever corporate records might be available related to the transaction or event in question. Such records may be supplemented by oral testimony provided by participants.

Some early commentators did try to provide simpler, workable frameworks for analyzing the often complex parent-subsidiary relationships in the litigation context. A future Supreme Court Justice William O. Douglas, along with a leading legal light of the day, Carrol Shanks, narrowed the focus to four factors which they considered key[520]:

1. Separate financing and adequacy of capitalization
2. Separate day-to-day business operations
3. Observance of corporate and business formalities
4. Separate representation of parent and subsidiary to the public

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[515] See Henry W. Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Cal. Law Rev. 12, at 15 (1928).
[516] See Cathy S. Krendl and James R. Krendl, P*iercing the Corporate Veil: Focusing the Inquiry*, 55 Denver Law Journal No. 1 (1978) [hereinafter "Krendl & Krendl"] (citing H. Henn, the Law of Corporations (1970).
[517] See William O. Douglas and Carrol M. Shanks, Insulation from Liability through Subsidiary Corporations, 39 Yale Law Journal 193 at 195 (1929).
[518] Id.
[519] See Henry W. Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Cal. Law Rev. 12, at 15 (1928).
[520] Douglas & Shanks, *Insulation from Liability through Subsidiary Corporations*, 39 Yale L.J. 193, 196-97, 218 (1929).

Of the four factors listed above, three are largely of no interest to an aggrieved plaintiff. The main attraction of piercing, from a plaintiff's perspective, is to widen the pool of available assets to cover damages suffered as a result of defendants' alleged actions. The other three factors all have their roots in the doctrinal importance of "separateness" tied to the legal person. Those factors may help a court find in favor of piercing, but in and of themselves are not of great interest to an aggrieved plaintiff. Nonetheless, the demands of consistent and incremental evolution of the common law have resulted in these aspects receiving great attention and scrutiny by courts. This legacy has continued down to the present, despite several commentators' pointing out its relative unimportance from a pure policy perspective.

The unpredictability of court decision-making in piercing cases presented a challenge for businesspersons. One of the first attempts to bring some order and predictability to this area of the law was a study performed by Frederick J. Powell in 1931[521]. Powell, a lawyer and academic, reviewed the case law dealing with these topics up to that time. He identified factors which seemed to occur regularly in the court decisions, and proposed a framework of factors which collectively should guide decision-makers dealing with difficult questions of corporate liability. In a way, this was an attempt to put some contours around a number of legal fictions (the legal person itself, the delineation between its "acts" and any attribution hereof to its owners or decision-makers) and hammer out a workable legal doctrine based upon some competing premises. Powell deemed the following factors to be most relevant:

1. The parent corporation owns all or most of the capital stock of the subsidiary.
2. The parent and subsidiary corporations have common directors or officers.
3. The parent corporation finances the subsidiary.
4. The parent corporation subscribes to all of the capital stock of the subsidiary or otherwise causes its incorporation.
5. The subsidiary has grossly inadequate capital.
6. The parent corporation pays the salaries and other expenses or losses of the subsidiary.
7. The subsidiary has substantially no business except with the parent corporation, or no assets except the ones conveyed to it by the parent corporation.
8. In the papers of the parent corporation or in the statements of the officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own.
9. The parent corporation uses the property of the subsidiary as its own.
10. The directors or executives of the subsidiary do not act independently in the interest of the subsidiary, but take their orders from the parent corporation in the latter's interest.
11. The formal legal requirements of the subsidiary are not observed.[522]

A number of topical threads run through this framework, whose weighting has evolved along with the jurisprudence of "piercing." The first and fourth factors relate to the ownership structure of a corporation, something which received much attention early on, but which over time faded in importance. The third, fifth and sixth factors all have to do with the financial structure and operation of a company. These factors are important to consideration of the independence- from a financial and operational perspective- of one corporation in relation to another.

The fifth- level of adequacy of capital- has remained a hotbed of legal discussion in this area, given its relevance in relation to the ability of a defendant corporation to provide redress for any plaintiffs who incurred damages. Some industries, such as banks, have specific guidelines in this area to mitigate the risk that accountholders lose their savings in the event of insolvency. Multilateral institutions coordinate minimum capital requirements for international banks through mechanisms like the Basel Accords. Other legal systems address the issue by having much higher capital requirements for all companies as well as tighter restrictions on solvency and the use of corporate earnings. But outside of

[521] Frederick J. Powell, Parent and Subsidiary Corporations (1931).
[522] Id.

those specifically regulated industries, general corporate law in the United States does not proscribe specific capital levels (beyond a minimal startup capital), leaving it to the professional judgment of those charged with managing the company. Thin capitalization increasingly became a chief argument for the alleged abuse of the corporate vehicle to unfairly externalize operational risks.

The second and tenth factors all deal with the management of the companies in question. Early on, interlocking directorates and officer positions were looked upon with great suspicion by courts and regulators. With time this suspicion, and scrutiny, subsided, provided that the companies could point to a clear delineation of the capacity in which the respective decision-makers were acting. Where that delineation was not clear, or worse yet, the fiduciary roles of the decision-makers appeared to have been blurred if not breached, courts were more likely to rule in favor of disregarding the separateness of the entity in question.

The seventh and ninth factors also relate to the level of independence of a corporation, but from a market or operational perspective as opposed to the financial perspective described above in relation to points two, five and six. There was an early perception that corporations should be able to stand on their own, such that if the bulk or even all of the demand for its products was with its own parent corporation, there was something not genuine about the business. As such, courts were more predisposed to rule in favor of piercing in such cases. In the interim, the value attached to having a demand for its products of services beyond that of a parent or related corporation has receded.

Finally, the eight and eleventh factors revolved around the appearance and formality of the legal separateness between companies. In addition to the separate documents establishing the corporations, this “separateness” factor extended to the ongoing filing requirements of the respective companies[523]. The recordkeeping regarding decision-making and operation were perhaps deemed most important. This was especially so for companies which had overlapping officers and directors, since these situations were naturally ripe for blurred or biased decision-making. The emphasis here was a combination of appearance as well as substance. From a policy (and aggrieved plaintiff) perspective, these two factors relate more to form and thus would appear less relevant[524].

Such attempts to systematically analyze the rationale or justification for disregarding the legal separateness of a corporation are referred to in this dissertation as “multi-factor balancing tests.” They filled a theoretical gap in the legal framework related to the liability of these relatively new creations, multi-corporate enterprises. As one of the first efforts to fill this void in legal doctrine, Powell’s suggested approach made a significant impact on US corporate law. Not too long after its publication, important courts began using it as a frame of reference when deciding piercing corporate-to-corporate piercing questions.

One of the earliest and most influential cases which leveraged Powell’s hypotheses was a decision of the New York Appellate Division just five years later involving the Baltimore & Ohio Railroad[525]. Though that court did not pierce the defendant’s corporate status in that case, the test presented by the court was indicative of what was to become known as the “three-factor piercing rule:”

> “*Restating the instrumentality rule, we may say that in any case except express agency, estoppel or direct tort, three elements must be proved:*
>
> *(1) Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked <u>so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own</u>; and*

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[523] See discussion in § III B. above regarding the disclosure requirements which accompanied the introduction of the general incorporation privilege.
[524] Several commentators have pointed out the arbitrariness of an approach which turns- even in part- on how well given companies document the degree of their legal and operational separateness.
[525] 247 App. Div. 144, 287 N.Y.S. 62, aff'd, 272 N.Y. 360, 6 N.E.2d 56 (1936).

(2) Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and

(3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.[526]"

Beginning with the last factor first, proximate cause was a well-travelled concept from tort law which jurists would be able to get their heads around. The second factor is a bit more complicated, as it presupposes the ability of the decision-maker (e.g. judge or jury) to ascertain the stated purpose. When one considers the evidentiary burden which a plaintiff generally faces, combined with the nature of corporate communications (e.g. likelihood of meeting minutes which expressly state "our goal is to circumvent this statute," or "deceive this person" or "commit this crime"), this is an obviously high hurdle. Finally, the metaphorical analysis suggested by the first factor ("separate mind, will or existence") entails similar challenges for the judicial decision-maker. As an artificial creation of the law, a corporation will only ever have a will or a mind in the form of those representatives, such as officers and directors, acting on its behalf. Thus in the corporate-corporate context, the actions of those acting on behalf of the dominant entity must essentially supplant those which should be the purview of the representatives of the dominated entity to justify a court piercing the corporate veil.

Interestingly, the citation highlights the growing concern regarding the nature of the cause of action sounding in piercing claims, expressly carving out situations of "direct tort" (in which case only one of the two entities would be deemed relevant) or "express agency" (in which case the actions of one entity would be attributable to another under general principles of agency law). In fact, the third factor (proximate cause) originated in tort[527]. At the same time, however, the first factor alludes (twice) to the "transaction attacked" in consonance with the traditional focus on claims resulting from a creditor-debtor relationship. The courts continued to grapple with both establishing a workable doctrine and considering whether to distinguish between specific causes of action. There followed a period of alternating attempts at creating a calculus-like formula of relevant variables in deciding piercing cases, and trying to simplify these when they appeared to be becoming too complex.

The early 20th century witnessed the propagation of the multi-factor balancing test concept and a resulting increase in its complexity. As with many innovations in the common law system, there followed a period of "fine-tuning" during which both courts and commentators attempted to work out the exact calculus for determining when to disregard the legal separateness of a corporation. As they did so, the list of relevant factors seemed to get longer and longer, with overarching factors increasingly divided into sub-factors. A survey of the factors considered in select cases reveals this growing level of complexity.

One example from Massachusetts focused on 12 factors[528]:

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[526] Id. at 157.

[527] A milestone in US jurisprudence came with Justice Cardozo's decision *Palsgraf v Long Is. R.R. Co.,* 248 NY 339 (1928).

[528] *Pepsi-Cola Metro. Bottling Co. v. Checkers, Inc., 754 F.2d 10 (1st Cir. 1985),* applying a twelve-factor test to determine whether the corporate veil should be pierced, summarized in *Evans v. Multicon Construction Corp., 30 Mass. App. Ct. 728, 736, 574 N.E.2d 395, 400 (1991)*

1. common ownership;
2. pervasive control;
3. confused intermingling of business activity assets or management;
4. thin capitalization;
5. non-observance of corporate formalities;
6. absence of corporate records;
7. no payment of dividends;
8. insolvency of the corporation at the time of the litigated transaction;
9. siphoning away of corporate assets by dominant shareholders;
10. non-functioning of officers and directors;
11. use of the corporation for transactions of the dominant shareholders; and
12. use of the corporation in promoting fraud.

Other courts refined certain factors and added additional ones. Figuring out how the facts of their particular claim fit into such comprehensive and complicated analytical frameworks became a daunting task for plaintiffs. This was particularly so in relation to the many factors which related to the internal workings of a corporate defendant, since the evidence for most of these factors could only be obtained through the litigation process (e.g. discovery).

D. The Piercing Continuum

Over time courts developed various tests, placing different weightings on similar factors, all in an attempt to do justice. On the whole, the "piercing" cases could be broken down into two main categories. The first category (referred to herein as "conclusory piercing") includes those cases where the identity of one company was- at least for the purposes of the litigation at hand- merged or fused into another. This category borrows heavily from the law of agency in analysing the control relationship between two legal persons such as corporations.

The second category (referred to herein as "analytical piercing") includes those where the separateness of the individual legal persons was deemed to have been "compromised" by one corporation overreaching in terms of the exercise of various control and influence levers it had over another corporation. The difference appears slight at first glance, but as we shall see, the two categories and the distinction between them began to take on added significance as US corporate law evolved into the 20th century[529]. From these various tests, a broad pattern of two doctrinal groupings began to emerge.

In short, if representing the piercing methodology mathematically, one could write:

Conclusory Piercing- Merger of identities	A = B, where A and B are separate legal entities (e.g. parent and subsidiary)
Analytical (control-based) Piercing- overreaching based upon application of multi-factor balancing test)	A > B, where A and B are separate legal entities (e.g. parent and subsidiary)

Courts, trapped within the doctrinal confines of corporate law, had to work within the boundaries inherent in the now steadfast principle of corporate limited liability. Even when, on an exceptions basis, they decided to disregard the corporate entity, they did so by trying to squeeze the proverbial square peg of unlimited, or secondary, liability into the round hole of the properly-incorporated company with limited liability when deciding to pierce. The clearly-defined asset pool attributable to a corporation as defined by its balance sheet (itself a by-product of corporate law), was expanded to include the asset pool of a related corporation (often the parent).

[529] See in particular the discussion surrounding „public-action piercing" in Section VI below.

1. "Conclusory Piercing"- Merger or Fusion of Identities

Doctrinally, the simplest way to achieve this was simply to define two legally separate persons as one, at least for the purpose of the litigation at hand. The concept of the "merger" for purposes of the dispute in question was justified on the grounds that it merely reflected the factual situation and operation of the corporations in question. In other words, they created their own legal fiction- a merger or union of legally separate corporations- to deal with the rigidness or inflexibility created by the individual original legal fictions which each separate corporation represented.

The above section highlights the tendency of the public courts to rely on conclusory piercing in what this dissertation has termed "private action veil-piercing." The level of overreaching by the management of one corporation into the affairs of another generally had to be so extensive, or dominating, as to effectively extinguish the independent decision-making or separate existence of the other. Only that level would allow the courts to conclude that the two entities were, in effect, one and the same in relation to the decisions or actions which had led to the injuries in the underlying dispute. After all, the courts were still bound to respect the default rules of corporate law (i.e. limited liability) as they had evolved to this point in time. As we shall see in Part VI, government agencies adopted approaches which permitted even greater flexibility when regulating intra-group conduct. This they did through the development of piercing tools which did not depend upon a level of dominance so great as to justify a conclusion of a single identity, or situation-specific merger. For the public action veil-piercing, a lower level of overreaching could suffice.

2. "Analytical Piercing"- Situational Overreaching by Shareholders or Management

When courts were not deciding cases in the binary fashion described above, they were often resorting to complicated multi-factor balancing tests. These are more sophisticated analyses of several factors deemed relevant to the question of whether it is appropriate to disregard the legal separateness of a corporation. In essence, these were meant to substantiate judgment calls regarding overreaching by management based upon the operational record, compared to the simpler conclusion regarding merger of identities or "principal-agent behavior." By adding additional factors regarding the interrelationship between two corporate entities, courts tried to elucidate and explain the types of factors and actions which would collectively determine the outcome of a piercing decision. As courts considered the various analyses applied in other jurisdictions, they sometimes felt the need to tweak the test and add their own particular flavor. As highlighted above, the number of factors in such piercing tests seemed to grow over time. One court appeared to set a new record when it applied a test which included 31 different factors related to the structure of and relationship between legally separate corporations[530].

The private action veil-piercing doctrines seemed to be creating problems and confusion as well as providing more flexibility and, arguably, justice in hard cases. Courts tried to provide prospective clarity to aid decision-makers. The piercing jurisprudence seemed to be ripening, but clarity and certainty were now mired in the increasing number of factors deemed relevant, as opposed to the literal ambiguity entailed by piercing via metaphor. Critics also addressed the drawbacks of the alternative, and more technical, approach represented by the multi-factor balancing test.

Firstly, the weighting to be applied to any of the factors was not quite clear. Without such clarification, factors were likely to receive equal weighting. Second, any interrelationship between the individual factors was generally ignored. The intricacies of statistical analysis were not part of the judicial decision-making framework. Finally, concluding on how an individual factor pushed the piercing inquiry in one direction or another can be quite difficult in practice. This is particularly due to the fact that such rulings are based upon a retrospective analysis of company records, supplemented by testimony. Knowing that, companies may also focus their energies on documenting

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[530] Cathy S. Krendl and James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 Denver Law Journal No. 1 (1978), hereinafter "Krendl & Krendl".

decisions, actions, relationships, and so on, in a certain way to mitigate the risk of veil-piercing in litigation. In other words, there may be an overemphasis placed on form rather than substance, purpose, or policy. Litigation avoidance, after all, is not the primary purpose of corporations. Yet legal rules influence corporate behavior, and financial self-preservation instincts may drive corporate management to place risk mitigation ahead of some of the higher social objectives which historically justified corporate privileges.

Thus for similar reasons as with the binary conclusory approach, the multi-factor balancing tests did not deliver the desired legal certainty. Businesses were now better informed about which aspects of its operations could run the risk of overreaching to an extent which might support a court decision to pierce the corporate veil. But uncertainty regarding the weightings of the factors, the interrelationships, and even how various courts might view specific factors all make it impossible for a company to plan and manage its operations in such a way as to definitively rule out the risk of a piercing decision. In an attempt to provide more clarity to both business managers and third parties, the tests developed by the courts have often become overly complex.

The critique of the overreaching approach falls into several broad categories, namely that the so-called "laundry list" approach

> 1) indiscriminately mixes elements of unequal importance (some factually ascertainable),
> 2) provides no real weighting to the individual factors or elements, and,
> 3) fails to define or even describe a threshold for when intrusion is so excessive that a court would pierce the corporate veil

The number and range of factors deemed relevant in some tests raises the question of whether they are sometimes created or applied as a form of post-facto justification to find for a plaintiff, an analysis flexible enough to achieve almost any desired result. Faced with that uncertainty plaintiffs may be encouraged to search for "deep pockets" from persons with at most tangential connections to the "real" defendant. The pressure to settle some cases may drive defendant decision-making, which may or may not lead to a better outcome for plaintiffs. "Concern regarding setting a precedent for similarly-situated cases may force the collective defendants to fight such cases to the death, even if it might otherwise be willing to settle a specific claim. Empirical research provides some insight into this dynamic and is covered in Part VII below.

3. <u>Critique of the Piercing Jurisprudence</u>

Though piercing provided courts with some form of "safety valve" for the rigidity of the otherwise binary approach created by the default limited liability privilege enjoyed by corporations, the solution was far from perfect. Nor was it without its critics, who pointed out several weaknesses of the approach. For starters, the piercing approach puts the burden on plaintiffs to prove that the factual relationship between two legal entities justifies disregarding the separateness, generally leaving it to the court or jury to decide which category- conclusory or overreaching- is most applicable. In addition, legal experts have raised other concerns related to piercing:

One of the basic criticisms relates to the sub-category of cases in which the courts essentially fuse or merge the otherwise separate legal identities to find liability which would otherwise be blocked by corporate status of each entity. In these cases the court is basically holding that for the purposes of the litigation at hand, A =B, even though A and B have correctly and separately attained the corporate status by following all of the statutory requirements. Early rulings used terms such as instrumentality to describe the attribution of actions of one corporation (e.g. a subsidiary) to another (e.g. a parent). Also included in this group were the cases in which courts decided that one corporation was essentially acting as the agent for another, with the same resulting attribution of responsibility to the other ("principal") corporation.

Whether relying on traditional agency principles, or arguments for a temporary and fictitious merger of corporate identities, courts addressing piercing decisions left a wake of judgments which did not permit a clear delineation of corporate (and group) behavior belonging in the one camp or the other. Commentators raised concerns that this form of jurisprudence was little more than conclusory rulemaking, and the absence of a clear methodology made it impossible for others to "learn" from the holding and avoid the same mistake in their operations. In that sense, the piercing doctrine was tantamount to a "judicial wildcard", which might strike an unsuspecting defendant despite the appropriate attention to the legal requirements of incorporation and operation.

If one of the functions of the public courts is to provide or at least work towards legal certainty, they did not seem to be succeeding when it came to veil-piercing analytical frameworks. From an objective standpoint, many of the factors cited as relevant in the various tests seemed to make sense, particularly those related to the exercise of influence or control by one corporation over another. Those appear to have a genuine nexus to the question of causation and thus, of liability attribution. Other factors, such as those dealing with corporate formalities, tended to introduce an element of randomness into the dynamic of whether or not a plaintiff could recover in a given case. Applying the tests to the actual decision-making and executional framework of modern businesses became very challenging against the backdrop of the developing piercing jurisprudence[531].

Another area of dispute is the equivalent piercing methodology applied regardless of the size of the company. In the common law world, jurisprudence such as *Salomon* and its progeny (including similarly-decided cases in the US) stand for the proposition that no distinction should be made in relation to a one-person corporation compared to the most complex multi-corporate enterprise. While that may be fair in relation to the general sanctity of the legal person, it may be shortsighted in relation to the policy arguments behind piercing. The doctrines behind piercing go towards finding the right balance between incentivizing entrepreneurial activity and protecting the general public from the negative externalities of that activity. In particular, larger, more complex enterprises have a greater opportunity to use successive layers of corporations in an attempt to insulate the head office from liability exposure of its constituent parts.

Another drawback to leaving the resolution of limited liability piercing to courts is that it is essentially a one-off decision. Only individual plaintiffs who pursue their claims through the litigation process can benefit from the fact-specific disregarding of corporate separateness. Arguably, similarly-situated individuals who are injured in the same way due to the same sort of overreaching by one corporation into the affairs of another should also be able to benefit from the holding. This particular point has received little attention in the legal literature. Possibly the old adage of rewarding the person who pursued the claim- giving them their "day in court"- applies with force to the attempted piercing scenario.

When individual plaintiffs seek to attribute liability across corporate boundaries, it is based on specific damages allegedly incurred by an individual or specific group. In other words, the remedy is compensatory in nature. , By contrast, in the regulatory context, the goal to be achieved is a broader societal one, which may be preventive or responsive in nature. Presumably some of the very drawbacks outlined above drove the decisions of legislatures to create specific carveouts by statute in the regulatory context.

One of the common critiques of making the protection of legal separateness absolute is that it unfairly shifts the risk of harm or damage to persons who have no voluntary connection to the corporation(s) in question. Members of the general public may suffer economic or even physical injury as a result of a corporation's activities. The tort victim is the classic example of the latter category. Naturally, courts may tacitly express their sympathy for a tort plaintiff in the way it applies a given piercing test, or attributes liability using the binary approach described above. But on the whole, the piercing tests themselves do not generally distinguish between the types of plaintiffs, i.e. (involuntary) tort or

[531] This is one of the reasons that public regulatory agencies have sought alternatives to the judicial doctrines of piercing. These are covered in detail in Section VI.

(voluntary) contract. Instead, they rely heavily on weighing factors regarding the internal organization and operation of a company, with all the disadvantages of such an approach as outlined above.

4. Analytical Piercing "Codified"- the Single Integrated Business Doctrine

The experimentation with approaches to deal with the tension between corporate law rigidity and concerns about fairness and equity continued into the late 20th century. Two US states, Texas and Louisiana, have distinguished themselves by adopting by judicial ruling an overall approach to the question posed by veil-piercing. It is worth looking at two leading cases which articulated the underlying jurisprudence particularly well.

In *Paramount Petroleum Corp. v. Taylor Rental Center*[532], the appellate court examined the interrelationships between a number of legally separate corporations involved in restoring a ship. When these companies defaulted on equipment rental contracts, the plaintiff sued them and their parent corporation for payment. In citing the state decisions first putting forward the theory of an enterprise made up of multiple corporations[533], the court noted:

> "*when corporations are <u>not operated as separate entities but rather integrate their resources to achieve a common business purpose</u>, each constituent corporation may be held liable for debts incurred in pursuit of that business purpose.*[534]"

The focus on the factual questions of the level of integration and common purpose in a business appear to get closer to the heart of the matter when it comes to piercing analyses. The court then went on to list several typical factors which can support a finding of a single integrated business, most of which are the same or similar to those courts turn to in applying veil-piercing jurisprudence. Because the evidence showed that the corporations were not operated as separate entities, the court held the parent Paramount liable for the debts created by the unpaid rental contracts. The significance of the decision lies in its focus on the factual operation of corporations, as opposed to tangential issues such as how well or poorly they document their incorporation and meet their public recordkeeping obligations. Business operation is a product of decisions and actions, and it is those actions which cause both beneficial and injurious impacts on the broader society.

To date neighboring Louisiana is the only other US state to have adopted the single integrated business doctrine. One representative case, *Green v. Champion Insurance*[535], provides another example of the application of the theory to a relevant fact pattern, this time an insolvency proceeding in which one defendant corporation was trying to avoid liability by arguing its legal separation from other affiliated and insolvent corporations. At the trial court level, the court had ruled that eight affiliated corporations made up a single business enterprise. One of the defendant companies, faced with covering the debts of the others, requested a declaratory judgment on this question from the appeals court. In reviewing the trial court's decision, the appellate court held as follows:

> *"Louisiana's corporations laws are similar to the corporation laws of other states. Corporations are recognized as a separate entity for various reasons. However, the legal fiction of a distinct corporate entity may be disregarded when a corporation is <u>so organized and controlled</u> as to make it merely an instrumentality or adjunct of another corporation. If one corporation is <u>wholly under the control of another</u>, the fact that it is a separate entity does not relieve the latter from liability.*[536]"

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[532] Paramount Petroleum Corp. v. Taylor Rental Center, 14th Ct. App. (Texas), 712 S.W. 2d 534 (1986).

[533] The court cited two seminal cases: Allright Texas Inc. v. Simons, 501 S.W. 2d 145, 150 (Tex. Civ. App. 1st Dist. 1973) and Murphy Brothers Chevrolet Company, Inc. v. East Oakland Auto Auction, 437 S.W. 2d 272, at 275-76 (Tex. Civ. App. El Paso, 1969).

[534] Id. at 536 (emphasis added).

[535] Green v. Champion Insurance Company, 577 So 2d. 249 (1991).

[536] Id. at 257-58.

The appellate court pointed out the reasoning of the trial court rested upon the single integrated business theory. It then examined the nature of the factors which supported that ruling, concluding that they were to a large extent the same as in veil-piercing jurisprudence. It noted that the particular factors examined by the trial court were illustrative and not exhaustive, and pointed out that no one particular factor was dispositive of a finding of a single integrated business[537]. Thus it was essentially recognizing some of the weaknesses in the complex multi-factor balancing test approaches. The court also repeated a mantra familiar from the veil-piercing case law, that extending liability across affiliated corporations was appropriate in order to prevent fraud or achieve equity[538]. In so doing it appeared to be following more of a guiding principle rather than a strict rules-based approach encapsulated in a mechanical, mathematical formula.

What is interesting about this minority approach is that by giving its imprimatur to an overall approach, a court makes it easier for plaintiffs to claim against a broader group of defendants based upon a court-approved theory. By adopting an approach with less complexity than the traditional multi-factor balancing tests, these states may have succeeded in refocusing the inquiry on what is genuinely important in deciding such cases, namely the objective operational scope of an enterprise.

The significance of the judicial development of the single integrated business is twofold. First, it may aid courts in focusing on the overall objective of the inquiry in such cases- whether a business can avoid liability simply because it has fragmented its operations across multiple, legally separate, corporations. By comparison, even though veil-piercing courts also consider a list of factors or variables related to the operations of a business, the absence of a guiding principle or goal may relegate it to a simple net weighing of factors deemed individually relevant. This may result in the diffuse, sometimes convoluted, reasoning process often complained of by commentators. The single integrated business doctrine has such a guiding principle, namely a focus on the way in which a business is operated, from a clearly factual standpoint as opposed to exclusively how its operation is set out on paper.

Secondly, if this guiding principle or direction proves to aid courts in two states to avoid decision-making in the "mists of metaphor", then it may provide an impetus to efforts at brining further consistency and clarity to this area of US corporate law, which is the topic of the final sections of this dissertation. All in all, the single integrated business approach's main contribution appears to lie in its avoidance of the exponential growth in factors relevant to analysis, and its focusing of the inquiry. But it would take the federal administrative agencies to initiate the next step in the evolution of the doctrine of piercing, creating statutory exceptions to specific situations. This contrasted with the judiciary's case-specific exceptions based upon the specific facts pleaded by an individual plaintiff.

[537] Id. at 258.
[538] Id. at 259.

VI. Public Action Veil-Piercing- Incremental Legislative Encroachment

A. The Federal Law Dimension

In analyzing the evolution of rules regarding liability, one needs to consider the broader systemic change taking place during key periods, since this determined the environment in which the characteristics of corporations- essential or non-essential- were shaped. The end of the Civil War and the subsequent Reconstruction period provided an opportunity for the federal government to reassert itself in the economic sphere. This was particularly evident in relation to the law of corporations, which was still primarily state law in its essence. This reassertion of authority would eventually impact the jurisprudence around piercing the corporate veil through the introduction of situations where corporate boundaries would be bypassed based upon the application of new doctrinal tools. Tracing the development of federal law in these areas shows its increasing role in relation to the scope of limited liability- or more broadly the scope of responsibility- for corporations and other legal persons.

1. Market Structure and Competition[539]

Federal statutory law had begun making major inroads into the state corporate regulatory sphere even before corporate groups became widely available in the United States. The Interstate Commerce Act of 1887[540] (ICA 1887) represented one of the first major attempts by the US federal government to claim back some control over the growing universe of state-created corporations. The ICA 1887 was a reaction to widespread public complaints about the abuse of dominant positions held by the leading railroad corporations of the day. The scarcity of alternatives led to concerns about society's increasing reliance on very few providers. The management of the railroad corporations were accused of raising rates on routes serving less populous areas and using the profits to subsidize more competitive routes (e.g. generally in more urban areas). By subsidizing such routes, sometimes even below the operating cost level, dominant railroads had an adverse impact on the level of competition and could run weaker competitors into insolvency. At that point they could acquire any useful assets of the defunct competitor railroad, often at bargain prices, thereby further strengthening their dominant position. Then they could more easily raise rates on those urban routes as well, now that the level of competition had been reduced.

At its core, the ICA 1887 was a sector-specific application of the general antitrust principles which would soon be enshrined in the antitrust laws outlined above. It addressed abuses of competitive positions by requiring the railroads to charge a "reasonable" rate directly tied to their operating costs. In addition, price discrimination, a popular form of favoritism to certain customers, was prohibited. Enforcement of the Act was by an independent federal regulatory body known as the Interstate Commerce Commission (ICC). The Act also applied to water transport services (e.g. riverboats, ferries) where these were owned and operated by railroad corporations. Later on the ICC's jurisdiction was expanded to include telecommunications services, until these became directly regulated by a separate, dedicated federal authority in 1934. The significance of the ICC lay in the direct intervention by the federal government into the management of business, in particular the monitoring of a healthy level of competition in industries imbued with a strong public component.

There were a number of drivers behind this development. One was economic efficiency and the desire to avoid the unnecessary duplication of effort and waste of resources. For example, there was a natural limit to the number of roads or train tracks connecting the major hubs of the day. Permitting corporations involved in these areas to build without constraint would have run the risk of oversupply, and hence a waste of scarce resources. Similarly, in relation to utilities such as electric power, it generally sufficed to have a single power transfer network feeding homes and businesses with electric power from a local utility. Given the huge investments needed to set up the initial

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[539] This introductory section relies upon the Lectures of Prof. Willard Hurst. available at http://library.law.wisc.edu/hurst/audiorecordings.html

[540] ch. 104, 24 Stat. 379, approved 1887-02-04.

infrastructure for such utility companies, it would have been unwise to simply permit entrepreneurs to create new power stations and utility lines- with their intrinsic occupation of land and other inputs which might be otherwise used- whenever they saw the potential for profit. The same applied to the burgeoning field of communications following the mass production and distribution of telephony products. There were strong arguments against unbridled competition in this area, leading legislatures to ration the supply (e.g. bandwith for communications, land for roads) available[541]. There were also strong local components involved and interests at stake.

Although antitrust law dealt with some of the perceived abuses of the concentration of economic wealth in a few hands, it did not get deeper into specific behavioral areas or activities which had definite impacts on society. Following the advent of the corporate group, potential harms aside from sheer monopolistic positions or coordinated business activities of natural competitors began to surface with increasing frequency. Also, direct advance regulation of economic activity had advantages over reliance on regulatory litigation under antitrust enforcement, particularly in times of limited regulatory resources. In fact, the latter complemented the former well in an aim to create a systematic and coordinated management of physical transport and utility infrastructure. Both the proactive and reactive components of antitrust law enforcement impacted the limited liability debate in their net objective and effect of improving the transparency around complex corporate structures.

2. Bankruptcy and the Federal Law Incursion into State Corporations Law[542]

Though not obvious at first glance, bankruptcy law provided an indirect way for the federal government to impact corporation law, as well as to increasingly assert its legislative authority in the economic sphere[543]. Developments in this area go back to 17th and 18th centuries. Some of the British Colonies had experimented with more liberal debtor protection laws in the 18th century, though these often failed when challenged to the higher courts back in England[544]. Given the agrarian economic and social structures of the 18th century, insufficient flexibility in matters of finance and lending hit close to home for the American population. Indeed, strict application of debt laws in Massachusetts had led to an armed insurrection in 1786 which almost resulted in the toppling of the state government[545]. The US federal government had the power to enact bankruptcy legislation post-independence in accordance with the US Constitution[546], and did so on a number of occasions during the 19th century. For the most part, however, these were temporary measures following severe economic crises, and expired a few years thereafter. It was not until the end of the 19th century that the country was ready for a more permanent solution.

The encroachment by the federal government into this area can be seen by the fact that many state corporation laws contained schedules- hearkening back to English law- which set out the rank of priorities of creditors in the event the company became insolvent. A federal bankruptcy law provided

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541 Later technological developments would dramatically impact the dynamics in these industries, permitting new entrants to enter the respective markets if granted access to the then existing infrastructure. This led to innovative doctrines, particularly in antitrust law, under which incumbent service providers were legally required to grant access to their networks to their competitors. This became known as the "essential facilities" doctrine, and has since spread to the competition law regimes in several countries. One of the major areas of contention in this area is the price which the network owners and operators are permitted to charge for granting that access.

542 This introductory section relies upon the Lectures of Prof. Willard Hurst. available at http://library.law.wisc.edu/hurst/audiorecordings.html

543 For further details on this development, see David A. Moss, Chapter 5 Bankruptcy, in When All Else Fails: Government As the Ultimate Risk Manager, pgs. 123-149.

544 Id. at pg. 126 (noting attempts by New Jersey, Massachusetts, New York and South Carolina to enact more lenient debtor protection laws).

545 Id. at 128. The rebellion was triggered by the attempted seizure of property of indebted farmers in western Massachusetts after the economic turmoil which followed the end of the Revolutionary War.

546 Art. I section 8 of the US Constitution reads as follows: "*Congress shall have the power to … establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States*."

an opportunity to bring some consistency to this area. The importance of clear rules here can only be appreciated by remembering the historical context in which the laws were applied. Under both English and US law of the time, creditors could enforce their claims not only against debtors' property, but also against their life and limb. Debtors' prisons were still in widespread use in the US throughout much of the 19th century. Proponents of an enlightened approach to dealing with debtors faced an uphill battle in many of the state legislatures. New York eventually abolished the institution of debtor's prisons in 1831, while Massachusetts retained it until 1857.

The shift in mindset which facilitated the abolition of debtors' prisons was driven by a combination of practicality and compassion. Creditors on both sides of the Atlantic had realized that throwing their borrowers in jail prevented them from earning anything at all. In fact, the prison stay often harmed their health and even led to death, thus jeopardizing the likelihood of even partial repayment. Its real value (if any) as an enforcement tool lay in the deterrent effect of emphasizing to borrowers the seriousness of the debt relationship by virtue of the severity of the potential punishment in case of default. It might also put pressure on a debtor to seek financial assistance from family or friends. Once a debtor had defaulted, however, that value disappeared. All that was left was an impoverished borrower, perhaps liable for debts to several creditors, increasingly unlikely to make good on his or her debts (at least on his or her own). Finally, by moving away from a first-come, first served approach inherent in most bankruptcy laws of the time, the legislatures attempted to avoid some of the chaos and destructive behaviors which that brought about[547].

Aside from the practical side, made evident over centuries of experience with the institution of the debtor's prison, there was also a moral or semi-religious component to the debate in America. The United States was founded on the basis of religious freedom, and the Christian community had a strong tradition of forgiveness of trespasses, to which unpaid borrowing might be attributed. Both elements of the discourse surrounding relieving debtors made their way into the public and legislative discourse. This culminated in the passage of the first permanent federal bankruptcy law in 1898. This breakthrough resulted in what has been described as "the most debtor-friendly system anywhere in the world.[548]" It also was arguably a reflection of the American attitude toward risk tolerance.

The evolution away from temporary reactionary measures can be seen as a sign of maturity of the US legal system. In addition to the enlightened approach which the debtor discharge represented, the original scope of protection was expanded beyond just traders. Farmers, craftsmen, manufacturers, and professionals, historically outside the protection of the early bankruptcy laws, were now on equal footing[549]. This perhaps represented recognition of the mutual interdependencies of the various economic and labor groups within the society of the young country.

The primary relevance of the law of bankruptcy to the topics in this dissertation lies in the fact that bankruptcy rules are essentially the flip side of the coin of limited liability privileges accorded to corporations. Limited liability rules are meant to incentivize the investment of savings and resources in commercial (and non-commercial) ventures which are inherently risky[550]. By limiting the potential losses of providers of capital to the amount of their investment, entrepreneurs should be better able to finance activities which have potential benefits for the broader society. These benefits can come in the form of employment for the workforce, taxes for the state, and earnings to the financers and owners of the business. As such, they represent an ex ante approach to dealing with the risk of loss, and entail a shifting of such risks to creditors.

Bankruptcy laws, on the other hand, follow an *ex post* approach in dealing with the consequences of business failures. By providing a discharge- often conditional on certain obligations such as partial repayment- to the debtor, such laws impact the risk appetite of all participants in a given economic (or other) venture. This is especially true for the borrower, no longer confronted with the risk of

[547] See discussion regarding debt litigation in colonial America at in § III B.
[548] When All Else Fails, at 138.
[549] Id. at 133-34.
[550] See discussion of this topic in "The Massachusetts Example" in Section III E. 3.

losing his or her liberty as a result of a failed venture. In this respect, the new bankruptcy law rounded out the existing protection of passive investors (e.g. shareholders in a corporation as providers of capital) through the addition of protection for active entrepreneurs (e.g. starters of businesses who required capital to convert ideas to operation). As during the debates surrounding the extension of limited liability to corporations, many voiced concerns regarding the moral hazard of encouraging excessive risk-taking. But here again, after a long period of experimentation and gestation, the promoters of economic risk-taking and entrepreneurialism won the day.

The bankruptcy laws brought clarity to claims against an insolvent company by setting out in statute the priority of defined classes of creditors. Tax authorities and fees for those involved in winding up the company came first, followed by secured creditors (further subdivided in order of ranking of claims), followed by unsecured creditors[551]. Equity investors belonged to this last category, thus emphasizing the risks of equity investment and drawing a distinction between debt and equity lenders. Only the former had the ability- through the loan agreement- to insist on security in return for the provision of capital.

The bankruptcy laws also introduced the equitable tool of substantive consolidation in order to address some of the problems created by the corporate group. Through this tool, courts are able to redefine the attribution of assets amongst members of a corporate group[552]. This enables it to make more assets available for compensation than a strict application of corporate law and limited liability generally permits. It thus arguably represents a form of veil-piercing, in that balance sheets of companies beyond that of a directly responsible company in a corporate group are opened up for meeting damage claims of successful plaintiffs as judgment creditors. But given the collective nature of such proceedings, definitively resolving the claims of all creditors, as well as the incentives for secured creditors to litigate any court plans which reduce their expected share of the bankruptcy estate, the extent to which such tools help individual tort judgment creditors varies widely in practice.

This brief foray into bankruptcy law was meant to provide additional context to the legal and social environment relevant to the broader liability debate. As with many of the legal developments outlined herein, the bankruptcy law development also emphasized the predominantly contractual nature of the liability debate in the common law world up until then. Tort claimants, for example, got nary a mention in all the debates leading up to the permanent federal bankruptcy law. The focus, as with the corporate limited liability debate decades earlier, was on the debtor-creditor relationship as the source of most liability.

In addition to this narrower doctrinal relevance, bankruptcy law would take on added significance in the 20th century as the multi-corporate enterprise arrived on the scene. This new business model provided unique opportunities for corporate management to use (some would argue abuse) the bankruptcy law protections for creditors to avoid catastrophic obligations arising in the non-contractual setting. Indeed, some were accused of actively designing their corporate structure to use a combination of state corporate and federal bankruptcy law contingent protection to insulate themselves from such forms of liability exposure. In so doing, they allegedly are able to externalize those risks and liabilities to the rest of society. Such consequences were not in contemplation at the time of the first federal bankruptcy law in 1898, but gained discussion traction in later revisions. They are also regularly part of the debate regarding limited liability. When courts have deemed it necessary, they have periodically accepted new theories of liability to prevent the perceived misuse of the corporate form.

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[551] US Bankruptcy Code §102.

[552] The details of substantive consolidation are beyond the scope of this dissertation. For more information on this tool in the bankruptcy context, see Chapter 11, US Bankruptcy Code, §1106-1113. See also, Amera & Kolod, Substantive Consolidation: Getting Back to Basics, 14 ABI Law Rev. 1 (2006), and Graulich, Substantive Consolidation- A Post-Modern Trend, 14 ABI Law Rev. 527.

3. Securities Legislation[553]

A number of factors combined to set the stage for the next major phase in the evolution of the law applicable to corporations. Most important amongst them was the meteoric and basically unsupervised development of the US capital markets. The holding company legislation had facilitated the growth of vast enterprises with an insatiable appetite for capital. The general public was investing on a scale not seen since the Great Bubble in England in the 18th century. The unlicensed nature of the stock brokerage profession introduced the era of "making money on money." At its peak in 1929, the US stock markets had reached levels never before seen, both in terms of valuation and the breadth of participation by the general public.

Everything came crashing down over a few days in October of that year. Fortunes built up over years were lost overnight. Some market participants and investors took their own lives because they could not face the reality of having been wiped out financially. Mass migrations began as entire regions of the country proved unable to sustain a basic level of survival. Unemployment reached levels never seen before in the century and a half of the country's history.

The dire situation which built up over these years shook the very foundations of the political and economic structures of the nation. There was concern that the country could go the way of the Soviet Union or other socialist countries. Though the political winds certainly took a turn to the left, overall Americans sought a solution which would preserve the original philosophical underpinnings of the country yet provide a way out of a downward economic spiral. This meant increasingly turning to the central government to provide direction and resources to get the country through this trying period. President Roosevelt's Federal Works Program was one example of the federal government funding major infrastructure projects, motivated to a considerable extent by the desire to provide jobs to masses of unemployed workers.

The unique political atmosphere of the 1930's also gave the federal administration significant leeway to alter the legal landscape of the country. The need for a new approach to regulating the economy resulted in part from a legislative autopsy done on the root causes of the Great Depression, and of the collapse of the stock markets in particular. The solution proposed was a major overhaul of the laws regulating economic activity. The revolutionary legislation was packaged in political terms as a "New Deal" by the Roosevelt administration, and ushered in the dawn of administrative law in the United States. What follows is a brief overview of the statutes from that era of most relevance to the topics regarding liability in this dissertation.

i. Securities Act 1933

Following the October 1929 stock market crash, the US Congress conducted intensive hearings into the causes and contributors to the largest economic loss in the nation's history. The first statute passed to introduce direct federal regulation of the capital markets was the Securities Act of 1933[554]. The Securities Act introduced registration and reporting requirements to those wishing to offer investment securities to the general public, soon to be known as "Issuers" in the new regulatory framework[555]. The basic premise of the 1933 Act was to ensure that investors had sufficient information regarding the nature of the investments underlying a company's security through detailed disclosure regarding its structure, markets, operations, and financial condition.

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[553] This section summarizing the impact of the securities laws on the limited liability debate draws on the federal securities laws and the following sources in particular: Prof. Joel Seligman, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance (Aspen Publishers, 3rd ed.). Another excellent resource for researchers of US securities laws is the website of the SEC Historical Society http://sechistorical.org/ which includes both primary and secondary materials (see in particular the Galleries and Papers sections; last visited Aug. 9th 2019).

[554] Securities Act 1933, ch. 38, title I, Sec. 1, 48 Stat. 74 (May 27, 1933), hereinafter "Securities Act."

[555] Section 10 of the Securities Act sets out the general requirement for information, which is further refined in implementing regulations.

The last element was deemed particularly important, as the Congressional hearings had revealed serious deficiencies in the way the unregulated US investment markets had been operating in the run-up to the crash. By requiring a comprehensive and consistent way of presenting the current financial condition of a company, as well as disclosure regarding its future prospects, Congress aimed to fill a perceived large gap in the communication channels between providers and recipients of private savings and capital. In so doing, it hoped to dampen the speculative nature of the US investment markets which had played such a major role in the dramatic crash of October 1929. Not only was detailed financial information required going forward, but the underlying accounting and auditing standards were also revised to improve transparency and comprehension. The (state) corporate law requirement for the provision of an annual report including financials was enhanced through the obligation of Issuers to have their financial statements audited and attested to by professional accountants (Certified Public Accountants, or CPAs).

The Securities Act also created a federal statutory cause of action for any material errors in the information required in the registration requirement[556]. This applies to both the non-financial information (company structure, markets, operations, etc.) as well as the financial information (i.e. audited financials) which comprise the offering document which underpins the legal offering of securities to the investing public in the US. In addition to the prospect of regulatory sanctions against a company which is discovered to have breached its obligations under the securities laws, an Issuer is also exposed to civil lawsuits. Investors commonly allege that company management misrepresented itself, its current condition, or its prospects (so called "forward-looking information") in a significant manner which caused them to incur a loss, for example through the drop in a company's stock price[557]. In keeping with the general common law requirements of suffering damages before claiming restitution, investors would have to have sold their securities and incurred a loss, one created or at least contributed to by the alleged misrepresentation.

As a result of the enhanced disclosure requirements, a whole industry of professional services grew around the registration and reporting obligations. Law firms specialized in corporate law and finance reviewed draft registration statements to minimize the risk of rejection by the Securities and Exchange Commission (SEC). Firms of professional accountants grew to assist the Issuers in meeting the requirement for an outside and independent review and attestation of a company's financial statements. Only after an Issuer's registration statement was approved by the SEC could a company legally offer its securities to the general public.

In addition to the above gatekeeping role which the SEC took on in relation to the offering of investment securities, it also became responsible for monitoring ongoing reporting of companies once they had transitioned from so-called "registered" companies to "reporting" companies. The information required under the ongoing reporting obligations is similar to that required in an original registration statement. As the securities markets evolved, the liability provisions extended across all relevant communications to the markets, such as communications regarding quarterly results or ad hoc events. The US investment markets quickly became some of the most sophisticated- and complex- environments for companies seeking capital from the general public. Realizing that the federal government needed specialists to enforce the revolutionary obligations which the Securities Act introduced, Congress set up the Securities and Exchange Commission (SEC) a year later by virtue of the Securities and Exchange Act 1934.

ii. Securities and Exchange Act 1934

The Securities and Exchange Commission (SEC) was established under the Securities and Exchange Act of 1934[558]. It is made up of five Commissioners appointed by the President, with advice and

[556] Section 11 of the Securities Act sets out the general civil liability provisions.
[557] Section 15 of the Securities Act sets out the civil liability provisions for so-called "controlling persons."
[558] Securities Exchange Act of 1934, ch. 404, title I, Sec. 1, 48 Stat. 881 (June 6, 1934), hereinafter "Securities Exchange Act".

consent of the US Senate[559]. To avoid the new agency politically leaning one way or another, the 1934 Act restricted the maximum number of Commissioners from any one political party to three[560]. In addition to the Commissioners, entrusted with leading the new agency, SEC "Staff" was recruited, again largely from the ranks of the (previously unregulated) investment securities industry.

The Roosevelt administration realized that it would need a professional group within the government to oversee the capital markets, one made up of experts who knew the weaknesses and vulnerabilities of the markets, from a structural stability standpoint. These vulnerabilities had been analyzed in great detail in the course of the Congressional hearings which led up to the two inaugural securities laws. To ensure that the appropriate level of industry expertise resided in the new federal agency, it hired many market participants and intermediaries as the original staff members. To head the SEC, it selected a well-known Wall Street figure, Joseph Kennedy, father of the later President John F. Kennedy.

The Securities Exchange Act 1934 extended the direct regulation beyond company Issuers to the key market participants, such as securities exchanges and brokers and dealers in company securities. There evolved a combination of direct supervision of such market intermediaries along with self-regulation of members of the respective organizations. The SEC has the right to access the accounts and records of such intermediaries[561], and conducts regular examinations and inspections to determine if these companies' activities are in compliance with their obligations under the US securities laws[562]. Violations can lead to civil or even criminal liability for the management of such regulated entities.

The SEC has the right to inspect and review the setup and operations of such intermediaries, as well as the right to sanction them for violations of the securities. Such sanctions can run from fines to temporary or permanent bans from the US investment securities markets[563]. The Act also included liability provisions for misleading statements made in connection with filings with the Commission[564]. As with its predecessor Act, the 1934 Act also introduced private litigation remedies to complement those administrative penalties which the SEC can enforce against violators of the securities laws.

Similar to the industry which grew up around the legally compliant submission of registration and reporting documents with the SEC, over time an entire section of the plaintiff's bar developed, specialized in securities law litigation. This growth has been particularly driven by the later introduction of changes to both substantive and procedural law. For example, the creation of the "class action", under which similarly-situated persons can join together and form a group to pursue equivalent claims against a defendant, provided particular impetus to this development. The broad dissemination of securities to thousands, or even millions, of individual shareholders made the class action a particularly suitable instrument for pursing claims on a collective basis. Generally these claims are based upon the fundamental obligations of Issuers not to make misleading statements, either in the public filings described above, or in related communications.

iii. Public Utility Holding Company Act of 1935

The securities laws gave the SEC wide-reaching powers to order the reorganization of multi-corporate enterprises not seen such the introduction of the antitrust laws. With its new legal framework and responsible agency in place, the federal administration turned its focus on a particular sector of the economy which had proven especially troublesome in recent years, the utility industry. Parallel Congressional hearings had run to investigate alleged abuses in this sector of crucial importance to

559 Id. at §4.
560 Id.
561 Id. at §17(a)(1).
562 Id. at §3.
563 Id. at §102(E).
564 Id. at §18.

the average citizen. Both households and industry had grown dependent on stable electricity and gas supplies to generate the economy and improve the general quality of life (heating, lighting, etc.).

As with the investment securities markets, the utility markets had been subject to limited regulation. This was partially due to constraints on state governments and regulators to oversee activities outside of state boundaries, as energy generation had increasingly become an interstate activity. But it was primarily due to the lack of a jurisdiction and institutional capacity at the federal level up until Great Depression. The 1935 Public Utility Holding Company Act (PUHCA)[565] was meant to fill that gap. And the SEC was entrusted with the authority to oversee compliance with its obligations.

The factual context for the introduction of federal legislation was the widespread use of holding company structures to tie together and manage what had historically been small power generation and distribution companies[566]. Following the introduction of the holding company at the end of the 19th century (e.g. the New Jersey legislation analyzed above), the utility industry underwent a broad process of consolidation and centralization. The holding company permitted owners to build enormous enterprises with relatively modest investments of capital by the use of "pyramiding." This basically entailed retaining preferred voting rights in each corporation which was acquired and added to the utility enterprise. In other words, by strategically structuring the acquisition of individual corporations which owned and operated utilities, those with a majority share of the holding company were essentially able to define the strategic direction and practical operation of all of the constituent parts. In other words, those at the top were able to control the activities of each of the individual corporations which made up the holding enterprise whole[567].

Throughout the early 20th century a small number of utility companies had managed to build up vast enterprises crossing multiple state lines. These brought with them the opportunity to centralize certain operational and administrative aspects (e.g. procurement, accounting, legal, other services), which both improved consistency and quality as well as reduced costs by virtue of the ability to spread overhead across the individual corporations[568]. In addition, the holding company structure also permitted the companies to diversify their risks and spread them over a larger pool to the benefit of all. Finally, the structure permitted improved access to capital markets through the sheer power of size and scale as well as through the efficiencies of centralized management.

The very advantages the holding company structure brought with it also hid the potential for abuse, depending on how top management exercised its authority in relation to the above-described operational and administrative coordination. For one, the leveraging model was often taken to extremes, going beyond what could objectively be justified in terms of seeking economic and organizational efficiencies[569]. The SEC noted that on average utility holding company structures had 5-6 layers, though there were examples with more than double that amount.

Having additional administrative layers permitted those at the top to charge service fees the corresponding number of times, essentially for the same services. Management at controlling corporations also often lent funds to corporations down the pyramid at rates considerably above those available on the market[570]. It also had the power to force the subsidiary corporations to pay dividends to it above and beyond anything which could be commercially justified[571]. This often led to artificially inflated profits and a bias of cash inflows and outflows in favor of those at the top companies.

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[565] 15 U.S. Code Chapter 2C; Repealed. Pub. L. 109–58, title XII, § 1263, Aug. 8, 2005, 119 Stat. 974
[566] Much of this discussion is based upon the U.S. Department of Energy's publication "Public Utility Holding Company Act of 1935: 1935-1992 (Energy Information Administration Jan. 1993).
[567] Id. at page 6, noting that there were also tax advantages and additional flexibility in terms of conducting activities which may have gone beyond those authorized by an individual corporation's charter.
[568] Id. at page 7.
[569] Id. at pages 10-11.
[570] Id. at page 12.
[571] Id. at 13.

When one ties this potential for abuse of intercompany relationships to the fact that many of the utility companies offered their shares to the investing public, the danger to the capital markets becomes clear. In an era of unregulated capital markets, it was rather easy for top management of holding companies to inflate the real value of the capital assets and manipulate the appearance of the financial condition of the constituent companies. Not surprisingly, the exercise of such authority at the top of holding company structures led to financial difficulties for those in the lower levels of the corporate pyramid. Several went bankrupt in the run-up to the Great Depression, and there were widespread complaints about the impact of the consolidation on the quality of service.

Based upon detailed investigation of the activities of the industry in the pre-Depression period, the Congressional committees were able to come up with a number of possible solutions to this crucial sector of the economy. One proposal was to simply ban holding companies from interstate sales of electricity (i.e. deprive them of their markets), or selling their securities in interstate commerce (i.e. deprive them financing)[572]. Other options considered included using the federal taxation powers, statutory inhibition, or compulsory licensing to level the enormous power of the holding companies[573]. Finally, there were even proposals for the introduction of a Federal corporations act, a topic which had died out over a century earlier[574]. In the end, the solution chosen by the Congress was to reduce the utility holding company enterprises to a "single integrated system" directly regulated by a dedicated group within the Securities and Exchange Commission[575].

Given the nexus to securities, the legislative solution for this sector became part of the overall package of securities laws. The SEC was given the mandate to oversee and regulate corporations which fell within the scope of PUHCA. By directly monitoring and regulating the sources of the original problems (e.g. intercompany transfers, ownership and governance structures), the Commission aimed to prevent a repeat of the abuses of the past. The authority of the SEC even extended to forcing such structures to divest certain corporations or reorganize to "rightsize" the number of corporate administrative layers. The Commission exercised this authority more frequently in the early days and then focused on the continuing operation of the industry in the "new era." These tools had parallels in the antitrust agencies' authority to break up monopolistic enterprises by requiring divestiture of parts of the business. It is this inherent executive authority to reshuffle corporate responsibility within a broader enterprise, including directing redress in specific cases, which is relevant to the broader analysis of a corporation's liability for its actions.

iv. Investment Company Act 1940

The Investment Company Act of 1940 (ICA)[576] was a reaction to the fallout of the unregulated capital markets in the run up to the 1929 stock market crash. Given the importance which certain companies, as investment vehicles, had in the allocation of savings and investment monies, the US Congress recognized that they represented a "national public interest." The overriding objective of this and the other securities laws was the protection of investors.

Taking a page from the PUHCA legislation of 5 years earlier, the ICA sidestepped the normal limitations which corporate boundaries might present to the statutory objectives., It introduced its own definition of relationships between companies by focusing on the typical mechanisms for the exertion of control by one company over another (which corresponded to the parameters examined by courts in veil-piercing cases). The definition of "affiliated person" represents the manifestation of such control mechanisms and includes situations where one person (legal or natural)[577]:

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[572] Id. at 16.
[573] Id.
[574] See the discussion around the establishment of the US Bank in the early days of the United States infra and the refusal of the President to renew that federal corporate charter.
[575] Id. at 107.
[576] Investment Company Act, ch. 686, title I, Sec. 1, Stat. 789, Aug. 22nd 1940 [hereinafter "ICA"]
[577] ICA Sec. 2 (3).

- Directly or indirectly owns, controls, or has voting power of 5% or more of another person
- Is under common control with a person deemed to be controlling under the above definition
- Is an officer, director, partner or co-partner or employee of such controlling person
- An investment adviser (see below) in such a situation where the company is deemed an investment company
- The depositor of an unincorporated investment company which meets the above scenario

This broad definition permits the SEC to cast a wide net in enforcing the respective regulations under the ICA. Similar to the PUHCA legislation, it does so by defining a responsibility which is tied to the underlying economic reality of investment companies. An aggrieved claimant has objective criteria for evaluating the scope of responsible parties in relation to a particular situation or event. There is no need to litigate some complex multi-factor test with weightings- if the statutory definition can be proven on the basis of objective criteria, then liability can be attributed across corporate boundaries.

v. Investment Advisers Act 1940

The Investment Advisers Act of 1940 (IAA)[578] follows essentially the same pattern as the ICA in applying the SEC's regulatory authority to the field of investment advisers. Investment advisers are those who provide investment advice and administrative support in return for a fee. As with investment companies, this group of market participants had also previously operated without regulation, a fact deemed one of the contributing causes to the stock market crash. This added yet another field of law where the control variable could trump otherwise sacrosanct corporate boundaries.

At first glance the link between the wave of securities statutes and corporate liability rules may not be evident. The significance lies in two primary areas. First, by preempting the states in relation to the law of corporate finance (up until then essentially unregulated without any real oversight at the state level), the federal securities laws drove right to the heart of the capital sources which formed the lifeblood of many commercial enterprises. The corporate finance model of the 18th and 19th centuries had made a swift and significant shift away from debt to equity financing. This brought with it a move away from the traditional reliance on contractual debt relationships for financing the establishment of new corporations or their ongoing operations. The change in the corporate finance model naturally brought with it changes to the liability exposure of the recipients of those funds, the businesses incorporated at the state level. In the "debt-only" era, the primary mechanism for claimants to seek redress from owners was the share capital and arguments in support of levying further assessments. In the emerging "equity-and-debt" era, the investment component represented by equity was itself becoming recognized as a (for some essential) characteristic of the corporate form.

Secondly, in pursuing their remit to enforce the US securities laws, the SEC operated under a liability framework which completely bypassed the strict boundaries of corporate regulation, which treated each legal entity separately. Rather than focusing on the corporate borders which businesspeople had created for their enterprises, the SEC looked at the broader economic and operational reality. With the introduction of the "control" concept as the basis for regulating corporations which tapped the public capital markets, the SEC redefined the legal scope of US enterprises in a way which aligned to the underlying economic realities. In other words, it began following an "enterprise" approach which looked beyond the personnel, property, and relationships which a given corporation legally possessed or had to the broader network of corporations deemed within the loose parameter of "control." The malleability of the control parameter made application of statutes across multi-corporate businesses much simpler compared to the clunky metaphorical or multi-factor balancing tests which judicial veil-piercing entailed. This would undoubtedly impact the thinking of courts considering piercing questions in the civil litigation context.

[578] Investment Advisers Act, ch. 686, title II, Sec. 201, 54 Stat. 847, Aug. 22nd 1940 [hereinafter "IAA"]

In some respects, the "control" framework represented a form of "piercing" the corporate veil along the lines as that developed by the courts to deal with similar tensions in the private liability (e.g. tort) sphere. Rather than try to find and prove overreaching by management as in the private action veil-piercing context, public veil-piercing assumes overreaching exists based upon certain, control-related, parameters. The main difference was that the driver behind the equitable "redrawing of legal boundaries" was the underlying objectives of the New Deal statutes. Though these objectives also entailed an element of private restitution, the overall ambit related to broader economic and societal goals, such as the protection of investors and the supervision of a well-structured, efficient, and fair system of capital investment and allocation. This overarching purpose had an element of permanence to it which differed from the "one-off" nature of judicial, or private action, veil-piercing. The New Deal framework soon became the benchmark for other US agencies, as administrative law in the United States began to grow and spread into other areas.

In addition to the development of the piercing doctrines and various tools to determine when the "liability circle" for a given case should be drawn beyond a given corporate entity, another development began to impact the legal situation applicable to groups. In part, these may have been motivated by the unpredictability of the piercing jurisprudence, combined with a desire to pursue specific public policies in particular areas. This development was the increasing regulation of economic activity, particularly at the federal level, by means of statutes addressing particular industries or conduct.

In some respects, the proliferation of federal regulatory statutes was a flashback to the origins of the corporate vehicle itself. The types of activities increasingly brought under federal regulation- transport, communications, utilities- were themselves the object of early forms of legal persons in most legal systems. The public component inherent in such activities had historically resulted in special treatment or consideration throughout the evolution of corporate law. And it was this public dimension which served as the legal basis for both federal and state governments' efforts to reign in the heretofore uninhibited spread and unregulated conduct of such activities throughout the United States.

Regulatory law, with its focus on the "control" concept in the application of its provisions, raises several interesting issues in relation to the veil-piercing doctrines considered in this dissertation. If the executive branch, in executing important public policies, ignores the formal entity boundaries in favor of an approach deemed closer to the economic reality of affiliated corporations, should the judiciary do the same? Thus far, the closest thing to this appears to be the single integrated business doctrine followed in a few jurisdictions which have experimented with enterprise liability. The majority of the state judiciaries continue to preserve the underlying entity concept enshrined in corporate law. In exceptional cases, where such preservation does not seem justified or fair, a court may temporarily put aside the legal fiction of the corporate legal boundary. But a guiding principle, such as a focus on the level of integration of a business, has yet to gain widespread acceptance[579].

4. <u>Labor Legislation</u>

The investment markets were not the only target of the New Deal Congress. The Great Depression caused massive unemployment, requiring the federal government to step in and develop work programs for the millions of idle workers. A portion of them were victims of corporate or banking insolvencies, either directly in terms of lost jobs, or indirectly in terms of credit tightening. The regulatory approach tested and cultivated through the securities laws spread to other areas of substantive law in the US, including employment law. There was a strong desire to bring stability to the labor markets, and the "control" concept began to be employed in federal labor statutes regulating various aspects of the employment relationship.

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[579] One exception to this was the "single integrated business" doctrine pursued in two states, discussed in more detail in Section V D 3.

i. *Labor Relations Laws*

In 1935 the US Congress passed the Wagner Act[580] to create a framework for workers' rights to organize and the role played by unions[581]. In the course of several amendments over the years, the Act was renamed the National Labor Relations Act (NLRA) and became "America's central labor law.[582]" Courts early on began to look across corporate boundaries in considering where responsibility lay for violations of the Act. Two of the primary doctrines utilized by the courts for this purpose have been the "alter ego" doctrine (described as "conclusory" veil-piercing in this dissertation) and the "single employer theory.[583]" The former is equivalent to the general doctrine applied by courts in deciding whether to permit a plaintiff to recover from an affiliated corporation of a defendant corporation with which they had direct contact. The latter takes into account the particularities of the employment relationship in an attempt to effectuate the underlying policies of US federal labor legislation.

The inquiry behind the single employer theory is for a court to consider whether two legally separate entities (e.g. corporations) have their operations connected to such a degree that it is appropriate to permit enforcement of a statute across corporate lines[584]. When applying the test, courts generally look at four operational factors[585]:

- Interrelationship between the entities' operations
- Degree to which the entities have common management
- Common ownership
- Centralized control over labor relations

The first three elements are similar to those which courts consider in traditional veil-piercing inquiries, while the fourth element represents a labor law twist. It is also perceived to be a *sine qua non* of cases attempting to apply veil-piercing theories in relation to federal labor law statutes. That said, the specific application in the employment context is considered by many observers to simply be an application of general principles of common law, in particularly in relation to corporations[586]. Irrespective of its characterization, the single employer doctrine has the effect of legally separate entities being lumped together for the purpose of applying federal labor law, such as in relation to the right of workers to organize and form unions.

A classic setting where the doctrine is applied is where business enterprises attempt to split their operations into separate legal entities, some unionized and the others not unionized[587]. Courts have focused on the degree of interrelation between such businesses to determine whether the legal separation appears to be lived in practice. If the formal separation appears to be more of a ruse to avoid certain obligations under laws such as the NLRA, courts may apply the single employer doctrine and apply the statute across the broader enterprise (i.e. across corporate boundaries).

A related statute in this area is the Labor Relations Management Act (LRMA)[588]. The LRMA originated in 1947 as an effort by the US Congress to provide clear federal jurisdiction over, and a

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[580] The railroad industry was subject to earlier legislation along these lines in the form of the Railway Labor Act of 1926. Ch. 347, §1, 44 Stat. 577 (1926). This set the stage for more general statues as well as more liberal application of the statutory purpose to cross corporate boundaries where this was deemed appropriate by courts.
[581] For a comprehensive treatment of veil-piercing issues in the US employment law context, see Wilson McLeod, Shareholder's Liability and Workers' Rights: Piercing the Corporate Veil under Federal Labor Law, 9 Hofstra Labor and Employment Law Journal, Issue 1 Article 3 (1991), pg. 115.
[582] Id. at pg. 140
[583] Id. at 141.
[584] Id. at 142.
[585] Id. (citing several cases which applied the test).
[586] Id. at 145.
[587] Id. at 141. This practice is sometimes referred to as "double-breasting."
[588] 29 U.S.C. ch. 7 §§ 141-197 (also known as the Taft-Hartley Act).

framework for, collective bargaining agreements[589]. The Act mandates arbitration for most disputes arising under such agreements, and is often plead by workers' representative when trying to force parent corporations' involvement in such arbitrations. The focus of the veil-piercing inquiry in such cases is whether two or more legally separate entities represent a "single bargaining unit.[590]" Similar to the non-labor veil-piercing setting, mere ownership alone will not suffice for a finding of parental (or sister corporation) responsibility. There must be a sufficient level of interaction or linkage between the two corporations in the area of labor negotiation and organization[591].

ii. *Compensation and Benefits Laws*

As discussed earlier, for many centuries the historical context in which corporate boundaries were considered by courts was in relation to debt contracts, i.e. examining the debtor-creditor relationship. At the beginning of the19th century, some US states recognized the particular needs of a different key corporate contract party, its labor force. State corporate statutes sometimes granted special protections to workers in the form of priority of a company's wage obligations in the event of financial difficulties. Though in practice such exceptions to what eventually became a general rule of limited liability might only mean a couple of weeks of pay before unemployment, it at least provided a financial buffer to the occasionally turbulent nature of local economies in the early years of the United States.

The New Deal legislation adopted and developed this treatment in the form of the Fair Labor Standards Act (FLSA)[592]. The FLSA aimed to address the working hours and pay of the American work force. As with the NLRA, it also became the beneficiary of the "single employer" and alter ego doctrines applied by the courts. This trend continued as labor legislation increasingly reflected the developments in the employment relationship in the second half of the 20th century as well.

In addition to general wages, retirement or pension benefits were becoming an increasingly important part of the employment relationship. Here as well the US Congress became active. It passed the Employee Retirement Income Security Act (ERISA)[593] in 1974 to address the growing relevance of post-retirement compensation. Similar to the NLRA and other labor contexts, courts deciding disputes regarding the payment of monies claimed due under ERISA also looked at the interrelationship between legally separate corporations. They also followed similar reasoning as the NLRA courts' "single bargaining unit", but with an added nuance. Under the ERISA statute, pension plans constitute a separate legal person, comprised of the collective funds which participants have paid in over the years. Therefore, there is no privity of contract with unions as exists in the classic bargaining scenario. Still, courts have been able to apply other bases for reaching across corporate boundaries, where appropriate. This could be the case, for example, where a parent company is deemed to be perpetrating a fraud, or frustrating the purpose of the ERISA legislation to drain funds (including underpaying any portions thereof due from the corporation) from such plans, to the detriment of employees.

iii. *Working Conditions Laws*

The trend towards increased workers' rights continued through the 20th century. In the 19th and early 20th centuries, the focus of laws related to employment mainly focused on guaranteeing payment for work performed. The economic disaster of the 1930's revealed the need for clear rules regarding collective actions by workers, leading to the laws described above. It took a few decades for the law to focus on the physical conditions, including safety, of the working environment. Though the issue had long been the subject of discussion, it was not until 1970 that the federal government introduced a

[589] See McLeod, Piercing the Corporate Veil under Federal Labor Law, at 156.
[590] Id. at 157 (citing several cases applying this test).
[591] Id. at 158.
[592] Fair Labor Standards Act of 1938, ch. 676 § 1, 52 Stat. 1060 (1937) [hereinafter "FLSA"].
[593] Employee Retirement Income Security Act 29 U.S.C. ch. 18 § 1001 et seq. [hereinafter "ERISA"].

comprehensive legislative framework for workplace safety in the form of the Occupational Safety and Health Act[594].

OSHA introduced specific requirements aimed at minimizing the risk of injury at the workplace by requiring the observance of specific standards. Since failure to meet these standards can form the basis of individual claims for breach, the statute thus has a direct relationship to the issue of business liability exposure. OSHA has both a proactive and a reactive dimension. The proactive dimension relates to the technical requirements for setting up and operating a workplace. The reactive dimension relates to assigning responsibility, and liability, when things go wrong at the workplace, leading to employee injuries. As with the earlier federal employment legislation, OSHA also took a broader view of the enterprise. The courts have consistently looked across corporate boundaries in evaluating employer liability.

iv. *Anti-discrimination Laws*

Having covered the standing, compensation, and physical safety elements of the employer-employee relationship, the next step in the gradual march of federal labor law was in the area of discriminatory practices. This originated as part of the civil rights legislation of the 1960's, which was also relevant to the treatment of individuals in the workplace. The Civil Rights Act of 1964[595] contains a link to federal employment law by virtue of the definition of "employer" in Title VII of that Act. Title VII of the Civil Rights Act prohibits discrimination on the basis of race, gender, color, religion, or national origin. This prohibition extends across the whole spectrum of the employment relationship, from hiring, to compensation and promotion, to disciplining and dismissal.

In interpreting these provisions, courts have generally relied on the single employer doctrine developed in the NLRA context[596]. Courts have reached across corporate boundaries when management at those companies participated in decision-making which was the subject of a claim of discrimination, or had control over some aspect of the basic elements of the employment relationship (terms, conditions, compensation, etc.)[597]. A few years later a gap was filled by adding an employee's age to that list by virtue of the passage of the Age Discrimination in Employment Act (ADEA)[598]. Here as well courts looked broadly at the involvement across multi-corporate enterprises, finding for plaintiffs where a parent or sister corporation had been significantly involved with the relevant act or decision[599]. As in related contexts, the focus of such inquiries was on the level of integration within such enterprises, and in particular the degree of centralized control of labor matters.

In a similar fashion, the Americans with Disabilities Act (ADA) of 1990[600] rounded out the group of antidiscrimination statutes by introducing similar prohibitions in relation to employees with physical or mental disabilities. Under the ADA, employers are required to make reasonable accommodation to address the limitations which disabled employees face. In enforcing claims under the statute, both the public bodies and the courts look at the broader operational and decisional framework of an enterprise in assigning responsibility for actions or inaction in the face of an affirmative obligation.

5. <u>Environmental Legislation</u>

Having addressed the finance (capital and financiers) and employment (employees) dimensions of the corporation in the 1960's and 1970's, the US Congress next turned its attention to affected things which were unable to directly voice their views on the impact of business activity on them- the elements which make up the physical environment. This came at a time when the environmental

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594 Occupational Safety and Health Act, Pub. Law No. 91-596, 84 Stat. 1590 (1970) [hereinafter "OSHA"]
595 Civil Rights Act of 1964, Pub. Law No. 88-352, title VII §701, 78 Stat. 253 (1964).
596 See McLeod, Piercing the Corporate Veil under Federal Labor Law, at 174-76.
597 Id. at footnote 264 on page 175.
598 Age Discrimination in Employment Act, Pub. Law No. 90-202, §2, 81 Stat. 602 (1967) [hereinafter "ADEA"].
599 See McLeod, Piercing the Corporate Veil under Federal Labor Law, at 176-77.
600 Americans with Disabilities Act of 1990, Pub. Law No. 101-336 (1990) [hereinafter "ADA"].

movement was first taking shape, and people were beginning to realize the essential role played by elements such as air, water, and earth, in a healthy environment for a country's citizens. This period represented a dramatic shift from the mindset of the 18th and 19th centuries, when natural resources were at an entrepreneur's disposal to exploit and develop. Indeed, at that time many even viewed it as man's duty to put such resources to productive use. But the period of industrialization and later mass production revealed the massive impact which business activity could have on such resources. As economists began to appreciate the finite supply of and assign a cost to such resources, and the general public joined in the debate, the legislators reacted as well by introducing a series of laws aimed at better regulating the use of natural resources, and the impact of that use.

i. The Clean Air and Clean Water Acts

Two major steps in legislating environmental protection at the federal level were the Clean Water Act and the Clean Air Act. The Clean Air Act[601] was enacted to address declining air quality, which had become a political issue as pollution began to impact millions of citizens following the post-war economic boom. The federal government recognized the growing impact of urbanization, industrial development, and dramatic increase in motor vehicle ownership and use on both the physical environment and thus on the physical health of citizens. The Clean Air Act aimed to "promote the public health and welfare and the productive capacity of the population[602]" by improving the quality of the air, which had also deteriorated rapidly following the industrial boom of the 20th century. In addition to humans, livestock and crops were also to benefit from the programs to be implemented and regulations to be set[603].

The Clean Water Act was enacted to "restore and maintain the chemical, physical and biological integrity of the Nation's waters.[604]" The Clean Water Act set into motion a number of programs to clean up navigable waters (over which the federal government has jurisdiction given their interstate nature), improve water quality for both people and other living things, and to prevent water pollution going forward[605].

The Environmental Protection Agency (EPA) had the authority to enforce both Acts and monitor the progress made in cleaning up the physical environment of the United States. The programs and regulations introduced to carry out that mission entailed setting acceptable standards for industrial pollutants, requiring technical changes to manufacturing or energy plants to reduce harmful emissions, proposing vehicle admissions standards for motor vehicles, and more. With clear objectives set forth in the legislation, the EPA addressed its enforcement activities to the relevant private sector industries on a broad scale. The legal and organizational structure of a polluter, whether comprised of one or hundreds of corporations, did not get in the way of EPA enforcement. The complexity of some organizational structures, however, could pose a challenge in terms of finding the right party or parties to address. As a federal regulator, the EPA had the advantage of being able to make the first move, addressing the purported correct party in relation to a given action. The burden would then be on that party to address it to another party, if they were indeed the incorrect addressee.

Both the Clean Water and Clean Air Acts are credited with having provided a legal framework for addressing issues regarding the physical environment. Though their detractors questioned the cost-benefit analysis which underpinned the statutes, most commentators agreed that these laws went a considerable way in focusing industry's attention on its current and future activities. One area where the Acts proved somewhat less effective was in relation to addressing polluting activities from the

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[601] Clean Air Act, 42 USC 7401 (1963).
[602] Id. at §101 (a) (4) (1).
[603] Id. at §101 (a) (2).
[604] An Act to provide for water pollution control activities in the Public Health Service of the Federal Security Agency and in the Federal Works Agency, and for other purposes, 33 USC 1251 (1972) [hereinafter "Clean Water Act"].
[605] Id. at §102.

past, particularly the far past. To fill this gap, the US Congress passed a third major environmental statute just a few years later. Given the approach adopted by this statute to deal in particular with multi-corporate enterprises, it is of particular interest to the topics in this dissertation.

ii. The Comprehensive Environmental Response, Compensation and Liability Act

While preventive legislation (such as the Clean Air and Clean Water Acts) went some way in mitigating the harmful effects of industrial activity going forward, it did little or nothing to address the problems created during the period when natural resources were treated legally more as inputs to an industrial process rather than in terms of their broader role in the physical and social environment. By the second half of the 20th century, pollution had taken a large toll on the quality of America's soil in areas of heavy industry. Its water and air resources were also being damaged by the indiscriminate dumping of industrial byproducts into the rivers and air. In 1980 the US Congress decided to react to this situation as well, passing the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)[606].

CERCLA aimed to force the cleanup of contaminated sites by assigning responsibility for damage to land and water resources to those who had either caused it, or had some connection thereto. In a sense, it represented a shift in the mindset of the US public, in that the public good element of natural resources was now being weighed against the public good element of manufacturing and industrial activity. The creation of jobs and provision of infrastructure were not the overriding policy objectives any more, or at least were considered in a more holistic framework. That framework entailed taking both the disadvantages and costs of such activity into account in addition to the societal benefits they brought with it (e.g. employment, tax revenue, consumer and industrial goods). In the vernacular of the economists, the law began to increasingly look at the externalities which resulted from manufacturing and industrial activity, and created rules accordingly.

The Environmental Protection Agency (EPA) was entrusted with the enforcement of the law. The logic of the CERCLA statute was to encourage, and even enforce, the active decontamination of toxic sites across the United States. Often, the acts which resulted in the contamination lay in the distant past. The parties factually responsible for the related decisions, or for carrying out the activities which led to the contamination, may also have been long gone. A major challenge for the EPA was in dealing with situations where the parties currently in possession or ownership of a site may have inherited the contaminated site. Perhaps not surprisingly, there was a range of the levels of awareness of the current parties of the specifics of events which had produced the contaminated site or facility.

In applying the statute to actual situations, courts also had a creative tool at their disposal when looking at corporations and enterprises to which they often belonged. Taking a page from the book of the securities laws, CERCLA also used definitions to sidestep some of the boundaries created by state corporate law in terms of finding liability. It does so by focusing on the so-called "owner or operator" of facilities which have caused environmental damage, and defines such persons as follows:

> *The term "owner or operator" means (i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel, (ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand.*[607]

[606] Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), Comprehensive Environmental Response, Compensa-tion, and Liability Act of 1980, as Amended through P.L. 107–377, December 31, 2002 [hereinafter referred to as "CERCLA"]. .
[607] Id. at section 101, 20(A), pg. 494.

This Act appeared to go even further than prior federal statutes which relied on the control factor to reach across corporate boundaries, if necessary, by adding "operator" to the mix of potentially responsible persons. It also contained a retroactive element in that prior owners or operators could be swept up by the definition. This was done to avoid parties from transferring ownership of equity in or assets of corporations which might be exposed to liability under CERCLA. The CERCLA definition seemed to broaden the exposure of a group of persons who may not have been covered under a strict application of the "control" concept, which often required a certain equity ownership threshold.

Not surprisingly, early on there was a wave of litigation around the scope of the terms "owner" and "operator" as they related to specific environmental contamination sites. In the early years, courts tended to interpret the owner and operator terms rather liberally, leading to a considerable uptick in the cleanup orders compared to attempts under pre-CERCLA laws. But there was some lingering uncertainty regarding the interrelationship between the federal environmental laws and the state laws which defined the boundaries and extent of limited liability protection which corporate laws brought to the equation.

That uncertainty was largely removed when the US Supreme Court decided the *Bestfoods*[608] case. In that case, the Court examined the responsibility of a parent corporation for the pollution damages at a facility owned by a subsidiary under the CERCLA provisions. The Court noted that it was a "*bedrock principle of (US) corporate law that a parent corporation ... is not liable for the act of its subsidiaries*.[609]" According to the Court, CERCLA did not change this fundamental principal, such that a parent corporation could not be held liable under the statute merely because its subsidiary owned or operated a polluting facility. The Court did state that liability could be triggered by one corporation's direct involvement in the actions or decision-making of another. This was the type of direct liability reasoning which had been applied by courts in other contexts.

The Court went on to discuss such derivative liability where a corporation overreaches in exercising whatever control or influence it might have over another corporation. It pointed to the traditional factors considered under veil-piercing theories to examine such issues. But the Court found no basis for "*abrogating*" the traditional common law position, finding CERCLA's silence on that specific point outcome determinative. In the words of Supreme Court: *against this venerable common-law backdrop, the congressional silence is audible*.[610]" Having rejected an approach of "*automatic attribution*" of the acts of one corporation to another, the Court then examined the key terms of the statute as applied to the facts at hand[611].

In interpreting the word "operate" in the parent-subsidiary context, the Court pointed out that there could be grounds for CERCLA liability if, for example, joint officers or directors "conduct the affairs of the facility on behalf of the parent." The same could apply if agents of the parent without any position at the subsidiary managed or directed the subsidiaries affairs in relation to a polluting facility. But the court reiterated the guiding rules for examining such situations, stating:

> "*Norms of corporate behavior (undisturbed by any CERCLA's provision) are crucial reference points, both for determining whether a dual officer or director has served the parent in conducting the operations of the facility, and for distinguishing a parental officer's oversight of a subsidiary from his control over the subsidiary's facility*.[612]"

It is the latter point which especially brings home the evidentiary challenges which face a regulator, even with the benefit of a term like "operate" which may be subject to broad interpretation. Since the party attempting to enforce the statute has the burden of proof regarding such interrelationships, absent clear evidence of overreaching, overcoming the presumptions of the respondent can be very

[608] US v. Bestfoods, 524 US 51 (June 1998) [hereinafter "*Bestfoods*"].
[609] Id. at 61.
[610] Id. at 62.
[611] Id. at 68-70.
[612] Id. at 72-3.

difficult. The testimony of a corporate officer regarding on whose behalf he or she was acting might be the only evidence on which a court's judgment may be able to turn.

The description of the leading precedent above highlights the changes, as well as the limits thereon, which statutory treatment of corporate boundaries may encounter. In practice, CERCLA did not live up to the expectations of its proponents. In applying the statute to identify parties responsible for the cleanup of contaminated sites, the potentially devastating costs which such parties might incur triggered considerable resistance. That resistance came primarily in the form of legal disputes surrounding a party's involvement in decision-making relevant to a case of contamination. Regulators often hailed dozens of parties into investigative hearings, each of which generally brought their legal counsel to accompany any discussions regarding liability. This tendency led to much of the resources related to environmental cleanup actually going to lawyers and other professionals as opposed to actual cleanup efforts.

As a result, after a few years additional legislation was introduced to address this natural defensive tendency of potentially responsible parties. Federal legislation such as the Resource Conservation Recovery Act (RCRA)[613] introduced new approaches to deal with some of the drawbacks of other laws. If an identified responsible party claimed that the cleanup costs for a contaminated site would drive it to bankruptcy, the government could order it to transfer the asset- often without any compensation- to another party. That other party, such as a purchaser, would have to have the financial wherewithal to afford the requisite cleanup. In this way, corporations were able to divest themselves of assets which were tied to considerable liability through a type of temporary state eminent domain. For the main topics in this dissertation, however, the main contribution which environmental laws have made to the liability debates has been in the addition of another conceptual tool (the "owner" or "operator" as the proximate cause in a chain of events) for looking beyond corporate boundaries in carrying out the underlying objectives of the statute.

Except perhaps for the legislative development whereby corporate groups first sprang to life, legislative developments in the form of statutory regulation represent perhaps the second most important in the substantive piercing jurisprudence. To see the extent of the statutory encroachment into the area of veil-piercing, Table Two contains an overview of the main federal statutes and the respective factors.

One can debate whether cases entailing the enforcement of statutes are genuine examples of "piercing" or disregarding, as these terms have traditionally been developed and applied by courts. To set the stage for this analysis, it is worth considering the overall objectives behind the tort and contract segments of the common law legal system. Tort law has traditionally been deemed to have two overriding policy objectives: restitution and deterrence. Restitution refers to the goal of compensating injured parties if they are harmed by the acts or omissions of a person (legal or natural) having a related duty. The deterrence objective, similar to that inherent in criminal law, is meant to influence human behavior, including humans that are involved in carrying out acts on behalf of corporations. The policy objectives of contract law, on the other hand, are primarily economic in nature. Substantive contract law aims to promote economic activity, providing a basis for efficient and mutually beneficial cooperation between persons, both natural and legal.

The objectives of specific statutes, by comparison, cover a wide range of generally much more detailed desired end results. Some may address a general, overarching concern, such as the condition of the environment (e.g. CERCLA, Clean Water Act, Clean Air Act). Others focus on the structure of the macroeconomic environment and the interaction of persons (legal and natural) therein (e.g. the securities and antitrust laws). Within the economic sphere, some statutes may focus on specific industries, particularly those deemed to entail a strong "public dimension" (e.g. utilities, energy, transportation, communication). Digging one layer deeper within the organization, other statutes focus on the individuals working within it, addressing issues such as working time, physical

[613] Resource Conservation Recovery Act (RCRA), 40 CFR 239-282 (1976) with parallel legislation at the state level, notably in New York.

conditions, psychological environment (e.g. laws addressing discrimination), or means for addressing disputes with the employer (e.g. the right to strike).

So is there any interrelationship between the executive and the judicial approaches in areas where regulatory law plays a significant role? The very nature of these more specific policy objectives makes cases in this area worthy of further study. In particular, the interrelationship between actions taken in this area (e.g. legislative and judicial action) and the approach to piercing in the non-statutory context would be an interesting subject of empirical research by itself, but is beyond the scope of this dissertation.

B. The State Law Dimension

One of the most significant developments in the liability area emerged not at the federal, but at the state level. Nor did it originate from the executive branch, but instead, interestingly, from the courts during a period of considerable judicial activism. In the 19th century, when the young nation of the United States was first grappling with the policy issues surrounding limited liability, economic survival and growth were the key priorities of both government and business[614]. Industrialization was still in its early stages, and large scale manufacturing was just beginning to take root. Society seemed more focused on the great benefits which these developments brought with them (e.g. employment, prosperity, decreased dependence on the former colonial master). There was not enough experience with industrialization yet to have a good idea what economists might call the "externalities" (social as well as physical) which it created. Not surprisingly then, as corporate charters increasingly dealt with manufacturing activities, the weighing of advantages and disadvantages favored a decision for limited liability. The impact on physical safety and the environment was too ambiguous at this early stage to play a key role in the debate. The one worker issue which did gain some attention early on related to rules to secure the payment of wages. And even that was another example of the emphasis on the economic dimension of manufacturing to the near exclusion of other aspects.

In addition to the focus on the financial aspects of economic development, the common law also historically stood in the way of a more liberal rule of liability attribution. The traditional rule regarding holding somewhat responsible for injuries they caused or contributed to, for example, was rooted in the contract law principles of the time rather than in tort law. Contract law brought with it the cornerstone concept of privity of contract, essentially a restriction against asserting claims against anyone other than a direct contracting party[615]. The classic case setting out this rule was *Winterbottom v. Wright*[616], an 1842 English case in which a passenger injured in a stagecoach accident attempted to sue the coach operator and the repairman for breach of warranty, as well as the postmaster general, who administered the route. Factually, the fault lay with the repairman, Mr. Winterbottom, who was an independent contractor of the carrier. Under the applicable English law of the day, that was enough for the Court of Exchequer to reject Mr. Wright's claim, since his ticket- which constituted the contract for transport- had been concluded with another party. The words of the presiding justices both summed up the legal view of the day and signaled the changes that would have to come before injured parties would be able to recover against anyone other than immediate contract parties:

> "*The only safe rule is to confine the right to recover to those who enter into the contract: if we go one step beyond that, there is no reason we should not go fifty.*[617]"

> "*There is no privity of contract between these parties; and if the plaintiff can sue, every passenger or even any person passing along the road, who was injured by the upsetting of*

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[614] For further detail on this period and its impact on the development of liability rules, see "The Massachusetts Example" in Section III C. 3.
[615] For further coverage of these issues, see David A. Moss, When Government Fails, Chapter 8, Product Liability Law, at pgs. 218-220.
[616] 10 M&W 109 (1842).
[617] Id. Concurring opinion of Baron Alderson.

> *the coach, might bring a similar action. Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit, would ensue.*[618]"

The quote reflects a clear policy choice favoring operators and carriers over consumers. Progress was deemed more important than personal safety, and in the words of another of the presiding justices considering the hardship on the plaintiff: "*Hard cases … are apt to produce hard law.*" This view was initially shared by American courts ruling on similar "hard cases," feeling themselves equally bound by the strict application of traditional common law boundaries on recovery. The cases in this area from both sides of the Atlantic reflected a "tough luck" view regarding injuries suffered by plaintiffs, even the classic innocent bystander. In addition to the social sentiments of the period, the rulings may also be a reflection of the relatively stratified nature of society. Wealth was limited and concentrated within a relatively small segment of society, and this group had considerable influence in terms of political and legislative developments. It would take another century, and a considerably different United States, before chinks in the armor of the "privity of contract" barrier began to appear.

1. Product Liability Law- §402A Restatement of Torts

By the time the next liability law milestone came, the economic, political, and social context of the United States had changed quite dramatically. Instead of being relatively new on the corporation scene, manufacturing businesses were now the norm. With the "New Jersey breakthrough", dozens or even hundreds of corporations were able to legally link together into massive groups. Often each constituent part played a specific role in the overall business enterprise. Politically, the United States population grew increasingly diverse, thus influencing the tone and substance of politics. Innovation in communications and transportation meant that people were much better informed than in the past, with information travelling at a much faster pace.

This set the stage for the next phase in the evolution towards more liberal liability rules. As mentioned above, tort law began to encroach on ground that was traditionally the purview of contract law. Courts began to chip away at the hard-and-fast privity of contract rule, long a barrier to successful recovery for tort claimants. Exceptions were introduced for injuries traceable to inherently dangerous goods, a reflection of the gradual recognition that humankind's interest in bodily integrity might- in some cases- outweigh the desire for economic advancement. Similarly, damages resulting from defective equipment could be the subject of a claim, but generally only if such equipment was used at the owner's invitation. The next step in this trend was to permit claims against defendants for failure to adequately warn about defects in a product. The gradual elimination of the privity of contract requirement set the stage for strict product liability, which ignored corporate boundaries in its own way. Over time the frame of reference in such cases became the overall chain of production and distribution rather than solely the boundaries of a particular corporation in that chain.

The final nail in the coffin of the privity-of-contract barrier was the court's decision in a case involving an injury resulting from perhaps the 20th century's most significant product innovation- the automobile. In 1916 the New York Court of Appeals decided a claim against a car manufacturer (Buick) for damages suffered as a result of defective wheel spokes which had been acquired from a third party supplier[619]. The case involved a plaintiff who at the trial level was stymied in recovering for injuries against the dealer which sold the car. Under the prevailing common law doctrine of privity of contract, the plaintiff generally would have been unable to recover damages against the manufacturer. But the Court broke new legal ground in holding that Buick had an affirmative duty to inspect the quality of the component parts before they were assembled into its final product and offered to the public. This began the rapid end of companies' ability to hide behind the contract privity liability shield. This erosion of a long-held common law principle presaged the veil-piercing jurisprudence in relation to corporate boundaries introduced by the courts a few years later.

[618] Id. Opinion of Lord Abinger, Chief Baron.
[619] MacPherson v. Buick, 217 N.Y. 382, 111 N.E. 1050 (1916).

The *MacPherson* decision marked a turning point in both the judicial and the societal calculus regarding the risk allocation philosophy. That philosophy had underpinned the traditional protection of corporations from liability based upon the contractual "distance" from between claimants (generally consumers) and respondents (generally producers or manufacturers). It also represented an elevation of the relative interests of the individual, in particular the individual's interest in bodily integrity, and the "right" not to be overly exposed to dangers of physical harm. In the words of the court:

> "*We have put aside the notion that the duty to safeguard life and limb, when the consequences of negligence may be foreseen, grows out of contract and nothing else. We have put the source of the obligation where it ought to be. We have put its source in the law.*[620]"

Following this ruling, plaintiffs asserting claims for damages resulting from manufactured goods increasingly did so through tort law. The significance of this judicial paradigm shift later prompted one legal commentator to herald "the Death of Contract.[621]" This incremental erosion of the privity of contract barrier had repercussions for the corporate limited liability debate. After all, what was a corporation but a contract between the state and the proponents of the business which the corporation housed? Even the relationship between the individual citizen and the state had long been described as a contract- the "social contract.[622]" As with the social contract, the privileges accorded a group of individuals- such as the owners of a corporation- came with responsibilities. In the event these responsibilities were not met, the state had every right to retract or condition such privileges.

Other courts nationwide quickly adopted the reasoning of the New York court in MacPherson, and soon manufacturers where faced with a much different liability exposure scenario. It would take several decades, however, for product liability law to take on the shape we know of today. In the interim, courts continued to rely on judicial safety valves such as "veil-piercing" to deal with especially hard fact patterns. Both of these judicial innovations still required the plaintiff to meet a heavy burden of proof, which both discouraged the assertion of claims, and led to the defeat of many asserted claims. And even with the shift to tort law, the challenges posed by proving the substantive requirements of negligence claims- existence of a duty, breach of that duty causing damages- often stymied injured persons in seeking recovery.

As both judicial and societal thinking on the intrinsic risk allocation policies behind tort law in America evolved, the balance continued to move in favor of the aggrieved individual who had suffered injuries on account of the perceived irresponsible behavior of the large, impersonal corporate behemoths. The next milestone came in 1944 when a California court decided to bypass the negligence requirements altogether. In that case against the Coca-Cola Company, a plaintiff injured by an exploded bottle was permitted damages despite the inability to prove that the manufacturer defendant corporation had been negligent in any way[623]. Unlike in the past, the plaintiff did not have to prove the specific cause of the accident, but merely that the responsibility for the circumstances - judged objectively on the underlying facts- must have rested with the defendant corporation. In the words of one judge in his concurring opinion:

> "*... I believe the manufacturer's negligence should no longer be singled out as the basis of a plaintiff's right to recover in cases like the present one. In my opinion it should now be recognized that a manufacturer incurs an absolute liability when an article that he has placed on the market, knowing that it is to be used without inspection, proves to have a defect that causes injury to human beings... Even if there is no negligence ... public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to*

[620] Id.
[621] See Grant Gilmore, The Death of Contract, 2nd ed.
[622] This line of reasoning is generally attributed to Thomas Hobbes in his 1651 work Leviathan. The general concept was further developed by thinkers like John Locke and Rousseau.
[623] *Escola v. Coca-Cola Bottling Co.*, 24 Cal.2d 453, 150 P.2d 436 (1944).

life and health inherent in defective products that reach the market. It is evident that the manufacturer can anticipate some hazards and guard against the occurrence of others, as the public cannot ... [The] risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business ... Against such a risk there should be general and constant protection and the manufacturer is best situated to afford such protection[624]."

This lines of cases introduced what came to be known as the "stream of commerce" doctrine. With this and similar decisions, courts wiped away centuries of common law which had made it nearly impossible for injured plaintiffs to recover against defendants who were able to raise the corporate wall defense. During the 1960's and 1970's, as the US economy and the reach of US corporations expanded considerably, voices for consumer protection were growing louder and impacting both the public discourse and the trends in the civil courts. The expansive trend of product liability law continued and culminated in the introduction of §402A of the Restatement of Torts. This entailed a strict liability approach for persons with proven involvement in the chain of production and distribution. The next stage in the evolution of this area of the law was in finding liability even where a plaintiff could not prove a direct link to a particular defendant.

2. Market Share Liability[625]

After the erosion of the up till then bedrock principle of privity of contract, it appeared that the boundaries of the common law of liability had been stretched to their systemic limit. The strict liability approach of product liability reflected a repositioning of legal norms to reflect the more complex manufacturing and distribution environment of the 20th century. There did not seem to be more room for legal norms to be stretched further without breaking fundamental tenets of the common law. But as with the development of veil-piercing, the common law showed its dexterity with a seemingly impossible next step- holding persons liable even in the face of uncertainty regarding their factual culpability.

The background for this next stage of the evolution of liability law was the terrible injuries suffered by consumers of pharmaceuticals which turned out to have serious side effects. The drug at the center of this development was diethylstilbestrol (DES), which had been approved by the US Food and Drug Administration (FDA) for the treatment of several medical conditions in women[626]. After further research DES was also marketed to mitigate the risk of miscarriages. The drug began to be sold on a wide scale, including by several manufacturers of generic versions once the patent had expired.

It was only after the children of consumers of DES began to mature that the true risksof the drug began to become clear. Only after several decades of widespread use did the FDA require manufacturers to inform health care providers about the dangers of prescribing DES for the treatment of miscarriage risk. As it turned out, daughters of women who took DES during pregnancy faced a much higher risk of developing certain types of cancer. They became known as "DES daughters," and their numbers were estimated to reach anywhere from half a million to several million.

The class of persons affected by the negative side effects of DES had a major legal obstacle in seeking compensation to cover the resulting medical injuries. Because of the nature of the marketing and distribution of the drug, it was often impossible exactly which company was responsible for the specific DES product taken by a particular plaintiff. Normally, this would have resulted in a case being dismissed despite the hardship on the plaintiffs. But the lawyers representing the class of DES

[624] Id.
[625] This section draws upon the following sources in particular: Mark A. Geistfeld, The Doctrinal Unity of Alternative Liability and Market-Share Liability, 155 U. Penn. L. Rev. 447; Clifton Perry, Tort Reform and the Market-Share Rule, 7 Cato Journal 2 (Fall 1987); Andrew B. Nick, Market Share Liability & Punitive Damages: The Case for the Evolution in Tort, 42 Columbia J. of Law and Social Problems 225.
[626] For further background see Clifton Perry, Tort Reform and the Market-Share Rule, Cato Journal Vol. 7 No. 2, pgs. 450-51 (Fall 1987).

plaintiffs proposed a novel theory of recovery to the court: the whole DES-manufacturing industry shares in the fault, such that all of them should be required to join in the compensation. The tool they proposed for doing so came to be known as “market share liability.” Companies who were found to have produced the dangerous good during the relevant time frame could be asked to provide funds in proportion to the level of their involvement in that particular market segment.

The court in this milestone case accepted the liability theory put forward by the plaintiffs, thus easing the usual burden of proof rules in common law litigation. It was sufficient for plaintiffs to provide evidence regarding a group of defendants' collective involvement in an activity (here the manufacture and sale of pharmaceuticals) which could be inherently dangerous to human life and limb. That would then shift the burden to the group of defendants to exculpate themselves by offering countering evidence which could prove their non-involvement, or a level of involvement much lower than that claimed by the class of plaintiffs. In short, the theory represented a reversal in the normal procedural rules regarding burden of proof.

The proxy used for the lack of evidence of direct and specific culpability was the share of a given defendant in a given market. This approach brought with it certain problems, starting with the definition of the relevant market. It also tended to reward defendants who had practiced better record-keeping over the years, generally large corporations compared to their smaller competitors. Nonetheless, it represented another example of the common law system's malleability and creativity in addressing new situations. It also was another step in the long, gradual, march of weighing the interests of the masses more highly relative to corporate actors compared to the jurisprudence of the prior century.

Examining the developments in this area at the state level over several decades yields the following conclusions:

- A mass impact was generally necessary to provide the grounds for a new legal milestone (e.g. the creation of strict liability in product liability).
- A critical mass of proponents with sufficient influence and determination was necessary to move the discussion forward
- Momentum and public opinion were crucial to success

At this point it is worth reviewing the key factors which have contributed to making the social and political context at any given time ripe for the next milestone or stage of evolution. Examined against the backdrop of history, three primary drivers appear to determine the likelihood of legal reform (i.e. a significant change in the status quo):

1. the public opinion regarding the need for change,
2. the adequacy of the political and legal machinery for reform, and
3. the response of the legal profession[627].

The first factor can be gauged to some extent by the extent of the freedom of the press and the active journalistic pursuit of legal reform topics. Periodically there were key thinkers pushing public opinion in the direction of change[628]. In the 19th and 20th centuries, special interest groups began to complement if not replace individual thinkers as drivers of political and legal change[629]. The second relates to the willingness of a particular government to expend limited legislative resources on topics

[627] See A.H. Manchester, Modern Legal History (Butterworths), at pgs. 10-20 [hereinafter Manchester, Modern Legal History].
[628] Id. at pgs. 12-15 (describing the influence of Jeremy Bentham and his contemporaries on legal reform efforts in the late 18th century).
[629] Id. at pgs. 406-407.

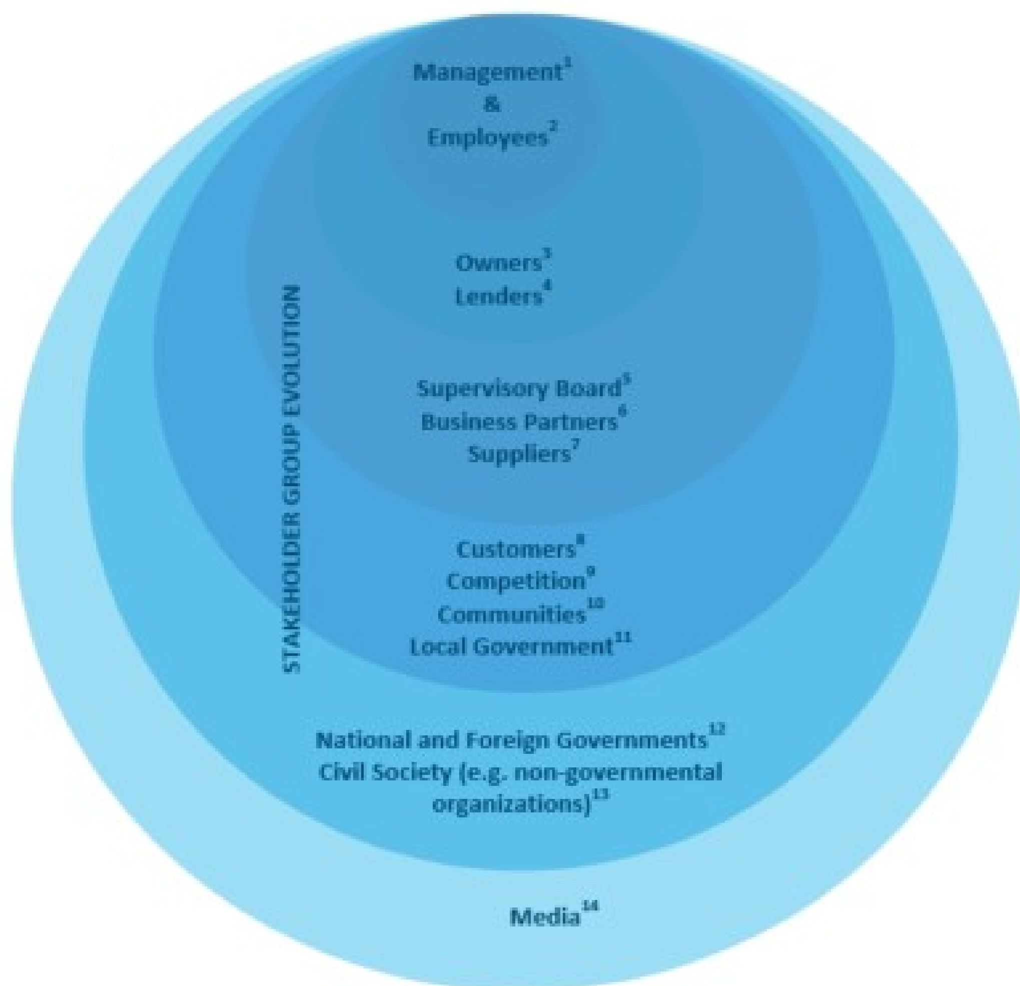
of legal reform. In general, the political system tends to follow rather than lead public opinion, as historically reform of the law "has rarely been a vote winner.[630]"

The third recognizes the instinctive conservatism of the legal profession, generally trained to prefer gradual steps over wholesale reform of longstanding legal doctrine and traditions. The legal profession was often subject to pressures of showing loyalty to the incumbent system as well as its own self-interest in the complexity of (particularly procedural) law[631]. As the influence of the legal profession grew, so did the role of its members in relation to any legal reform efforts. On occasion, other components of the legal system, such as the jury or judges, could be an instrument for change[632]. But juries and judges decide individual cases, and it takes the legislature to make lasting modifications to legal rules.

All three of these drivers must be viewed against the backdrop of the specific stakeholder situation at a given time. The diagram on the next page is meant to highlight the stakeholder context, so important to the prospects for change. The various milestones described in this dissertation can be viewed through the lens of these three factors. Their collective support or neutrality with respect to a given initiative or change determined the final outcome as well as the level of struggle needed to achieve the desired change, for example:

Milestone	**Role of general change drivers** **1) Public opinion** **2) Political and legal machinery of reform** **3) Stance of the legal profession**
Advent and general acceptance of the corporate vehicle	1) and 2) relatively neutral and 3) relatively underdeveloped at the time such that played no major role, hence long period for evolution towards general acceptability
General incorporation	1) and 2) net supportive and 3) relatively neutral such that introduction took place in a relatively short time period once the issue had become one of general public and political debate
Limited liability for corporations as a general default position rule	1) and 2) net supportive and 3) relatively neutral such that introduction took place in a relatively short time period once the issue had become one of general public and political debate
Multi-corporate enterprises	1) rather split in US, 2) net supportive, and 3) actively facilitating in specific states (NJ, NY) such that legislative change occurred in rather short period with eventual spread nationwide. Not a major issue in UK.
Private action veil-piercing	1) vaguely informed and concerned but without proposals, 2) not yet sufficient to induce change, 3) active but sporadic role by judiciary in creating case-specific exceptions to general rule of limited liability
Public action veil-piercing	1) vaguely informed and concerned but without proposals, 2) active and concerted role by legislature in creating area-specific exceptions to general rule of limited liability and enforcement by administrative agencies, 3) split, depending upon general stance on respective area, i.e. whether tending to be active in plaintiff's bar or defense bar

[630] Id. at pgs. 402-404.
[631] See Chapter 9, The Nineteenth Century: Liberalism and Reform, in Plucknett, A Concise History of the Common Law, at pgs. 73-74 (citing Sir Thomas Erskine May about the dangers to lawyers of *"[questioning] the perfection of English jurisprudence"* as *"..a political heresy which could expect no toleration."*). Id. at 73.
[632] Manchester, Modern Legal History, at pgs. 406-07 (noting the trend of juries deciding in such a way as to reduce the number of offences subject to the death penalty).



The increasingly complex context of stakeholder groups

1. ranging from owner-managers to professional managers in large companies
2. dramatic evolution in gradations of employee and employee rights
3. ranging from active owner-managers to passive investor-shareholders
4. dramatic evolution from debt as sole/primary source of financing to many variations of equity financing
5. ranging from self-supervision in small companies to a separate and independent supervisory board in large, public companies
6. increasing use of collaboration with third parties to conduct business operations
7. increasing integration of suppliers into company operations (e.g. supply chain)
8. with owners and employees, the third essential component, with dramatic evolution in consumer rights
9. antitrust/competition law has signficantly impacted the dynamics of competition
10. dramatic evolution in the involvement of communities (incl. social media)
11. particularly important for regulated businesses
12. particularly important for regulated businesses operating cross-border
13. often impacting or even interacting with governments
14. dramatic evolution of financial, consumer, and general media necessitating public relations function for some companies

Diagram I Stakeholder Groups

As highlighted above, the net impact of these three drivers generally determines the pace and extent of any modification of the legal status quo. Collectively, they represent the general attitude toward law reform at any point in time. The final result of any law reform effort is generally a product of "the eternal debate concerning both the speed with which it is desirable to introduce change and whether that change should be systemic or situational. This informs the debate around just how radical that change should be.[633]" The framework is worth keeping in mind in the final section's review of possible further iterations in the law of corporations in general and limited liability rules in particular.

C. The Impact of Public Action Veil-Piercing on Limited Liability

The increasing legislative activity described above and termed "public action veil-piercing" is another sign that the traditional binary limited liability regime in corporate law has inherent structural deficiencies. The slow and steady march of both federal and state statutes covering specific activities indicates that the public policy choices which drove the initial introduction of limited liability no longer enjoy the same weight today. Each statutory exception represents a chink in the armor which limited liability protection has meant for corporate actors since around the mid-19th century.

Each topical area for which a legislative exception to limited liability was created represents a decision to change the law in order to address certain externalities of corporate activity, which would otherwise fall upon the general public. Examining this in relation to the examples covered above reveals how lawmakers, like the judges in relation to private veil-piercing, wish to redirect liability for the general risk of harm or injury to persons who have an intentional and voluntary connection to a particular business which is factually creating or contributing to those risks. A graphical depiction of this phenomenon of statutory "crowding out" of the veil-piercing space is shown on the next page[634].

The federal anti-trust and bankruptcy laws, introduced at the end of the 19th century, aimed to address some of the externalities of the capitalist system itself. The former did so by addressing concentration of economic power, while the latter attempted to more equitably divide up the remaining assets of a failed business. Prior to the implementation of such laws, the rougher edges of capitalism tended to place operative business risks on those least able to protect themselves. Similarly, the host of capital markets laws and direct regulation of the securities markets initiated in the 1930's were meant to address the externalities of the capital-raising function of business. This it did through the heightened disclosure requirements as well as the direct liability provisions outlined above. Both these measures had the objective of increasing investor protection in an era of broadening participation in the investment markets.

The range of employment laws which looked beyond corporate boundaries aimed to address the unequal bargaining power of the individual employee compared to the employer, particularly the large corporate employer. They thus address the externalities which can exist in the labor markets. The environmental law category, on the other hand, has as its main objective the prevention or remedying of externalities of the physical goods production process. The stated beneficiaries are both the general public, which has an interest in a healthy physical environment, as well as animals, other living things, and the very ingredients of nature, which have no influence over the activities of man.

Finally, at the state law level, the rules around product liability as well as the innovative liability theories for especially dangerous products attempt to address the externalities arising from the use and existence of certain end products. As with the other categories outlined above, these also have as a common feature the attribution of responsibility for activity, and hence liability, beyond the strict legal boundaries established by corporate law. Having now thoroughly investigated the intricacies of both private action and public action veil-piercing doctrines, it is time to step back and consider the collective impact of these developments on the underlying policies behind rules of liability in relation to legal persons such as corporations.

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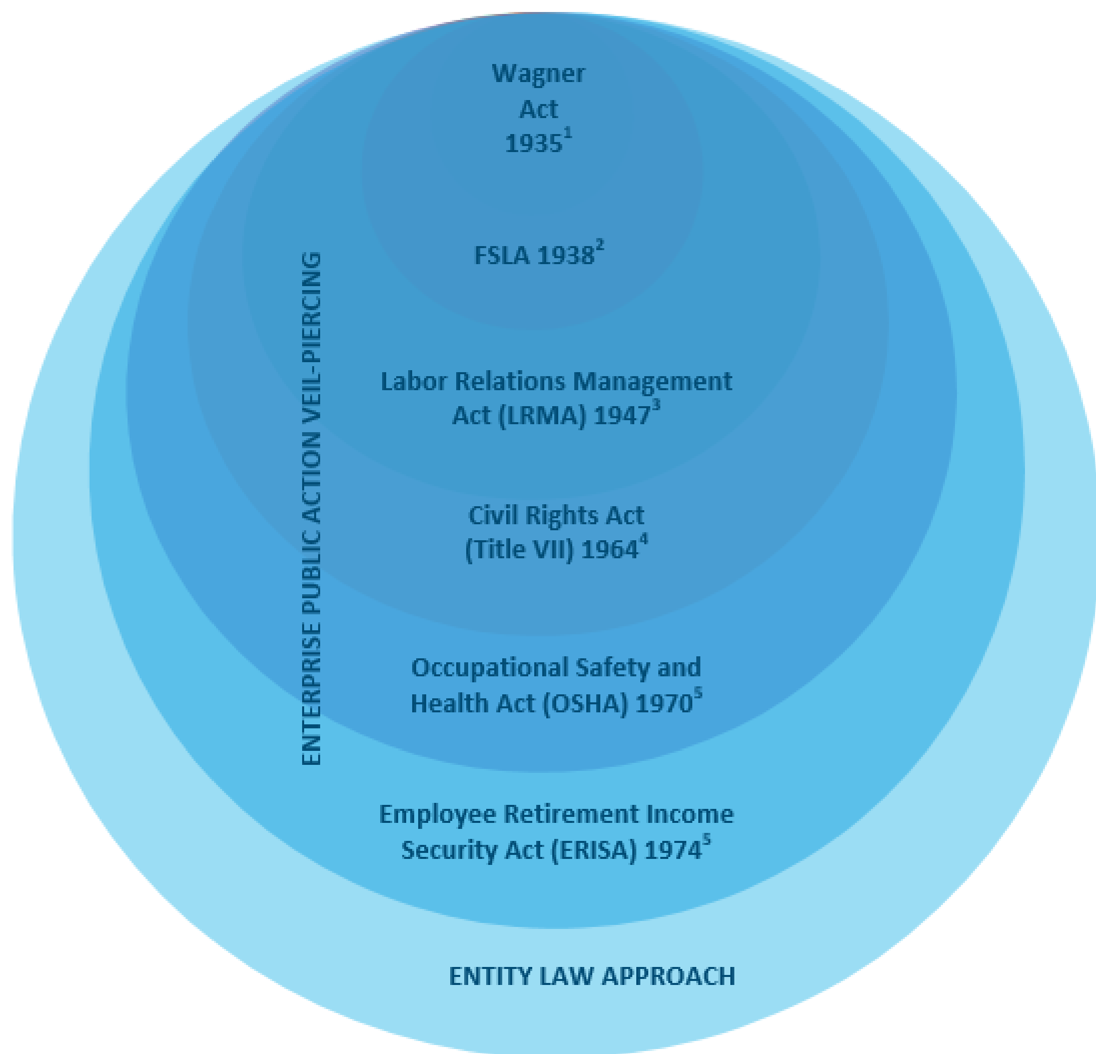
633 Id. at 410.

634 The proportions are suggestive only. The key point of the diagram is to show how enterprise law principles began to occupy more and more of the veil-piercing decision-making space.



Gradual spread of enterprise approach (here: single employer doctrine) over time

1. National Labor Relations (originally Wagner) Act- labor relations
2. Fair Standards of Labor Act- working conditions and hours; compensation
3. Labor Relations Management Act- labor relations
4. Title VII of the Civil Rights Act 1964- nondiscrimination
5. Occupational Safety and Health Act 1970- workplace safety
6. Employee Retirement Income Security Act 1974- retirement benefits

Diagram II Public Action Veil-Piercing Encroachment

VII. Understanding the Overall Company Liability Landscape

The evolution of piercing in the civil litigation context, the experiments with enterprise law in a couple US jurisdictions, and the dramatic developments in administrative regulatory law collectively beg the question of whether these are signs of a general trend towards enterprise liability, i.e. attributing liability across corporate boundaries. Might the growing list of exceptions some day swallow the otherwise sacrosanct default rule of limited liability? At what point does the resulting systemic administrative burden (e.g. litigating piercing cases) of defending the status quo outweigh the traditional fidelity to limited liability as a so-called "essential" characteristic of the corporate form? To examine that topic, it is worth taking a deeper look at what the tools currently employed by US courts do in practice. In other words, what is the practical impact of a court deciding to pierce, or lift, a corporate veil in the civil law context, or applying statutory tools to cover a broader enterprise extending across multiple corporations?

A. Piercing in Operation

The development of a "safety valve" to deal with specific cases was not the first time the common law opted for an exception to deal with the perceived rigidity of applying a one-size-fits-all rule. Indeed, the body of law which became known as equity arose to provide some flexibility to decision-makers and avoid the potentially harsh consequences of applying a default rule to all fact patterns, regardless of their particular nuances. In evaluating the normative value of the specific equitable doctrine of piercing, it is useful to consider exactly what is, and what is not, happening when a court rules in favor of plaintiff's request to collapse otherwise valid legal structures for the purpose of attributing liability and requiring payment or some other action when deciding a given case.

First of all, courts generally do not initiate a discussion of piercing or disregarding on their own initiative, at least not in the standard tort or contract case. They may be more proactive when dealing with the application of statutes, but this is understandable given their somewhat different remit in such cases. In other words, there may be more leeway for courts to find "piercing-related" issues when ruling on a cause of action sounding in statute. This derives to a large extent from the different piercing tools available under many statutory frameworks compared to the common law framework applicable to pure contract or tort claims.

In some ways, the terminology which has come to prevail in this area of the law is potentially misleading. When a court decides to pierce a corporate veil, this almost suggests that it is tearing it down for good. The suggestion is less strong in relation to the term "disregarding", because the action is more clearly linked to the specifics of a particular case. It is creating one legal fiction- "piercing" or "disregarding"- to address the flaws of another legal fiction, the legal person, which triggers the issue. Whichever term is used, in reality what is happening is that the court is focusing on the ends (e.g. fairness, broad notions of justice and equity) to justify the means.

In the tort context, the court is essentially expanding the pool of assets available for recourse for an aggrieved plaintiff. In the contract setting, the court is often preventing form (e.g. express contract parties) to prevail over substance by "redefining" the scope of responsibility regarding how a contract should be performed compared to its actual text. It does so by effectively writing in additional parties to the contract which gave rise to the dispute. Finally, in the statutory context courts are subordinating the importance of formal legal structures to overriding policy concerns and objectives inherent in specific statutes. This is often made easier through instruments such as the "control" trigger in attributing responsibility for the effects of corporate conduct.

The above points highlight the "one-off" nature of corporate veil-piercing. Where courts "pierce" or "disregard" corporate boundaries, this is always in relation to the specific facts of each given case. There is a limited scope of time- in essence a legal second- during which the veil of limited liability protection is lifted or "pierced." The existence of the legal person with its limited liability is not disputed in relation to any other situations or contexts. No changes are made to the public registry

containing information about the corporation. In fact, aside from the possible publication of the opinion by the court[635], the act of piercing or disregarding is not even communicated to the general public. There is no scarlet letter which corporations must "wear" on their websites or other forms of disclosure. In most cases, the corporation or corporations in question continue to carry on- from a legal perspective- without any real change to their form or substance. The executives in charge may adjust the corporate behavior to address the risk of piercing in the future, but otherwise, the act of piercing or disregarding is indeed at the conceptual level, reflected at most in a written judgment or regulatory ruling.

This raises an interesting question regarding the potential impact of a decision to pierce or disregard in a given case. In theory, it is possible to trace the two key dimensions of piercing jurisprudence, the structural (i.e. legal entities and relationships, including their financial structure and condition) and the behavioral (i.e. the decision-making apparatus as well as the actual decisions which led or contributed to the act or omission connected to the injury or harm which is the subject of the complaint). The former are reflected in company filings required by law, while the latter should be documented as records in the ordinary course of business.

Presuming the collective evidence supports a decision for veil-piercing, what does that mean for other similarly-situated-persons who may have suffered similar injuries or harms as a plaintiff who makes a successful piercing argument? Can they avail themselves of the ruling to have it apply to their own particular facts? What if the facts are slightly different, but the key legal question (e.g. undercapitalization, overreaching by management of one corporation into the affairs of another) has been decided affirmatively by a court? Can such rulings be plead as *res judicata* to support other causes of action which involve the same elements, or rely on some of the same evidence? If there is a nexus or "knock-on effect", one can better understand the relative paucity of reported cases in this area. Defendants would have an even greater incentive to settle a case rather than risk setting a precedent for liability, possibly in relation to a much larger group of claimants. While the evidence on the above interrelationship is primarily anecdotal or theoretical, for many other aspects of veil-piercing there is considerable empirical evidence.

B. Empirical Studies on the Nature of Piercing

Despite the widespread attention and sometimes heavy critique, "piercing" jurisprudence has stumbled along its way for decades. Though the factual situations in which the piercing issue might be disputed increasingly appear to be crowded out by other legal developments[636], these have not completely displaced piercing. To understand just how disruptive (according to its critics), or well (according to its proponents) the piercing fiction has functioned in the US legal system, some commentators have performed empirical research both to flush out individual issues as well as to gain a better understanding of how piercing is applied in practice by the courts. This section shall review some of the major empirical studies done in this area.

One of the first major empirical studies of piercing jurisprudence was conducted by Prof. Robert Thompson [then] of Washington Law School[637]. Thompson reviewed the decisions in about 2000 individual cases from the early 1900's through 1985 which addressed the topic of piercing. By classifying various factors related to each case, Thompson and his research team were able to identify possible patterns and trends. This groundbreaking study provided some real-life evidence of some of the hypotheses related to the functioning of piercing jurisprudence in practice. The individual findings of the study are summarized below and discussed in relation to the topics in this dissertation:

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[635] Not all decisions of US courts are published, such that any research is generally based only on the population of published judgments.
[636] In particular product liability law and, to some extent, statutory developments. These are discussed in Section VI above.
[637] *Piercing the Corporate Veil: An Empirical Study*, 76 Cornell Law Rev. 1036 (1991).

Finding 1- Frequency: Courts pierce the corporate veil in about 40% of reported cases[638].

Given the long period of evolution before limited liability became the norm, this statistic appears rather favorable to plaintiffs (especially in light of the reported influence of *Salomon*-type jurisprudence). Naturally, the fact that a dispute made it into the study generally indicates that the underlying facts were likely favorable to the plaintiff. In other words, the plaintiff (or plaintiff's attorney) made a risk calculation or professional judgment regarding the extent to which the case matched the evolving "pattern" (however nebulous in the absence of empirical research) of past piercing cases. The study itself pointed out that there may be many more cases involving relevant fact patterns where the parties decided to settle rather than incur the risk and costs of litigating the issue[639]. At the very least, the plaintiffs in these reported cases analyzed thought they had a good case for piercing.

Even accounting for the fact that the study does not reflect cases which were settled or never brought to trial, the success rate appears at first glance surprisingly high. As highlighted in the section covering the origins of piercing jurisprudence, the disregarding of the legal separateness of the corporation was meant to cover truly "exceptional" cases involving "extraordinary" circumstances. In this connection it is worth recalling the number of actual litigated cases uncovered by the research. While the overall success rate may be high, the absolute number of cases (1583) is arguably miniscule when one considers the overall level of (contractual and non-contractual) contacts and relationships between persons (all potential plaintiffs) and corporations (all potential defendants) in the US over the roughly 80-year period of the study. Broken down by underlying cause of action, the research reveals only 779 instances where a plaintiff decided to contest the legal separation of companies in a contract setting. Only 226 fact patterns covered in the research period related to causes of action sounding in tort.

One may hypothesize as to the reasons behind the numbers. One obvious reason may be the incentives for defendants to settle such cases, particularly if there is a risk of the "disregarding" in one instance might facilitate the same treatment in others. Whether there is a possible nexus between decided cases and potential disputes is an interesting subject, but one beyond the scope of this dissertation.

Finding 2- Consistency over time: The rate at which piercing occurs is very consistent over time.

Despite all the complaints about the lack of predictability afforded by the various piercing theories and tests, the courts themselves have been rather consistent in terms of the frequency of piercing over time. For the three decades leading up to the study's publication, and for the roughly half-century which preceded it, piercing requests were approved in a very narrow band of 38.6%-41.1%. This was the period during which the piercing tests evolved from their metaphorical origins to short "laundry lists" of factors and in some jurisdictions rather complex multi-factor balancing tests. The fact that the piercing statistic remained so stable suggests that courts may indeed have a core idea of what factors are most relevant to support a decision for disregarding the corporate boundaries inherent in the limited liability status. They may also suggest that the increased complexity of the piercing tests do not significantly change the underlying dynamics of the factfinding-based litigation context.

In addition, it is worth keeping in mind the changes in both the legal landscape, particularly the encroachment of other areas onto the "piercing" arena[640], as well as the underlying changes in the litigation system over these periods. For example, the plaintiff's bar has grown significantly over this period both in terms of sheer numbers as well as in terms of the mechanisms available to provide potential plaintiffs access to the litigation system. Taking that into account, the level of sophistication

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[638] Id. at 1048.
[639] The research methodology and possible selection bias is discussed on pages 1045-47.
[640] In particular product liability law and, to some extent, statutory developments. These are discussed in Section VI B above.

may be growing and the percentages in the study may understate the true level of private action piercing in the later periods.

Given the number of factors which might play a role here, as well as the level of complexity today compared to the 1920's and 1930's (i.e. at the origins of the piercing jurisprudence), it is difficult to draw any definitive conclusions from these findings. Again, the relatively small number of litigated and reported relevant cases is worth keeping in mind. The study revealed only 130 relevant cases prior to the 1960's, despite this being one of the busiest periods in terms of the creation of corporate groups. Thereafter, the number appeared to be steadily climbing (399 in the 1960's, 572 in the 1970's, and 484 in the period 1980-1985 alone).

One would expect the number of cases to generally trace the rate and level of interaction between both natural and legal persons in a society over time. An expanding society and growing economy would suggest more opportunities for such interaction to result in controversies. Against the backdrop of more complex multi-corporate enterprises, the challenge for plaintiffs in finding a defendant against whom judgment could be recovered would grow in tandem. Moreover, although courts and commentators were constantly tweaking the recommended tests for piercing, the broader inquiry regarding who is responsible remained relatively unchanged. Thus, given the relatively high probability of success for "good" fact patterns, absent any changes in legislative or judicial policy in this area, a degree of stability could be expected. There may be a natural evolution in the sophistication of participants on both sides of piercing litigation, leading to a relatively stable success rate. Beyond that, it is difficult to draw any more specific conclusions from this finding of the study.

Findings 3-5- Consistency across courts and within court appellate systems: The percentage of cases in which piercing occurs is relatively consistent irrespective of whether the decision is from a federal or state court, trial or appeal court, or whether the plaintiff is a natural person or a legal person.

This part of the research reflects the federalist structure in the US. Whether a plaintiff ends up in federal or state court does not seem to make much of a difference, as the likelihood of success in relation to piercing claims at all court levels is very much in line with the overall findings. Federal courts ruled slightly more often in favor of piercing compared to state courts (41.4% compared to 39.3%)[641]. This finding is particularly interesting in relation to the occasional debate surrounding whether there is, or should be, a federal law of piercing, or even a federal corporation law. The research does not make a distinction between categories of federal jurisdiction, e.g. so-called diversity jurisdiction (e.g. based upon litigants from different states) or subject matter jurisdiction based upon some federal statute[642].

Similarly, the percentages in favor of piercing remain in a narrow range (39.3%-42.1%) whether the case involves a trial court, an intermediate court, or the ultimate appellate court[643]. Natural persons were only slightly more successful at winning the piercing argument (37.7% to 36.8%)[644], but even that was surely well within the margin of error of the study's methodology. This statistic may be somewhat surprising given the important role which judicial discretion, and abstract notions of equity and justice, often play in deciding whether to pierce the corporate veil. The average observer, and even expert commentators, would likely expect courts to have somewhat more sympathy for a natural person aggrieved by the actions of a corporation. This instinctive result applies to both the contract, and even more so in a tort, setting. This expectation, however, does not appear to be borne out by the research.

[641] Thompson at 1049.
[642] For a discussion of the relevance of the latter category from a policy-making perspective, see Section VI on public action veil-piercing.
[643] Id. at 1050.
[644] Id.

Finding 6- Geographic consistency: There is a wide distribution amongst the individual US states. Given the relatively small sample size in relation to some states, particularly the outliers, it is difficult to conclude that this is attributable to a different understanding of the law related to corporations.

The Thompson study also broke down the piercing decisions based upon the individual US state in which the deciding court sat. On one end of the spectrum, some states (New Hampshire, Delaware) had no decisions approving the piercing argument. This could have been due to the relatively small sample size or the fact that the corporations in question were public corporations, where the likelihood of piercing is believed to be next to zero. On the high end, other jurisdictions (Kansas, Alabama, Washington D.C.) found piercing in a majority of the respective piercing cases (79%, 65%, and 60% respectively).

Given the margin between these results and the median for the US as a whole, combined with relatively healthy sample sizes, this may be an indication of a certain judicial leaning or opinion on the piercing issue over this period. If such outliers persist over longer periods, they may provide an incentive for plaintiffs to "forum shop", where possible. The wide range of success rates revealed are certainly interesting, but do not really tell us more about the dynamics of piercing analyses or approaches without digging deeper into the facts of the cases reviewed. Moreover, the sample size for some of the state-level statistics is quite small, thus making any conclusions regarding the orientation of the courts in relation to piercing risky.

Finding 7- Frequency of piercing varies across types of corporations and with the number of shareholders. The risk of piercing appears to decrease as the number of shareholders increases. Whether the shareholder is an individual or a corporation does not appear to make much of a difference.

This finding supports much of the doctrinal discussion above. It appears easier to attribute responsibility the fewer the number of individuals are involved. As suggested by the *Salomon*[645] case in England and its counterparts in the US, including statutory adoptions, one-person corporations are completely legal and- if properly formed and operated- enjoy the same limited liability protections as larger and more complex corporations. Nonetheless, they may be more vulnerable to facts which can support an argument for disregarding the corporate form and holding a sole shareholder liable. If a sole shareholder is making all the decisions, even purportedly when wearing his or her "corporate hat", there is both a high risk of overreaching the competence of the particular corporate office as well as of the appearance of such overreaching. Both factors tend to support a decision to pierce.

Similarly, with a single decision-maker, the expectation is that the risk of acts which could be deemed commingling of corporate assets with those of the individual is by its nature higher than when decision making is shared amongst several corporate actors. The Thompson study revealed a definite trend in relation to piercing as a factor of the number of shareholders. Single-shareholder corporations were pierced roughly 50% of the time, those with 2-3 46% of the time, and those with over three shareholders only about 35% of the time[646]. This suggests that it is more difficult to delineate the capacity in which individual shareholders may be acting in the close corporation setting. That likely applies equally regardless of whether courts are pursuing a conclusory or merger of identities approach or one of the more complex multi-factor balancing tests.

In addition to highlighting the general point regarding the nexus between the number of shareholders and the likelihood of a court to pierce a corporate veil, they also highlight something of a rift within the common law world. English courts are considered to be much stingier when it comes to

[645] See discussion above in section III.
[646] Thompson at 1055.

disregarding corporate boundaries, as discussed in more detail above[647]. Thus for any resolution to work and still retain a degree of systemic consistency, such differences may be explained by different policy choices within common law countries as opposed to an outright doctrinal divergence.

The analogous situation in the corporation-shareholder context raises additional questions. Given the greater likelihood of blurring decision-making across an inanimate-sounding board or similar company body, the level of responsibility deems being considered increasingly diluted, especially in the “control-based” piercing cases[648]. When decision-making is stretched across several layers of an enterprise (and hence multiple legal persons), it may seem naturally more difficult to attach responsibility to a given layer in the chain. Some commentators have lamented this aspect of the modern enterprise ever since, some even going as far as accusing corporate management (or their advisers) of abusing corporate law to shift internal business operating risks to external parties. Wherever the diving line is between legitimate allocation of assets and abuse of the corporate privilege, the Thompson study did not reveal a statistically relevant difference in claims asserted against individual as opposed to corporate shareholders of corporate defendants.

Sub-Finding 7a- The “Public Company Exception”: Piercing does not seem to occur in relation to shareholders of public companies.

The Thompson study also revealed that courts do not pierce the corporate veil of public companies, i.e. those with considerable portions of their equity in the hands of private investors generally with no real influence over corporate decision-making. This could be understood to result from a number of factors. First, the presence of private shareholder investors tends to act as a check on the decision-making and thus the conduct of corporations. The larger the share of the equity held by public investors, the greater that check is likely to be. Second, there are the public policy arguments behind granting limited liability to corporations because of their characteristic of facilitating capital-raising. That characteristic yields important benefits to persons on both sides of the investment equation, the corporate managers seeking capital and the private investors with excess savings they would like to put to productive use. Courts are likely to take that social utility factor into account in a given case and in a way that mitigates against piercing.

Sub-Finding 7b- Frequency as a factor of the inter-group corporate relationship: Within corporate groups, the status of the entity (i.e. parent, subsidiary, sibling corporation) appears to influence the likelihood of piercing.

The Thompson study revealed that it was easier to reach through a subsidiary to get to a parent corporation (roughly 38% of the cases) than it was to reach through a parent to get to a subsidiary corporation (roughly 28% of the cases)[649]. This finding is not too surprising given the general power and control relationships which exist within corporate groups. Interestingly, however, the highest probability of courts piercing the corporate veil was in cases involving “sibling” (i.e. without one being subordinate to the other in terms of equity ownership, voting rights, other forms of control, and so on) corporations (roughly 42% of the cases)[650].

Though often framed from the viewpoint of the parent over-exerting its control, on its face piercing jurisprudence appears to be neutral. In other words, courts will look at the nature of the underlying influence or control which is argued as a basis for extending liability across corporate legal boundaries. To the aggrieved plaintiff, it really does not matter in which “direction” the influence or control which contributed to the damages claimed flows. This appears to be supported by the statistics as well, which perhaps simply reflect the overall nature and extent of “intermingling” in the corporate group world. The relatively high numbers for the subsidiary-parent and subsidiary-

[647] See discussion in Section V. E.
[648] See discussion in Sections V and VI above regarding the two categories of piercing.
[649] Id.
[650] Id.

subsidiary scenarios also suggest that the courts do not appear overly prejudiced regarding these issues.

Finding 8- Frequency as a factor of the category of the plaintiff: The nature of the plaintiff appears to be a significant factor in whether a court decides to pierce the corporate veil.

Corporations trying to "self-pierce" had the least amount of success in litigation, with only 13.4% of courts agreeing with such plaintiffs[651]. This finding is not too surprising, given the general position that the choice of legal vehicle is one made independently by founders and operators of businesses. Owners are free to change that form at any time by garnering the necessary internal support. In other words, the legal system generally expects the insiders in such situations to take the disadvantages along with the advantages. Courts have often pointed that out in their decisions.

The Thompson study found that the "most successful" piercing proponents are government plaintiffs. It also noted that this may be mainly attributable to underlying policy of the statute being enforced, as compared to overarching policies behind tort and contract law[652]. This is in keeping with the doctrinal analysis in this dissertation of private action compared to public action veil-piercing, with the latter category having the benefit of more malleable piercing factors (e.g. control presumptions) compared to the former. Enforcement resources may also play a role. Shareholder plaintiffs fell somewhere between these percentages (at 25.4%). There was overall consistency between the decisions related to creditor as opposed to non-creditor plaintiffs (42.3% and 40.3%, respectively).

One finding of particular note here is the higher success rate of "government" plaintiffs. Unlike private litigants when enforcing their own rights (e.g. under tort or contract law) as opposed to a private right of action under statute, government plaintiffs are often seeking a different type of redress. The particulars of that redress are spelled out in the respective statutory provisions which the government plaintiff is trying to have the courts enforce. It would be interesting to learn the breakdown of where the government plaintiffs in the study were pursuing causes of actions sounding in tort and contract (where the same policies would drive the result vis-à-vis private litigants) as opposed to where the cause of action is created by statute, with its contours defined thusly. This distinction is discussed further below[653].

Finding 9- Frequency as a factor of the specific cause(s) of action: The cause of action significantly impacts the likelihood of piercing.

This was one of the big surprises of the Thompson study. Not so much that the underlying cause of action could influence the veil-piercing decision outcome, but rather the direction that influence takes in practice. Plaintiffs whose claim sounded in tort were noticeably less successful (at roughly 31% of the cases) than those whose claim sounded in contract (roughly 42% of the cases)[654]. This appeared to counter the expectations regarding the impact of the cause of action sounding under these two areas of law on the likelihood of piercing. Contract law has the restitution remedy more at heart, while tort aims at both deterrence and restitution. The nature of the tort remedy has led many commentators to assume that tort plaintiffs would be more successful. The layperson might have similar expectations based on general notions of greater sympathy for a person who suffered physical injuries compared to only financial damages.

A key feature of this (apparently false) presumption is the nature of the contact between the litigants, i.e. voluntary or involuntary. Contract parties make an intentional decision to deal with a corporation in the contract setting. Thus they have an opportunity to make enquiries and ascertain the nature, financial health, and so on of the company. They have the benefit of being able to make a risk assessment based upon that information, which can even cause them to walk away or withdraw from

[651] Id. at 1056.
[652] Id. at 1057.
[653] See discussion of private right of actions under certain statutes in section VI.
[654] Thompson at 1058.

the contractual relationship. Tort plaintiffs, on the other hand, often become such through no intentional act of their own. They just happen to be at the proverbial wrong place at the wrong time. Thus instincts of legal fairness would generally lead one to expect just the opposite result. The expectation is that judges and juries would be more likely to use whatever discretion they have to conclude in favor of tort plaintiffs, presuming the requisite case is proven. Yet this is not borne out by the statistics.

Once one digs a bit deeper into the Thompson study findings, possible explanations for this discrepancy between expectation and reality become clearer. A large number of the contract cases entail proven cases of misrepresentation, a factor which dramatically increases the likelihood of a court piercing the corporate veil. Interestingly, misrepresentation is a claim which in the common law world can sound in both contract and tort. Against the backdrop of a litigation system which provides pleading in the alternative, and the increasing sophistication of the plaintiff's bar, there may be an element of claims pursuing a path of perceived least resistance. But even if such cases are stripped out, contract piercing arguments still succeed more frequently than do tort ones, though by a smaller margin. [655]

The highest percentage of piercing success related to claims brought under criminal law ((roughly 67% of the cases). Claims sounding in statute were more in line with the overall findings of the study (roughly 41% of the cases). The former can perhaps be understood in light of the role of the government and in particular the prosecutor in such cases[656], while the latter likely entails nuances which the study could not flush out[657]. When comparing this with the statistics for government plaintiffs, it would appear that non-governmental plaintiffs face higher hurdles in asserting and proving their statutory claims.

Finding 10- Frequency as a factor of the specific statute being applied: There is a wide range in terms of the statutes being enforced .

The Thompson study also looked at situations where government agencies looked beyond corporate boundaries when enforcing statutory obligations within their remit. Here the results revealed a broader spectrum: Claims for workers compensation were successful in 13% of the reported cases, compared to Tax with 31%. As depicted in Diagram II[658], this could be attributed to the gradual spread of the single employer doctrine to specific areas of employment disputes over time. Environmental cases fared even better, though for reasons discussed already, these are in a different category. In all categories, the chances were greater if other factors (e.g. undercapitalization) are also present in the fact pattern.

Part of the breadth of this spectrum is explained by the varying mechanisms (e.g. owner-operator liability in environmental law) available under the respective statutes and the nature of the enforcement tools available to the enforcing agencies. At this stage it is important to keep in mind that comparisons such as these are based upon different applicable definitions, tools, and remedies. They do not always represent a comparison of equivalent situations, as described in more detail in Part VI. A. 5 above.

[655] Id. at 1059.
[656] It is worth noting that the generally higher burden of proof and evidentiary hurdles work against such a presumption.
[657] This is one of the objectives of this dissertation, to supplement the existing research by flushing out some of those very nuances in both the doctrine and the actual practice of piercing jurisprudence. As discussed within, cases of regulatory "piercing" have certain policy and doctrinal differences, which distinguish them from a plaintiff seeking to expand the pool of parties from which recovery for damages could be drawn.
[658] See page 139.

Finding 11-Frequency as a factor of whether it is plead as a substantive or a procedural law matter: The likelihood of piercing as a question of procedural rather than substantive law moves within a relative narrow range.

The Thompson study also distinguished cases according to whether the piercing arguments were raised in relation to the underlying liability of the defendant (i.e. as a question of substantive law) or as a procedural question (e.g. who are possible proper party defendants). On pure jurisdictional questions, the likelihood of piercing was only slightly lower than that for the overall study (roughly 37% of the cases)[659]. Interestingly, for disputes regarding venue related to corporate defendants, the rate was much higher (roughly 58% of the cases), although the sample size was fairly small. This ties into a broader debate around whether piercing, or disregarding, corporate separateness should be considered an aspect of procedural or substantive law[660].

The Thompson study, with its empirical approach, provided some insight regarding how the piercing safety valve was being applied by courts in the US. It also highlighted some doctrinal debates which continue to this day.

The Thompson Study tested the general views regarding jurisdictional principles applied in the corporate group setting. These included the view that enterprise principles should always guide courts in making jurisdictional decisions related to affiliated corporations, thus guaranteeing that a plaintiff has an opportunity to make a substantive veil-piercing argument in an actual litigation[661]. Other views maintain that the standard for including a potentially responsible defendant in litigation (i.e. jurisdictional assertions) should be more lenient than the standard applied to substantive veil-piercing cases[662]. In reviewing the extent to which courts "pierced" (i.e. deemed the defendant in question subject to personal jurisdiction of the court despite minimal or even a lack of direct contact with the plaintiff) the corporate veil in the jurisdictional context, Professor Thompson discovered that the likelihood of "procedural" piercing was actually slightly lower than that for "substantive" piercing, at 36.9% to roughly 40%[663].

The impact of this line of cases on parent-subsidiary litigation was actually the topic of another empirical study which built on and supplemented the Thompson study[664]. As outlined above, courts often deal with procedural issues which relate to some of the same variables analyzed in relation to questions of substantive veil-piercing. The *Cannon* case of 1925 represented a high watermark of entity law over competing concepts such as enterprise law. Over the ensuing decades, decisions dealing with personal jurisdiction jurisprudence would soften some of the harder edges of the formalistic approach in *Cannon*[665]. Yet the importance of formalities has remained surprisingly resilient despite the evolution of procedural law in general and piercing jurisprudence in particular.

While coverage of these detailed issues is not possible within the confines of this dissertation, it is worth reviewing the practical impact of the relevant cases. Perhaps the leading case in the law of personal jurisdiction introduced the "minimum contacts" doctrine[666]. Under this theory, personal jurisdiction can be established if a plaintiff can prove a certain threshold level of activity by a given defendant in a particular forum. This was a move away from the formalistic "presence" test and

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[659] Thompson at 1060.
[660] This topic was dealt with in further detail in Section V B. above.
[661] This is the view promoted by Professor Blumberg, among others.
[662] See e.g. The Thompson Study, at 1059-60.
[663] Id. Interestingly, the rate was considerably higher for questions dealing with the venue of the court.
[664] See *Piercing the Veil to Assert Personal Jurisdiction over Corporate Affiliates: An Empirical Study of the Cannon Doctrine*, 84 B.U. Law Rev. 445 (2004).
[665] See for example, the US Supreme Court's decisions in International Shoe Co. v. Washington, Keeton v. Hustler Magazine, Inc., Asahi Metal Industry Co. v. Superior Court of California, and United States v. Bestfoods.
[666] See International Shoe *v. Washington*, 326 U.S. 310 (1945) and decisions relying on it.

deemed to better serve "notions of fair play and justice.[667]" Later decisions of the Supreme Court appeared to sure up certain elements of the *Cannon* approach, such that the modern legal situation is deemed to lie somewhere between the *Cannon* and the International Shoe jurisprudence.

The *Cannon* Doctrine study, performed over two decades later, drilled a bit deeper into the nuances of procedural law in testing where the courts appeared to stand on the entity-versus-enterprise debate. This study was meant to cover issues such as which jurisdictional rule courts applied in specific cases and the extent to which this rule had changed over time[668]. To test the continuing vitality of the *Cannon* strict approach (entity law), the researchers tested the relationship between the following variables on the strength of the decisions in 387 cases in terms of their tendency to support the rationale and holding of that case:

- year of decision,
- court,
- underlying cause of action (e.g. tort or contract),
- type of plaintiff or defendant (e.g. natural or legal person),
- nature of ruling (constitutional or statutory),
- affiliates relationships with each other,
- primary versus secondary liability of defendant as asserted by plaintiff, and
- jurisdictional ruling (i.e. personal jurisdiction confirmed or rejected)[669].

One main finding of this study was that courts' decisions did indeed appear to fluctuate with the broader liberal or conservative trends in jurisdictional or procedural jurisprudence. They had not, however, appeared to abandon the *Cannon* rationale altogether. Specifically, they did not always include putative responsible affiliates (i.e. parents or subsidiaries) within the initial stages of litigation so that plaintiffs always had their "day in court" against the broadest possible group of defendants. For a plaintiff facing a thinly-financed corporation, success at this stage can very much determine the overall likelihood of recovery. It also dramatically influences the settlement dynamics of a given case.

Given the nature of procedural law in the United States, failure to win the jurisdictional argument against a particular defendant may be an indicator that its involvement with respect to an affiliate is similarly low. As these decisions are heavily fact-based, however, failure or success on the one does not necessarily guarantee failure or success on the other. It is the interplay of the individual elements in the procedural and piercing tests applied by the courts which determine the alignment of the decisions. For that reason, the authors of the *Cannon* Doctrine Study coded individual elements of the fact patterns underlying the decisions as described above.

A plaintiff may cast a wider net in litigation if there is:

1. Uncertainty about who was responsible for a relevant act or omission that had a causal connection to the injury suffered, or
2. Concern about the ability to recover the full amount of damages if these are enforceable only against a particular entity (e.g. subsidiary).

The *Cannon* Doctrine Study revealed some interesting trends in the jurisdictional case law, in particular[670]:

[667] Id.
[668] See the Cannon Doctrine Study, at 458-462.
[669] Id.
[670] Id. at 462-75.

- That state courts tended to "find" personal jurisdiction more frequently than federal courts, thus confirming the belief that state courts may be sympathetic towards local plaintiffs and lean towards ensuring that claims are heard
- That courts tended to "find" personal jurisdiction more frequently in relation to remote entities which are foreign (i.e. non-US) defendants, perhaps out of a concern that the plaintiff's claim might not otherwise be heard, or properly heard, in a foreign court
- That the nature of the cause of action plays a key role in the likelihood of a court finding personal jurisdiction over a particular defendant, in particular a higher percentage of jurisdictional "piercings" in cases where the cause of action arises under statute (especially the antitrust statutes). This is not surprising, given the doctrinal differences and tools available between private and public veil-piercing highlighted above.

Although of interest to the theses in this dissertation, there is a risk in being drawn too deeply into an analysis of procedural law issues. Thus at this stage we will recognize the interplay between procedural and substantive piercing, but continue the focus on the broader policy debate and the doctrinal mechanisms which support the respective policies.

C. Towards a More Consistent and Defendable Approach

Observed over the period of its evolution and in multiple contexts, the solidity of the case for limited liability as a "bedrock principle" of the corporate form is weakened by the following points:

- The "essentialness" of limited liability as a characteristic of a corporation (or equivalent legal entity form) described by early commentators was made at a time when corporations were mainly used for municipal and charitable purposes. Early manufacturing and general trading companies did not automatically have limited liability except through a special charter provision. It can thus be argued that the any essential component should be tied to the respective purpose of a corporation, rather than being an intrinsic part of the (judicial) legal person itself. This point was traced in Part III above. Is the limited liability characteristic truly essential for enabling a corporation to meet its general purpose?

- Limited liability for corporations in arguably the result of a series of historical accidents relating to both the substantive and procedural law of liability. Since corporations only later became a standard vehicle for conducting private, profit-seeking economic activity, it is fair to question whether any limited liability treatment should be automatic or discretionary. Veil-piercing jurisprudence suggests that there is a fundamental disconnect between the binary law of limited liability tied to the form of a legal person, with unincorporated individuals or associations exposed to full liability risk[671]. This is so even where such persons undertake the same activity as an incorporated entity. In other words, there is a different shifting of externalities depending directly on the form- corporate or noncorporate- of the economic actor. A rule which tied the legal liability privilege to the underlying, risk-producing activity would make more sense. Not only would this encourage appropriate incentives and safeguards regarding the activity, but it could improve legal certainty. Admittedly, this would be more difficult to implement than a categorical approach tied to a clearly discernable metric such as the form of a legal person. At present, the unpredictable jurisprudence of veil-piercing- with its multiple factors, some focused on form and not substance- guides much of corporate decision-making and action. The related tools are even more difficult to apply when a corporate group is the defendant. These developments were covered in detail in Parts III and IV above.

- Underlying liability policies are societal decisions regarding the perceived value of certain outcomes or objectives. These involve weighing the benefits achieved through the protected

[671] See Stephen Griffin, Company Law Handbook, 3rd ed., Law Society (2013); see also Nicholas Stewart QC, Natalie Campbell, and Simon Baughen, The Law of Unincorporated Associations (Oxford Univ. Press 2011).

activity (economic or other) against the risks and externalities which those very activities create. Legislatures and judges make such decisions by creating and interpreting the framework of rules under which special treatment such as limited liability is sanctioned, and where it will be ignored. These dynamics were covered in detail in Part V above.

- As the law has evolved, regulation has stepped in to provide correctives where decisional law alone did not appear to provide the appropriate conditions regarding how much of a given activity should be encouraged, and (perhaps more important) under what conditions such activity should be take place. In other words, regulation signals a failure in the default or automatic treatment of the limited liability privilege for corporations and their kin. These dynamics were covered in detail in Part VI above.

There is an inherent risk allocation policy in any grant of limited liability to a person, whether natural or judicial. In light of the above points, the question arises whether it is time to revisit the framework for the default legal privilege of limited liability for the corporate form.

1. The Evolving Nature of “Essential” Elements of the Corporation

The first point in the list above - “essentialness”- deserves particular attention. Much of the legal literature describes the legal person in general, and the corporation in particular, as a static concept which has remained virtually unchanged since its development. It also describes certain elements of the corporation as “essential”, like organs on which the life of the corporation depend for its continued existence. In reality, there are few, if any, absolutes in law. Law is a reflection of the views and priorities of a society at any given time, and law can evolve to address changes in those views or priorities. Indeed that is the essence of the common law system.

Corporation law is no exception, and as this dissertation has tried to show, this body of law has undergone dramatic changes over its long history. Some of these changes took a long time to occur, while others were rather sudden, representing genuine legal turning points. An example of the former is the corporate seal, which for centuries was necessary to conclude valid legal agreements. This was also the case for natural persons in certain circumstances, and reflected the nature of society’s ability to verify the identity of a natural person or the authorized status of a representative of a legal person. As that general practice evolved, and alternatives for the seal began to surface, it gradually fell away as a mandatory requirement. This happened despite its being described as a *sine qua non* of the corporation by leading legal experts of the day. If one distinguishes between general purposes, and specific characteristics which support these, this becomes clearer.

A similar fate met the seemingly bedrock principle of *ultra vires*, or narrow restrictions on corporate purpose or activities. Until late in the 19th century, or even later in some US jurisdictions, corporations had to stick to the list of enumerated activities in its corporate charter, or risk having actions outside that scope be deemed unenforceable. As discussed within this dissertation, this actually impacted the number and structure of corporations. Over time the drawbacks of such an approach became clear, and the *ultra vires* concept was eventually whittled down to a point of non-existence.

Other originally essential elements have disappeared in everything but name, such as the traditional requirement of a physical office, or location. For centuries this also was deemed a “must” for the creation and operation of a legitimate corporation. There had to be some centralized meeting place for those involved in managing the affairs of a corporation. As those affairs became more broadly spread, or especially when their nature increasingly shifted from the physical (i.e. manufacturing goods) to the virtual (e.g. services), the need for a permanent physical establishment began to decline. It came to suffice to have a registered office to meet this “essential” requirement of the corporation. Shortly thereafter, third party providers assumed this nominal requirement for dozens or even thousands of corporations in return for a fee. This permitted corporations to meet the letter of the law in a minimalist fashion. In the age of the internet and the virtual economy, the office requirement

may appear even more antiquated. But its evolution and near-disappearance is another example of how pliable specific elements of the corporate person can be over time.

In addition to the above substantive legal requirements of corporate persons, there have also been dramatic changes in relation to the process for breathing them into existence. Because corporations exist "at law, by law", they are essentially a legal fiction, justified on the grounds of various societal policy objectives. Whereas early on corporate charters were granted selectively and directly by the state, following industrialization and the growth in the use of the corporations, self-incorporation became the norm. Thus the response to the fundamental question of who could initiate and essentially self-approve (i.e. by meeting the disclosure requirements in the respective corporation statute) was also something that turned out to be quite flexible.

But the evolution and changes have not gone in one direction. While many elements deemed "essential" early on in the history of corporations have faded away, others have taken on such significance that they have been elevated to a key characteristic. Indeed, such factors are often hailed as if they had been part of the basic makeup of the corporation from the outset. A good example here is the capital-raising characteristic of corporations. During the majority of the corporation's history, business financing was done by way of debt contracts. It wasn't until the advent of broad trading markets for equity shares in corporations that their utility as a capital-raising vehicle became prominent. Not too long thereafter, this feature was often described as a key justification for granting corporations the privilege of limited liability. Viewed through the longer lens of legal history, however, this feature could hardly be considered as "essential" to the corporation's very existence.

The above examples make clear that though the law generally moves slowly, it does move, and absolute rules or premises deemed permanent or unchangeable are rare if not non-existent. So it is with limited liability for corporations as well. As highlighted in this dissertation, the common law jurisdictions have tried various approaches to the scope of limited liability over time, in different contexts, and in relation to different kinds of claims. In fact, the limited liability of corporations has been eroded by the actions of both the judiciary and the legislature. Given that background, it is time to consider whether further change may be appropriate in the near or distant future.

2. <u>Lack of Uniformity in the Treatment of Scenarios and Claimants</u>

As has been outlined above, there has been a long, gradual march away from absolute limited liability for legal persons such as the corporation since this became anchored in statute in the mid-19th century. First, through the courts, in what this dissertation has described as private action veil-piercing. This was followed shortly afterwards by statutory regulatory rules with even more robust tools for looking past corporate boundaries. This dissertation has described this development as public action veil-piercing. Having traced this overall evolution, the question arises whether there are any remaining gaps which the law need fill.

Can the law ever reach an equilibrium point where the combination of- often competing- legal doctrines provide an adequate level of consistency and observe desired principles of fairness? Might the growing list of exceptions to the general rule of limited liability end up swallowing it? Since neither the form nor the structure of economic activity have remained static over the centuries, why should the respective legal rules remain so? Would it not be preferable to focus the inquiry on that which is truly relevant to a litigant's attempts at justice and recovery?

Such questions in the debates around limited liability of corporations bring us back to the crucial factor of the capital structure of a given company. In addition to making decisions about the level of vertical integration of an enterprise's operations, or the number of legally separate entities, top management also make decisions regarding a company's financing strategy. While this may not seem relevant at first glance, the way a company finances its operations directly impacts the ability of a claimant to recover damages. Just as capital is the lifeblood of a corporation, it is also the source of any available funds to compensate plaintiffs with justifiable claims.

A corporation generally finances its operations from a combination of internal funds, commercial loans, or by seeking investors through the public capital markets. Money in a corporate bank account generally comes from one, or some combination of, these three sources. If a plaintiff suffers injuries caused by a corporation's acts or omissions, and that corporation is completely self-financed, then the level of those funds will determine the amount of potential recovery at any point in time. If a corporate defendant is completely equity-financed, in other words derives all of its working capital through funds provided by investors in the public capital markets, then a claimant may be unable collect on a successful judgment given the traditional bar on veil-piercing in the case of public corporations.

Finally, if a corporate defendant is fully debt-financed, the ability of a plaintiff to recover against it is directly tied to the nature of those underlying debt arrangements. If, as is common in commercial transactions, lenders insist on security for providing debt capital, the plaintiff may similarly be unable to collect on a judgment on account of the legal ranking of priority of debts. Judgments to be enforced against a defendant's assets are generally unsecured debts, and thus only receive payment from a bankruptcy estate after all higher-ranking debts have been satisfied.

Most litigation scenarios likely fall somewhere between these extremes. The key point to consider is the direct relation between the capital structure of a corporation and the level of funds which might be made available to a successful plaintiff. Since corporate management makes decisions which directly impact the nature of any "money on hand" at any point in time, should that be something which courts take into consideration? In a way, this is just another variant on the risk allocation debate which underpins the whole limited liability discussion. Just as corporate management can make decisions which "externalize" the risk of physical or other harm to third parties, it can also make decisions which influence the availability of financial recourse in the event such "externalizing" leads to specific injuries or damages. This could be linked to the underlying activity.

Tying the above to the overall analysis of the various veil-piercing doctrines, there may be a more sensible approach to the analysis of when a claimant should recover. If a court considers the level of capital which objectively should be necessary to set up and operate a particular business, it could better judge whether management had provided this, taking into account the general operating risks of the business (e.g. of causing injuries). Expert evidence could guide the courts in their decisions. If a parent company had so exercised its control over a subsidiary or other corporation to so deplete its financial resources beyond this level, this could be deemed contrary to general principles of justice and ethical business. Therefore, it would be consonant with justice to force the parent or other relevant company to cover any deficiencies related to a claim for a claimant.

In fact, some of the tests outlined above did include these factors. By making them one of a list of possibly dozens of factors, however, with unclear and thus likely equal weighting, they diluted the genuine value of the causes behind a defendant's financial condition when examining culpability and liability. At the end of the day, the funds on hand to make a claimant whole is the only things about which they are concerned. Whether a corporation maintained spotless corporate records, or exactly delineated when directors were acting in which capacity for which corporation which is part of a corporate group, are meaningless facts for a claimant. They do not change the underlying fact that a defendant set a chain of events into motion over which they had no control, and on account of which they suffered personal injury or property damage.

Naturally, the challenge with such an approach is finding the appropriate level of funds which a corporation should have at its disposal to make whole legitimate claimants who can prove such damages. Many civil law systems generally have a higher level of initial share capital required compared to common law countries, but even these amounts are often insufficient in light of the size of operations of the average corporation. The fields of accounting and auditing could help, as they contain well-established guidelines for such financial metrics. Companies are required to observe such standards in order to avoid "going concern" (US) or "trading" (UK) issues. It probably would not require too much additional effort to calculate how much of a financial cushion would be appropriate

for a business operating in particular market segments. These would tend to be uniform for all participants, for example, tied to size. In a way, that would be the flip side of the market share liability theory, except from a preventive rather than a reactive standpoint. At present, this only exists for certain industries, but could be made a more general requirement. The key adjustment to the current rules would be to make the corporate capital requirement a more dynamic one, tied to the nature and risk levels of the company's underlying activities.

If agreement surrounding such calculations proved to be too contentious, this would probably highlight the attractiveness of a legal requirement for a certain level of business insurance. This was attempted in the early stages of corporate law development on the US, but abandoned because solutions were too difficult. In the modern era, many of those informational and other challenges to an insurance requirement are likely not relevant or considerably diminished (e.g. through technology). Though many corporations do self-insure against risks such as director and officer liability, or even products liability, this is done as a voluntary measure of risk management. It is not required by corporate law. The absence of a legal requirement has traditionally been identified as one of the reasons why a widespread insurance market for general corporate liability insurance has not quite developed.

Keeping these thoughts in mind, what might the next stage of the evolution of liability look like? How would it come about? By looking to the examples from the evolution of corporate and liability law to date, we can identify a number of avenues which next steps might take.

VIII Possible Ways Forward

Upon consideration of both the historical evolution and analyses of the current issues and concerns related to the appropriate level of liability which a legal system might afford a legal person, there appear to be a limited number of options available to policymakers interested in further reform of the rules. The first two categories below focus on the substantive law of legal persons, while the third focusses on the procedural law related to enforcement of claims against legal persons. A combination of any of the approaches below would also be thinkable.

A. Company Capital-Focused Solutions

The main obstacle to a claimant's recovery against a culpable defendant is often the lack of liquid funds to cover the costs of physical injuries or damage to property. A legal rule could conceivably be crafted to require companies not to be overly leveraged and to require a minimum amount of available cash to cover the normal costs of operating a business. If claims from involuntary third parties were a normal and foreseeable result of carrying on that business, then the law could require a proportionate financial cushion to cover potential claims.

Similar rules exist for certain regulated industries, such as financial institutions. The regulatory objective there is to mitigate insolvency risk and preserve sufficient deposit holder capital, including to avoid a "run on the banks" in times of financial market turmoil. For participants in that industry, the proportion of capital to be held available for contingencies is set by regulation after lengthy negotiations between regulators and market participants. The specific rules are based on deep technical knowledge of the intricacies of money flows, in particular the net rate and size of deposits and withdrawals over time. What is possible in one industry based on its specifics could serve as a guide for a general rule applicable to other industries. Though attractive in theory, it would likely prove difficult to find a rule of thumb agreeable to all in terms of reserves for such potential contingencies. Absent such an accurate metric, it could possibly lead to as much litigation as veil-piercing, focused on the sufficiency of such reserves.

Alternatively, a capital-focused solution could be in the form of insurance (tried and rejected earlier) or some form of clawback, along the lines of substantive consolidation in bankruptcy. This approach would not necessarily need a definitive lynchpin for cross-entity liability (e.g. control or affiliate relationship, overlapping directorates) as is necessary in veil-piercing. If the actions of a parent (or sister) company led the defendant corporation to be unable to meet the claims of such involuntary third party claimants, that parent (or sister) corporation could be required to cover any shortfall. This already exists in many civil law jurisdictions.

The idea of requiring corporations to self-insure against the risks which they create in relation to the general public has been considered in the past. Despite the general attractiveness of the idea, the sheer complexity of defining and monitoring what would be considered adequate insurance has thus far led policymakers not to adopt such a general requirement. The risk and externality measurement challenges bear similarities to those which plague the approach of requiring an adequate level of corporate capital. That may be changing thanks to digitization and developments in data analytics, as technology lowers the bar to accurate measurement of such variables.

Many corporations do carry a whole host of insurance policies (e.g. director and officer liability, product liability, employment, litigation, and so on) on a voluntary basis as opposed to on account of a legal requirement. But as a general rule, the smaller and more private (in terms of equity ownership) the business, the less likely it is that the management will decide the cost-benefit analysis in favor of purchasing such insurance. Unless a formidable interest group revitalizes this potential approach to the issue, it is unlikely that the legislature will become active.

B. Specific Exceptions to the General Rule of Limited Liability for Legal Persons

This dissertation outlined a number of situations where the general rule of limited liability is not applied in specific instances (e.g. "private-action veil-piercing") or under certain categorical circumstances (e.g. "public-action veil-piercing"). A fusion of the two approaches is also imaginable. For example, the legal system could fashion a categorical carveout from limited liability for involuntary judgment creditors who have suffered damages based in certain causes of action. A good starting point would be those already covered from a regulatory standpoint by public-action veil-piercing. The carveout treatment could be extended to other causes of action, such as tort or human rights violations. The main burden on a claimant in such cases would be to prove that their claim belonged to a category subject to such a legal carveout. They would then not need to engage in litigation around the proper party defendant, or around the appropriate amount of capital or reserves a defendant corporation should maintain.

Where claims arising from a specific activity threatens to bankrupt a defendant corporation, the respective bankruptcy laws could include a measure which gives preferential status to involuntary judgment creditors. That way those belonging to a protected class (i.e. claimants asserting specified causes of action) would have a better chance of at least partial recovery. At present, in the bankruptcy situation such claimants generally have the status of unsecured general creditors. This means that only if there are funds available after satisfying all claims with priority (e.g. statutory or contractual secured claims) does an involuntary judgment creditor stand a chance to recover anything. With the introduction of changes such as those described above, shareholders (e.g. parent corporations) would not be able to rely on the limited liability shield in those situations. They would thus have to better incorporate the risk of liabilities into their activities and operations in those situations, including in relation to the original structure and capitalization.

A narrower variant of the above would be to include a causation requirement for the specific causes of action, where causation is not an express element thereof. In other words, no categorical carveout, but special treatment for involuntary judgment creditors who have suffered damages, where those damages are directly linked to an activity in which the legal person- through its managers or owners- has decided to engage. The liability rule could be further tied to a presumption regarding the burden of proof. It would make it easier for plaintiffs to pursue legitimate claims if the evidentiary burden were placed on defendant.

C. Procedural Solutions

If a categorical carveout were too much for the US legal system to bear at present, a slightly less dramatic step could be the simple reversal of the burden of proof regarding responsibility for actions against the owners of close corporations, or entities within a corporate group. At present the burden in private veil-piercing cases lies on the plaintiff to show that the owners or management of another corporation so overreached in the exercise of its influence over the defendant's activities, that it should be held accountable. This is often a very steep evidentiary obstacle for claimants, especially in light of the fact that the corporate defendants basically create the trial record. The absence of clear evidence pointing to abuse of influence leads to many claims being dismissed at an early stage. If a corporate record is particularly clean, or opaque, or even missing, a claimant is often left without redress. Reversing the burden of proof would at least go some way towards evening out that inherent informational and evidentiary advantage which defendants from a corporate group have.

A narrower variant of the above could be to require that any special treatment be rooted in a specific statute, or the aims of that particular statute. This would be similar to the status quo at present for some public-action veil-piercing situations, with the addition that the procedural requirements for a private action claimant could be simplified. With the introduction of such treatment, private litigants could be relieved of the often outcome-determinative challenge of convincing a court to pierce a corporate veil.

In essence, this would be tantamount to extending the statutory remit to include restitution of damages which result from a directly regulated activity. This approach is a slight variant in A. above. It would use the same mechanism, but apply it to fewer, pre-defined, fact patterns. The experience from administrative law could be leveraged to apply to private litigation, even when the respective statutes do not contain an express private right of action.

D. Status Quo Ante

Finally, there is the alternative of no immediate change. In relation to private-action veil-piercing, it would mean allowing the common law to continue its natural evolution on a case-by-case basis, perhaps further refining or even converging the various multi-factor balancing tests already widely used. Similarly, public-action veil-piercing could be expanded or contracted in line with the views of the makers of law and public policy. Evolution would mean the continuation of the disadvantages of the current veil-piercing approach outlined above. In the view of the author, this is the most likely scenario.

Though several legal milestones in the common law system have been covered within the confines of this dissertation, they actually took decades, sometimes centuries, to evolve. The judiciary in both the US and England have shown their general preference for small steps in relation to fundamental principles. The legislature, on the other hand, has occasionally shown a willingness to take bolder action, including the introduction of new frameworks for responsibility for specific situations. Such frameworks often bypass some of the legal hurdles courts face, but only in relation to the narrow remit of the statute. The historical coverage of the relevant legal milestones indicates that most such developments were only in reaction to pressure from the general electorate or influential interest groups. Without some dramatic social or political change, or pressure from outside the legal profession, accretion appears to be the most likely scenario. An interest group with the ability and influence to push through some of the possible approaches described above does not yet appear on the horizon at the time of writing.

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