THE UTILISATION OF EVOLUTIONARY CONCEPTS IN LEGAL HISTORY: COMPANY LAW AS A CASE STUDY

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Evolutionary concepts that draw upon Darwinian principles have been highly influential and widely used in many social science disciplines. This article suggests that an evolutionary perspective provides a useful theoretical framework from which to analyse legal change and its interaction with its environment, and in some cases, the persistence of suboptimal laws. An evolutionary approach does not seek to provide a determinist or predictive explanation of legal change, but rather, invites critical analysis of law because it sees legal outcomes as the result of historical contingencies, chaotic developments or sometimes chance accidents that quite feasibly could have turned out differently.

After discussing the utilisation of evolutionary concepts to law generally, the article then analyses the historical development of three fundamental concepts of company law: joint stock, separate legal personality and limited liability so as to provide an example of the application of evolutionary concepts to legal change. In so doing, a particular legal problem concerning the tort liabilities of corporate groups is identified that has been widely criticised around the world as a suboptimal legal outcome. An evolutionary perspective, by recognising the significance of chance occurrences, encourages us to change the law for the better where this is appropriate.

I INTRODUCTION

The literature linking legal developments to evolutionary theories or concepts encompasses a diverse range of ideas concerned with the reasons why, and the ways in which, legal systems and concepts change over long periods of time and the interrelationship of legal development and changes in the economic and social environment. This paper discusses what is meant by an 'evolutionary' perspective in the context of legal history, briefly outlines early examples of the utilisation of evolutionary ideas to interpret or examine legal change and identifies the

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main features of evolutionary change in legal concepts. The paper then presents an overview of the historical development of three fundamental company law concepts: joint stock, separate legal personality and limited liability, so as to provide an illustration of how these major developments in company law can be viewed and understood as evolutionary processes.

The utilisation of evolutionary perspectives in the social sciences has a very long and strongly disputed history.[1] Nevertheless, especially after the publication of Darwin's *Origin of Species*,[2] theories of evolution have been highly influential and widely used in many social science fields, including legal history and jurisprudence. The application of ideas and concepts associated with Darwinism to fields outside biology has been described as 'generalising Darwinism' or 'universal Darwinism'[3] and is based on the claim that there are common abstract features in both the social and biological spheres so that '[e]volutionary theory is a manner of reasoning in its own right quite independently of the use made of it by biologists'.[4] Darwin himself considered that his central idea of natural selection had application to language and social customs.[5]

In this article the meaning of 'legal evolution' is based upon the idea that over a long period of time, the law interrelates with its environment in a manner that broadly shares some common abstract features with the way species interrelate with their environments in accordance with Darwinian theories of evolution in biology. While biology and jurisprudence are entirely separate disciplines, and the mechanisms identified by Darwin as applying in biology may not appear to readily operate in the social sphere, they do share in common 'a vital dependence on close and contextualized study that is as much accountable to parochial

1 Daniel C Dennett, *Darwin's Dangerous Idea: Evolution and the Meanings of Life* (Penguin Books, 1996) 17–21; Geoffrey M Hodgson and Thorbjørn Knudsen, *Darwin's Conjecture: The Search for General Principles of Social and Economic Evolution* (University of Chicago Press, 2010) 47–60; Howard E Aldrich et al, 'In Defence of Generalized Darwinism' (2008) 18(5) *Journal of Evolutionary Economics* 577, 578–9.

2 Charles Darwin, *On the Origin of Species by Means of Natural Selection: Or the Preservation of Favoured Races in the Struggle for Life* (John Murray, 1859).

3 The term 'universal Darwinism' was first used by Dawkins: Richard Dawkins, 'Universal Darwinism' in DS Bendall (ed), *Evolution from Molecules to Men* (Cambridge University Press, 1983) 403, 403–25. See Aldrich et al (n 1) 579.

4 J Stanley Metcalfe, *Evolutionary Economics and Creative Destruction* (Routledge, 1998) 36. Metcalfe, in the context of using evolutionary theory in economics, argued that 'generalising' Darwinism went further than drawing biological metaphors and analogies and did not depend on the proposition that the detailed mechanisms of social and biological evolution were similar: at 36. Nelson argued that 'Universal Darwinism' was persuasive and powerful when applied to cultural, economic and social phenomena however there were important differences in how evolutionary processes operated in cultural evolution compared with the evolution of biological species: Richard R Nelson, 'Universal Darwinism and Evolutionary Social Science' (2007) 22(1) *Biology and Philosophy* 73. The importation of biological concepts into social sciences is controversial and has been strongly criticised: see, eg, Carl N Degler, *In Search of Human Nature: The Decline and Revival of Darwinism in American Social Thought* (Oxford University Press, 1991), who discussed the fall and rise of the utilisation of Darwinist social thought in the behavioural sciences.

5 Darwin (n 2) 422–3, cited in Aldrich et al (n 1) 578. This has been expressed as 'Darwinism is too important to be left to the biologists', which has been attributed to Joel Mokyr by Geoffrey Hodgson in Ian Gough et al, 'Darwinian Evolutionary Theory and the Social Sciences' (2008) 3(1) *21st Century Society* 65, 76.

circumstances as it is to generalized principles'.[6]

The application of evolutionary concepts to the analysis of legal change, as suggested in this article, does not attempt to set out a comprehensive meta-theory based upon the notion that legal change necessarily exhibits the precise characteristics of the evolution of biological species.[7] Nor does it enable predictions to be made of the effects of legal change on the broader economic and social environments, or how socio-economic developments result in changes to the law, as the interplay of complex historical forces often results in unpredictable outcomes which are attributable to particular historical circumstances.

Legal evolution in a Darwinian sense raises for consideration various historical questions such as the following. What were the various possible alternatives to a particular legal change? Why was a certain choice made or not made? Why was it made at that time? How was this influenced by changes in the socio-economic environment? To what extent did the new legal development retain the inherited characteristics of its earlier versions? To what extent did the new law represent a change from the past? Darwinian evolutionary theories share in common the idea that 'evolution involves moving away from an existing, inherited set of capabilities, rather than moving towards a predestined, optimal state'.[8] While it can be said that these questions can be raised and considered by other approaches that are not based upon evolutionary concepts, this paper contends that the adoption of a Darwinian approach provides a helpful theoretical framework from which to examine why legal change occurred, the causal relationships involved, the interrelationship of legal change and economic and social developments, why legal diversity persists and the chaotic nature of the historical factors at play.[9] An evolution-based inquiry raises questions involving the adaption of legal concepts (as a form of program-based behaviour) in changing circumstances and the discarding of possible alternatives through a form of selection.[10]

The nature of evolutionary change, as it applies to law, is that changes in the law are largely incremental following long periods of stability and usually confined to

6 Allan C Hutchinson, *Evolution and the Common Law* (Cambridge University Press, 2005) 271. Hovenkamp restricted the term 'evolutionary jurisprudence' to include only 'those jurisprudential theories that explicitly focus on legal change, or that make use of a particular model to explain how legal change occurs'. This need not necessarily involve Darwinian theories of natural selection although this is the model often used to explain evolutionary change in a wide range of disciplines: Herbert Hovenkamp, 'Evolutionary Models in Jurisprudence' (1985) 64(4) *Texas Law Review* 645, 646–7. Elliott considered that a theory is 'evolutionary' if it is explicitly analogous to some model of biological evolution: E Donald Elliott, 'The Evolutionary Tradition in Jurisprudence' (1985) 85(1) *Columbia Law Review* 38, 39.

7 Hodgson and Knudsen (n 1) argue that 'generalized Darwinism does not claim that social or economic phenomena can be adequately and entirely explained in biological terms. It is not a version of biological reductionism': at 21.

8 Simon Deakin, 'Evolution for Our Time: A Theory of Legal Memetics' (2002) 55(1) *Current Legal Problems* 1, 10 (citations omitted).

9 Of course, questions of causation sequences are often difficult to determine and especially in complex circumstances there may well be no definitive answers, even after close historical investigation.

10 Aldrich et al (n 1) 590.

variations on existing law so the evolving law can be seen as a 'carrier of history'.[11] An evolutionary perspective therefore implicitly addresses the apparent paradox that law changes as social and economic change occurs, yet at the same time, law also remains stable and predictable. An evolutionary perspective involves taking a historicist approach[12] to the study of law that places importance on its historical economic and social context and how the economic and social environments affect, and are affected by, changes in the law. Such an approach emphasises a contextualised interpretation of history as a means of understanding legal change. In a 'chaotic' historical environment,[13] outcomes are the result of the interaction of complex historical factors, chance occurrences and unexpected consequences.

The modern use of evolutionary concepts in legal discourse therefore provides a framework from which a detailed historical study may be undertaken that sees historical developments as highly complex and not necessarily 'progressing' towards predetermined end points.[14] Hutchinson suggested that:

> The salutary lesson of the evolution debate is that the best story is the one that weaves together lots of different threads into a quilt that is as complex and as complementary as circumstances allow; there is no one set of simple rules that can capture or explain the complexity and contingency of life.[15]

Because an evolutionary perspective rejects the notion that legal change progresses in a teleological way towards the 'best' outcome,[16] it challenges functionalist perspectives that suggest law functions in an instrumentalist way to produce desirable socio-economic outcomes or brings about a form of survival of

11 David explained why history matters in the form and functioning of institutions: Paul A David, 'Why are Institutions the "Carriers of History"? Path Dependence and the Evolution of Conventions, Organizations and Institutions' (1994) 5(2) *Structural Change and Economic Dynamics* 205. Holmes observes that lawmakers, both judicial and legislative, generally adapt existing law to meet changed circumstances rather than design entirely new law so that legal change largely occurs in an evolutionary rather than revolutionary way: Oliver Wendell Holmes, 'Law in Science and Science in Law' (1899) 12(7) *Harvard Law Review* 443, 444–55. Sinclair used the history of the tort of seduction to contrast the evolutionary nature of changes to the common law with the sometimes revolutionary nature of legislative change: MBW Sinclair, 'The Use of Evolution Theory in Law' (1987) 64(3) *University of Detroit Law Review* 451, 455–8, 467–71. He explained why old common law rules survived with minor evolutionary adjustments from time to time: at 455–8. 'Tinkering with old rules is a common judicial game; replacing old rules is not': at 458. The writer concluded that common law adaptions often resulted in imperfect laws that carried maladaptive features but generally worked well enough: at 477. Sinclair later rejected the idea of basing an evolutionary approach to law on the biological model: MBW Sinclair, 'Evolution in Law: Second Thoughts' (1993) 71(1) *University of Detroit Mercy Law Review* 31 ('Evolution in Law').

12 'Historicism' has a number of meanings but in this paper it suggests that social and cultural phenomena are determined by history.

13 George A Reisch, 'Chaos, History, and Narrative' (1991) 30(1) *History and Theory* 1, 4–9. Reisch explains why history is 'chaotic'. In a chaotic system, 'small differences among initial conditions produce very great differences in its final states': at 5. Generally, socio-economic and legal systems are complex and chaotic. See also Mark J Roe, 'Chaos and Evolution in Law and Economics' (1996) 109(3) *Harvard Law Review* 641, 642 ('Chaos and Evolution').

14 Peter J Bowler, 'The Changing Meaning of "Evolution"' (1975) 36(1) *Journal of the History of Ideas* 95, 112–14.

15 Hutchinson (n 6) 56.

16 See below nn 88–9.

the fittest, being the most efficient system.[17]

As discussed in Part II, the utilisation of evolutionary perspectives to examine and interpret social change became largely discredited and virtually disappeared from social sciences, including law, during much of the 20th century. In more recent times, the use of evolutionary ideas in the social sciences based upon, or incorporating ideas that originated in biological evolution, has been resurrected.[18] Evolutionary concepts have been adopted in a range of disciplines including economics, psychology, sociology, technology, anthropology and ecology. The renewed interest in the utilisation of evolutionary theories as a theoretical framework for legal studies and legal history is part of this broader trend. Because evolutionary perspectives do not see historical forces as working towards a particular predetermined design and they allow for the existence and persistence of suboptimal outcomes, evolutionary perspectives generally lend themselves to critical appraisals of current legal positions.

This paper then goes on in Part III to describe the main characteristics of legal change when viewed from an evolutionary perspective. This Part provides the theoretical framework from which the evolution of three fundamental concepts of company law is discussed in Part IV. These concepts are joint stock, separate legal personality and limited liability, which comprise the main universal features of the modern corporation.[19] This Part comprises a case study of how evolutionary concepts and implications can be utilised in the study of the history of an area of law and in doing so it presents a non-teleological perspective of how legal concepts develop. The analysis in Part IV aims to provide an explanation of how law interacts with the socio-economic environment, why diversity of legal systems persists, the chaotic nature of legal change, why suboptimal legal outcomes often occur and why legal change often occurs in fits and starts.

II THE DIFFERENT MEANINGS OF THE CONCEPT OF 'LEGAL EVOLUTION'

The concept of 'legal evolution'[20] has been used in a number of different ways which encompass various approaches to legal history that are broadly aimed at

17 Examples of functionalist approaches referred to in Part II are the legal origins thesis, the law and economics 'survival of the fittest' argument and the 'end of history' thesis. See below nn 32, 34.

18 See, eg, Dennett (n 1) 338–52; Richard Dawkins, *The Selfish Gene* (Oxford University Press, 2006) 189–201.

19 John Armour et al, 'What Is Corporate Law?' in Reinier Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 3rd ed, 2017) 1, 5–11.

20 The etymology of the word 'evolution' has a Latin origin from *evolutio* which means to unroll or unfold. This original meaning referred to opening up something that already fully existed, although in a miniature or hidden form. This is no longer the meaning widely attributed to 'evolution', which now implies a process of development or 'the creation of new structures or entities': Bowler (n 14) 95–6. Bowler suggests that the modern use of the word stems from Herbert Spencer, who coined the term 'theory of evolution' as the general explanation for the process of development: at 106–7.

'explaining general patterns of continuity and change in the law'.[21] It is useful to consider these various meanings and how they differ from each other before focussing on a Darwinian evolutionary perspective in the remainder of the paper. These approaches can be placed in three categories.

The first and simplest way in which the concept may be used is to describe how the law has changed during a specified period of time so that the differences in the law at the end of the period as compared with at the beginning indicate the ways in which the law has 'evolved'. This first meaning can be described as 'autonomous' legal evolution as it tends to mainly focus on legal sources and so perceives law as operating in an autonomous way that is largely disconnected from economic, social or political environments.[22] It tends to view legal history as largely self-contained because it was mostly written to serve the needs of the legal profession and so is focused largely on the development of legal doctrine.[23] Autonomous legal histories tended to distrust or ignore theorisation and abstraction, 'value laden' methodologies and the use of economics in history. This divorce of 'theory' from 'history' resulted in a historical paradigm that was largely devoid of theoretical frameworks and which frustrated rather than fostered the growth of economic and social histories of law.[24] Examples of the autonomous approach in the area of company law can be seen in the work of Samuel Williston[25] and William Holdsworth.[26]

The second way in which the term 'legal evolution' can be used is based upon the notion that legal change operates in a functionalist way so as to determine or affect certain social and economic outcomes. The functionalist paradigm encompasses a very broad range of often conflicting perspectives which may include ideas and methodologies from a number of social science disciplines such as economics and

21 Mauro Zamboni, 'Making Evolutionary Theory Useful for Legal Actors' in Peer Zumbansen and Gralf-Peter Calliess (eds), *Law, Economics and Evolutionary Theory* (Edward Elgar, 2011) 270, 272. See also at 270–94.

22 See Ron Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720–1844* (Cambridge University Press, 2000) 3–6 ('*Industrializing English Law*').

23 David Sugarman and Gerry Rubin, 'Towards a New History of Law and Material Society in England, 1750–1914' in GR Rubin and David Sugarman (eds), *Law, Economy and Society, 1750–1914: Essays in the History of English Law* (Professional Books, 1984) 1–123.

24 Ibid 107–8. Sugarman and Rubin contrast the 'internal' legal history approach (which corresponds to autonomous approaches) with the historical sociology of law written by Max Weber. Weber constructed a new history of economics and law by paying conscious attention to methodology and the construction of an analytical framework in his study of society and regarded economics as part of history. To Weber 'theory' and 'history' were inextricably bound together.

25 Samuel Williston, 'History of the Law of Business Corporations before 1800' (Pt 1) (1888) 2(3) *Harvard Law Review* 105; Samuel Williston, 'History of the Law of Business Corporations before 1800' (Pt 2) (1888) 2(4) *Harvard Law Review* 149.

26 Holdsworth is best known for his 17th volume: see WS Holdsworth, *A History of English Law* (Methuen, 3rd ed, 1903). Of relevance to this paper see also WS Holdsworth, 'English Corporation Law in the 16th and 17th Centuries' (1922) 31(4) *Yale Law Journal* 382 ('English Corporation Law'). See Richard A Cosgrove 'The Culture of Academic Legal History: Lawyers' History and Historians' Law 1870–1930' (2002) 33 *Cambrian Law Review* 23. Cosgrove suggests that from the late 19th century until the 1960s, legal history became the province of lawyers who 'viewed the past only as the path to the present without sufficient respect for historical context': at 31.

finance.[27] A 'functional' approach to legal evolution is fundamentally different to an autonomous view of law because it attempts to interpret legal change in the context of social or economic developments and so it examines the nature of the relationship between legal change and developments taking place in the broader society. These diverse perspectives have in common the notion that the function of law is to facilitate the natural and proper evolution of a 'progressive' society and that 'law' and 'society' are linked but also independent of each other. Functionalist approaches assume that society has various needs such as stability, efficient organisation for production and preservation of continuity in the midst of change.[28] A central need is for society to develop along the 'appropriate social evolutionary path'. This path is determined by impersonal historical forces which follow a 'natural' evolutionary development leading to the liberal democratic model we have today. It follows then, that functionalist histories are generally concerned with the responsiveness of legal systems and legal change to social needs.[29]

Functionalist analyses tend to assume that there are clear determinate relationships between law and the economy or society, so that if a legal system possesses certain characteristics it will have a predictable impact on economic development or on the society. Approaches that view law as operating in a functionalist way, therefore, tend to be optimistic because they generally assume that law ultimately adapts to changing social needs even though there may be periods where the law lags behind or is dysfunctional for some time. Functionalist analyses are also often based upon the teleological assumption that law progressively improves towards the form that is best suited to its function or purpose.[30] According to this perspective, law is seen as forming an important part of the socio-economic infrastructure and as a necessary precondition for economic development.[31]

A highly influential example of this functionalist perspective of legal evolution is the strongly disputed 'legal origins' thesis. The central argument made is that

27 Harris lists a diverse range of writers who he categorises as adopting a functionalist approach. They include political economists and social theoreticians such as Marx and Weber, left-wing writer EP Thompson, American realists J Willard Hurst and Morton Horwitz, the law and economics writer Richard Posner and new institutional economists Douglass C North and Oliver Williamson: *Industrializing English Law* (n 22) 6–7.

28 Robert W Gordon, 'Critical Legal Histories' (1984) 36(1–2) *Stanford Law Review* 57, 61. Gordon questioned whether it was possible to define what the 'needs of society' were when there were in fact many different interest groups in society with diverse and often contradictory needs: at 69–71. The vision of law and society as comprising separate spheres also tended to produce generalised and overly simplistic theories which regarded 'law' as being fixed and a necessary precondition for serving society's needs for economic development in an instrumental or functional way: at 75–87.

29 Ibid 64. Gordon described the functionalist approach in the following terms: 'The general functionalist method is to construct (or, as is rather more common, to assume without much discussion) a typology of stages of social development and then to show how legal forms and institutions have satisfied, or failed to satisfy, the functional requirements of each stage'.

30 Ibid 61–3; Curtis J Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development Around the World* (University of Chicago Press, 2008) 17–21.

31 For critical discussions of functionalist approaches, see Milhaupt and Pistor (n 30) 17–22, 59–67.

the origin of a country's legal system is the most important determinant of the extent of development of its financial markets. According to this line of argument, differences in the characteristics of financial markets, the importance of stock exchanges and rates of economic growth in various countries are determined by, or closely associated with, the effectiveness of investor protection laws. Accordingly, strong investor protection laws result in more highly developed financial markets. Strong investor protection is more likely to occur in countries with common law legal systems where there are generally stronger investor protection laws than in civil law systems. This is because the common law is supposedly more adaptable than civil law and so can more effectively align legal rules and economic growth.[32] A functionalist approach to legal evolution has also been adopted by a number of law and economics writers who saw legal change as a form of Darwinian survival of the fittest[33] to argue that more efficient laws would inevitably prevail over less efficient laws which would presumably disappear into history.[34]

The third, and the most complex meaning of 'legal evolution', seeks to utilise Darwinian evolutionary theories to explain the nature of legal change and its relationship to the wider environment. It thereby provides a theoretical explanation for the mechanisms which underlie legal change. This theoretical framework is

32 Rafael La Porta et al, 'Legal Determinants of External Finance' (1997) 52(3) *Journal of Finance* 1131; Rafael La Porta et al, 'Law and Finance' (1998) 106(6) *Journal of Political Economy* 1113; Rafael La Porta et al, 'Investor Protection and Corporate Governance' (2000) 58(1–2) *Journal of Financial Economics* 3. The 'legal origins' thesis was developed by a group of law and finance academics who adopted a detailed empirical methodology, comprising 15 shareholder and creditor protection laws across 49 countries, which attempted to measure the strength of investor protection laws across a large number of countries. In introducing a 'leximetric' approach, this thesis has aroused considerable controversy on several fronts and given rise to an extensive critical literature. For some examples of critical responses see Mark J Roe, 'Legal Origins, Politics, and Modern Stock Markets' (2006) 120(2) *Harvard Law Review* 460; John Armour et al, 'Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis' (2009) 6(2) *Journal of Empirical Legal Studies* 343; Daron Acemoglu, Simon Johnson and James A Robinson, 'The Colonial Origins of Comparative Development: An Empirical Investigation' (2001) 91(5) *American Economic Review* 1369; Beth Ahlering and Simon Deakin, 'Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complementarity?' (2007) 41(4) *Law and Society Review* 865; Milhaupt and Pistor (n 30) ch 1.

33 This view of evolution which links natural selection and economic determinism stems from the writings of Herbert Spencer, who is credited with first using the phrase 'survival of the fittest' and the early sociologist, William Graham Sumner. See Hovenkamp (n 6) 664–71.

34 For examples of such law and economics writers see Paul H Rubin, 'Why is the Common Law Efficient?' (1977) 6(1) *Journal of Legal Studies* 51; George L Priest, 'The Common Law Process and the Selection of Efficient Rules' (1977) 6(1) *Journal of Legal Studies* 65; Robert Cooter and Lewis Kornhauser, 'Can Litigation Improve the Law without the Help of Judges?' (1980) 9(1) *Journal of Legal Studies* 139; Ronald A Heiner, 'Imperfect Decisions and the Law: On the Evolution of Legal Precedent and Rules' (1986) 15(2) *Journal of Legal Studies* 227; Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89(2) *Georgetown Law Journal* 439. Hansmann and Kraakman claimed that the US shareholder primacy model has prevailed over other corporate law models because of its inherent greater efficiency and so has won a battle of survival of the fittest and will increasingly be adopted by other countries. The 'end of history' argument attracted considerable criticism: see, eg, Masahiko Aoki, *Corporations in Evolving Diversity: Cognition, Governance, and Institutional Rules* (Oxford University Press, 2010) 178–83; Douglas M Branson, 'The Very Uncertain Prospect of "Global" Convergence in Corporate Governance' (2001) 34(2) *Cornell International Law Journal* 321; Ahlering and Deakin (n 32) 903. Hansmann and Kraakman responded to some of their critics in their article: see Henry Hansmann and Reinier Kraakman, 'Reflections on the End of History for Corporate Law' in Abdul A Rasheed and Toru Yoshikawa (eds), *The Convergence of Corporate Governance: Promise and Prospects* (Palgrave Macmillan, 2012) 32.

based to varying extents around the central idea that the law interacts with its environment in a manner that is broadly similar to how species interact with their environments in accordance with Darwinian evolutionary theories.[35] The concept of legal evolution used in this paper can be described as 'Darwinian legal evolution'. The adoption of Darwinian ideas from biology in the social sciences[36] has been controversial and strongly resisted.[37]

A Darwinian evolutionary approach to the examination of legal history has in common with functionalist approaches that they both utilise economic and social sources so as to place legal change in the context of developments that took place in the economic and social spheres. An evolutionary approach, however, differs from functional perspectives in a number of important respects. It leaves open the possibilities that legal changes may both bring about social and economic developments and that social and economic factors may influence legal change in a 'co-evolutionary' rather than linear way. The path of legal change is not seen as an inevitable progression towards the best form to suit its function because it is shaped by the complex interplay of historical factors that could conceivably have produced significantly different outcomes. Evolutionary theories provide a theoretical framework for the analysis of legal change which recognises that suboptimal laws may arise and persist. An evolutionary perspective stresses the importance of detailed examination of specific legal, economic and social histories in order to explain how and why legal change came about. The historical path of legal change may be influenced in unpredictable and complex ways by a number of historical factors so that law is not static but dynamic and changeable.

The utilisation of Darwinian evolutionary theory to explain how legal doctrines and common law principles evolved has a long history dating back at least to the 19th century.[38] Oliver Wendell Holmes[39] explained the evolution of legal

35 Hovenkamp (n 6) described the adoption of Darwinian models in evolutionary jurisprudence: at 645–50. See also Simon Deakin and Frank Wilkinson, *The Law of the Labour Market: Industrialization, Employment, and Legal Evolution* (Oxford University Press, 2005) 26–35; Elliott (n 6) 39.

36 The importation of Darwinian ideas to social sciences has been described as 'generalized' or 'universal' Darwinism: Aldrich et al (n 1) 578–9.

37 Ibid 578–81. The writers contend that critics of generalised Darwinism argue that it is a form of 'biological reductionism' which relies upon biological metaphors or analogies, and that the differences between the biological and cultural domains are too great. They also suggest that a reason why social scientists resist the idea of generalising Darwinism is the danger of 'social Darwinism': see below n 53.

38 Stein discusses early forms of evolutionary methodology which include theories of legal evolution that were developed in the 19th century to link the broad stages through which societies were thought to progress with the changing nature of legal systems in these different stages. This discussion includes writers such as Friedrich Karl von Savigny and Henry Maine: Peter Stein, *Legal Evolution: The Story of an Idea* (Cambridge University Press, 1980) 51–98. In this article I begin this discussion with evolutionary perspectives that consciously incorporate Darwinian concepts and biological metaphors.

39 Holmes was a professor at Harvard Law School, judge of the Supreme Judicial Court of Massachusetts and Justice of the United States Supreme Court where his dissenting judgements over many years focussed criticism on the legal conservatism of the majority during the period before the New Deal era. Horwitz described Holmes as 'the most important and influential legal thinker America has had': Morton J Horwitz, *The Transformation of American Law 1870–1960: The Crisis of Legal Orthodoxy* (Oxford University Press, 1992) 109. Horwitz provides a detailed discussion of the importance of Holmes' contribution to American legal thought: at ch 4. See also Gary Minda, 'One Hundred Years of Modern Legal Thought: From Langdell and Holmes to Posner and Schlag' (1995) 28(2) *Indiana Law Review* 353, 361–4.

doctrines in Darwinian terms[40] as responses to changes in the social environment and as an argument that judges should take into account historical and social considerations.[41] In a very modern way, Holmes pointed out the similarity of legal evolution to biological evolution when he drew the analogy of the clavicle of a cat as illustrating the adaption of existing biological structures to different uses in later periods and that legal doctrines also evolved so that precedents that once served a purpose may continue to survive long after their original purpose had disappeared.[42] Holmes' central idea that societies were constantly reinterpreting legal forms and transplanting them to serve new purposes came to be known as 'evolutionary pragmatism'.[43] Holmes described these transformations of legal ideas as 'the struggle for life among competing ideas' resulting in 'the ultimate victory and survival of the strongest'.[44]

Arthur Linton Corbin extended Holmes' observations on how legal doctrines evolved. Corbin described the evolution of legal rules as akin to living things where the 'struggle for life is keen among them and only the fittest survive'.[45] He saw the rules declared by judges as being in a form of competition with each other. The law that ultimately prevailed was the law that survived because it was the fittest in the same way as occurred in the biological world.[46] Just because a rule was of long standing did not mean it would necessarily continue to survive. As new cases arose, judges were required to make decisions whether or not to follow the existing rule or to modify it in the case at hand. 'A new and different application of the rule is the creation of a new rule.'[47] Corbin suggested that while judges had the power to make decisions in cases, this power was derived from a broad community consent and acceptance.[48]

40 Gordon referred to Holmes' book OW Holmes Jr, *The Common Law* (Little, Brown, 1881) as Darwinian: Robert W Gordon, 'Holmes' Common Law as Legal and Social Science' (1982) 10(3) *Hofstra Law Review* 719, 739. See also Vetter, who claimed that the theory of natural selection was 'the largest single influence on *The Common Law*' and described Holmes as a 'Social Darwinist': Jan Vetter, 'The Evolution of Holmes, Holmes and Evolution' (1984) 72(3) *California Law Review* 343, 363. On this point see Hovenkamp (n 6), who suggested that Holmes generally opposed judicial review of economic regulation legislation because he favoured judicial restraint more highly than Social Darwinism which opposed state attempts to redistribute wealth: at 660–1. Hovenkamp discussed how evolution theory influenced Holmes' thinking: at 656–64.

41 OW Holmes, 'The Path of the Law' (1897) 10(8) *Harvard Law Review* 457, 474. Holmes wrote in *The Common Law* (n 40) that '[t]he life of the law has not been logic: it has been experience. The felt necessities of the time, the prevalent moral and political theories, intuitions of public policy, avowed or unconscious, even the prejudices which judges share with their fellow-men, have had a good deal more to do than the syllogism in determining the rules by which men should be governed': at 1.

42 Holmes, *The Common Law* (n 40) 35.

43 Elliott (n 6) 52, quoting Philip P Wiener, *Evolution and the Founders of Pragmatism* (Harvard University Press, 1949) 172.

44 Holmes, 'Law in Science and Science in Law' (n 11) 449.

45 Arthur L Corbin, 'The Law and the Judges' [1914] (3) *Yale Review* 234, 237, quoting Frederick Pollock and Frederic William Maitland, *The History of English Law before the Time of Edward I* (Liberty Fund, 2nd ed, 2010) vol 2, 588. Corbin appears to have been influenced by Herbert Spencer in his use of the idea of survival of the fittest. Elliott (n 6) stated that this article nearly cost Corbin his academic position because in it he made the highly controversial argument at the time that judges made law rather than merely applied it: at 56 n 113.

46 Corbin (n 45) 238.

47 Ibid 239.

48 Ibid 250.

Albert Kocourek and John Henry Wigmore presented the Darwinian argument that, just as environmental conditions influenced the evolution of biological forms, the law developed by continually responding to a wide range of environmental factors.[49] An article by Picard was included within their book, which identified a number of factors that influenced legal evolution such as race, the environment, foreign intrusion or imitation, great jurists and density of population. In a particularly modern insight, Wigmore refuted the notion that legal evolution implied progress in a normative sense. Rather, he suggested that legal evolution means that the law continually adapts to changes in the environment.[50]

After this early interest in the application of evolutionary theory to the processes of legal change, Darwinian theories of legal evolution became widely discredited for much of the 20th century. This was in part the result of the general disillusionment with the idea of human progress which was associated with 19th century biologists and philosophers such as Herbert Spencer[51] as well as with theories of legal evolution, especially as espoused by Victorian writers such as Henry Maine.[52] The association of evolution with progress towards a more developed state and the concept of the survival of the fittest among racial ethnic groups led many to see the concept of evolution as underpinning ideologies such as Nazism which incorporated notions of racial superiority and inferiority and justified racism, imperialism and eugenics leading to many of the horrific events of the 20th century. This highly negative view of evolution was sometimes described as 'Social Darwinism' by critics who opposed the use of biological insights into analyses of social behaviour.[53] It wasn't until the 1970s that evolutionary ideas

49 Albert Kocourek and John H Wigmore (eds), *Evolution of Law: Select Readings on the Origin and Development of Legal Institutions* (Little, Brown, 1918) vol 3. This three-volume work was essentially a collection of primary sources and other readings that embodied a Darwinian perspective. For the purposes of this article, the most significant contribution was by Edmond Picard, 'Factors of Legal Evolution', tr John H Wigmore in Albert Kocourek and John H Wigmore (eds), *Evolution of Law: Select Readings on the Origin and Development of Legal Institutions* (Little, Brown, 1918) vol 3, 163. See especially at 170.

50 John H Wigmore, 'Planetary Theory of the Law's Evolution' in Albert Kocourek and John H Wigmore (eds), *Evolution of Law: Select Readings on the Origin and Development of Legal Institutions* (Little, Brown, 1918) vol 3, 531, 533.

51 See Bowler (n 14) 96, 107–9.

52 Maine's best-known book was Henry Sumner Maine, *Ancient Law: Its Connection with the Early History of Society, and Its Relation to Modern Ideas* (John Murray, 1861). For a modern critique of Maine's work see Calvin Woodard, 'A Wake (or Awakening?) for Historical Jurisprudence' in Alan Diamond (ed), *The Victorian Achievement of Sir Henry Maine: A Centennial Reappraisal* (Cambridge University Press, 1991) 217.

53 For a discussion of the reasons put forward against the application of Darwinian principles to the social sciences see Hodgson and Knudsen (n 1) 13–23. Hodgson argued that the label 'social Darwinism' was unhelpful and misleading and there was in fact no self-declared school of 'Social Darwinists': Geoffrey M Hodgson, 'Social Darwinism in Anglophone Academic Journals: A Contribution to the History of the Term' (2004) 17(4) *Journal of Historical Sociology* 428 ('Social Darwinism in Anglophone Academic Journals'). Rather, the label was at first used as a weapon to discredit opponents especially during World War II, most notably by Richard Hofstadter: at 445–8. See Richard Hofstadter, *Social Darwinism in American Thought, 1860–1915* (University of Pennsylvania Press, 1944). In more recent times the label has been used to criticise the use of biological ideas in the social sciences. '[A] widespread opinion remains that Darwinism has intrinsic, intractable and ideological problems for social science, and hence it should be banished from social science altogether': Hodgson, 'Social Darwinism in Anglophone Academic Journals' (n 53) 430, citing Mike Hawkins, *Social Darwinism in European and American Thought, 1860–1945: Nature as Model and Nature as Threat* (Cambridge University Press, 1997).

based upon Darwin's theories came to be more widely used in social sciences including legal discourse.[54]

A Darwinian perspective of 'legal evolution' is fundamentally different from the first two approaches outlined earlier in this Part. This difference corresponds to the distinction drawn in the field of biological evolution between evolution as 'fact' and as 'theory'. 'Facts are the world's data. Theories are structures of ideas that explain and interpret facts.'[55] In much the same way, writers who adopt the first approach describe the 'fact' of legal evolution by pointing to changes in the law over a period of time. The second approach goes further to connect this change in the law to changes in the economy or society but does not try to examine in abstract terms the mechanism or nature of legal change. The third 'evolutionary' approach seeks to explain the theoretical mechanisms which govern why and how the 'facts' of evolution occur and the broad characteristics of legal change. It also draws attention to a more complex inter-relationship between legal and social or economic change.

An evolutionary perspective in this Darwinian sense presumes that the cause and effect of the relationship between legal evolution and changes in the social and economic environment is complex, multi-linear and interactive.[56] This is a major difference with functionalist approaches which see law as operating in an instrumental one-way relationship with economic and social spheres to meet the needs of society. A Darwinian perspective suggests that just as legal change could be instrumental in effecting social and economic change, so too could social and economic change create a setting which ultimately leads to legal change. This may occur where economic change causes a realignment of interest groups that is conducive to legal change. It is also observable that legal and social or economic changes are not necessarily synchronised and while an interrelationship may exist, it could often be marked by considerable lags, variations in the degree of synchronisation, unpredictability and unforeseen consequences.[57]

As noted earlier, Darwinian evolutionary ideas can be usefully applied to better understand the development of legal concepts, however it cannot be said that these evolutionary theories can be used to provide a complete determinist explanation

54 See, eg, Dennett (n 1); Dawkins (n 18).

55 Stephen Jay Gould, *Hen's Teeth and Horse's Toes: Further Reflections in Natural History* (Penguin Books, 1984) 254. Gould noted that Darwin was well aware of the distinction 'between his two great and separate accomplishments: establishing the fact of evolution, and proposing a theory — natural selection — to explain the mechanism of evolution': at 255.

56 Deakin and Wilkinson (n 35) 30. See also Milhaupt and Pistor (n 30) 219–24; Marie Theres Fögen, 'Rechtsgeschichte: Geschichte der Evolution eines Sozialen Systems' [Legal History: History of the Evolution of a Social System] [2002] (1) *Zeitschrift des Max-Planck-Instituts für Europäische Rechtsgeschichte* [Journal of the Max Planck Institute for European Legal History] 14, 14 [4].

57 Deakin and Wilkinson (n 35) 28–30. These characteristics were also noted by Harris, *Industrializing English Law* (n 22) 3–12.

of how law develops.[58] Specific investigation is still required of a particular law and its historical and social context.[59]

Darwinism has been applied to social evolution in various ways.[60] At one end of the spectrum, ultra or 'hard' Darwinists contend that an evolutionary approach is not merely Darwinian by analogy but involves processes that are evolving according to the core Darwinian principles of variation (the mechanism by which slightly different or new organisms are created), selection (the process by which a choice is made as to which of the possibilities are transmitted and which are discarded) and inheritance (the method by which new characteristics are transmitted to later generations).[61] An important way in which the Darwinian principles may be applied to social phenomena involves the concept of memes. This is discussed below.

A 'softer' Darwinian approach sees common abstract features in both the biological and social spheres 'at a high level of abstraction and not at the level of detail'.[62] In particular, Darwin's central idea of 'descent with modification' can be seen as applicable to both the evolution of species and social institutions and ideas. Darwinian evolutionary change can at times be stable and move very slowly and at other times occur with rapid speed and unpredictability.[63] This can also be readily observed both in the biological sphere and in relation to social and legal evolution. It is more difficult to envisage how the biological mechanism of natural selection operates in relation to institutional or legal change as we usually do not have a large number of varied entities that display different capabilities of adaption to a changing environment. It is therefore less apparent how natural selection, as it operates in the evolution of biological species, can apply in a social or legal context.

One explanation of how the mechanism of natural selection can be applied to the evolution of cultural ideas, including law, is based on the idea that just as genes are the means by which organisms inherit features from their ancestors, so the way in which cultural ideas are replicated through a population can be described in

58 Elliott (n 6) 93.

59 Geoffrey M Hodgson, 'Generalizing Darwinism to Social Evolution: Some Early Attempts' (2005) 39(4) *Journal of Economic Issues* 899, 900–1. Hodgson noted that Universal Darwinism cannot predict future developments, nor can 'Universal Darwinism … give us a full, detailed explanation of evolutionary processes or outcomes. It is a meta-theoretical framework rather than a complete theory': at 901. For an example of legal history from an evolutionary perspective see Deakin and Wilkinson (n 35) which analyses the development of labour law in Britain.

60 Darwinism when applied to social evolution is described as 'universal' or 'generalised' Darwinism. See Aldrich et al (n 1) 578–81.

61 These principles were discussed in the context of social evolution by Aldrich et al (n 1) 583–5 and in the context of legal evolution by Sinclair, 'Evolution in Law' (n 11) 454–5.

62 Aldrich et al (n 1) 579.

63 This was described as 'punctuated equilibria' by Stephen Jay Gould and Niles Eldredge, 'Punctuated Equilibria: The Tempo and Mode of Evolution Reconsidered' (1977) 3(2) *Paleobiology* 115.

terms of the transmission of 'memes'.[64] A meme is a unit of cultural transmission; that is, it is an idea or concept that is shared by individuals within a population. The memetic process of cultural transmission and change corresponds to the role of genetics in biological replication, and the spreading of memes to others was seen by Dawkins as being subject to the Darwinian principles applicable to genes so that cultural transmissions also evolve over time by means of natural selection in ways which reflect environmental pressures.[65] Memes that succeed in being widely replicated (or reproduced) are those best adapted to being communicated and selection pressures may change over time. Both memes and genes will 'succeed' in being reproduced if they are good replicators, whether or not they are beneficial to society. Hence memes are in a sense 'selfish' in much the same way as genes. The process of natural selection operates between rival memes in a similar way to organisms. There is competition between memes for minds in a similar way as competition between organisms for resources, so a readily understood meme is more likely to survive than a turgid or difficult to remember meme.[66]

From a memetics perspective, legal concepts are abstractions which act as mechanisms of cultural inheritance by taking complex information from the outside socio-economic environment and coding it in a form that is usable by the legal system itself. Legal concepts play an important role in the legal system because they provide a series of broad inter-linked principles that make the body of legal rules and doctrines understandable and cohesive rather than random and arbitrary.[67] This notion of legal concepts is compatible with evolutionary theory as legal concepts provide the basis for legal continuity while at the same time allowing for mutation and adaption over time as the environment changes.

While memetic analysis can be generally applied to the transmission of cultural concepts, legal doctrines and rules are particularly well suited to this type of analysis.[68] Legal principles represent a precise and carefully organised written record which has been maintained over long periods of time and in many places both within countries and internationally. This standard form of documentation facilitates historical and comparative analyses more readily than verbal

64 The term 'meme' was first used by Richard Dawkins in *The Selfish Gene* (n 18) ch 11. Dennett also utilised the concept of memetics: see Dennett (n 1) ch 12. In relation to the application of memetics to law, see Deakin (n 8) 1. The use of memetics to explain cultural evolution has been described as 'ultra-Darwinian' because it sees cultural evolution as controlled by the principles of natural selection: see Hutchinson (n 6) 38. The adoption of the concept of memetics has been criticised on the basis that there has been no scientific demonstration of such an 'immaterial replicator' and 'no clear-cut definition of a "meme"': see Luis Benítez-Bribiesca, 'Memetics: A Dangerous Idea' (2001) 26(1) *Interciencia* 29.

65 Fried discussed the role of natural selection in evolutionary theory: Michael S Fried, 'The Evolution of Legal Concepts: The Memetic Perspective' (1999) 39(3) *Jurimetrics Journal of Law, Science and Technology* 291, 292–5. Fried suggested that memes and organisms evolved in similar ways, having in common that they did 'not evolve toward some preordained state of perfection': at 298. See also Deakin (n 8).

66 Fried (n 65) 298–300.

67 Deakin and Wilkinson (n 35) 31.

68 Fried (n 65) 307–8.

communications or less formal written forms which raise problems of certainty and accessibility. The methodology of the common law also facilitates memetic analysis because precedents form the basis of judgements and legal opinions and thereby provide continuity and links to the genealogy of a particular meme. The writing of judgements is a careful process requiring precedents to be closely considered and accurately cited. This ensures that changes to legal doctrines occur slowly and deliberately as a result of a natural selection process rather than mutations occurring by way of unfaithful reproduction or 'random memetic drift'.[69]

Another way in which evolutionary concepts have been used to describe legal change is by utilising the idea of law as an 'autopoietic' system. The concept of autopoiesis was developed to explain the dynamics and organisation of living systems around which natural selection operates. It later came to be applied in the social sciences.[70] Autopoiesis means 'self-creation' or 'self-production' and is used to describe the circular self-referential system in which the elements of a system generate the network of operations producing the elements of the system. The core image is 'the individual organism, ceaselessly generating elements out of elements, forming each element into an indissoluble unity from a more complex base of energy and matter'.[71] Elements which are outside the 'circular dance of autopoiesis are outside the system' and therefore form part of its environment.[72] While its elements may change in response to outside pressures, the system responds on its own terms and according to its own operations not on terms established by the environment.

The autopoietic approach can be applied to law.[73] The view that law operates autonomously is based on the idea that legal evolution is driven to a large extent by

69 Ibid 308. Dawkins (n 18) distinguished between 'replicas' which are exact copies copied from the same source and 'replicators' which form a lineage with an ancestor-descendant relationship so that if a blemish appeared in the series, it will 'be shared by descendants but not by ancestors': at 273–4. It is the ancestor-descendant series which has the potential to evolve: at 274.

70 The autopoiesis theory was formulated by the Chilean biologists Humberto Maturana, Francisco J Varela and Ricardo B Uribe. See FG Varela, HR Maturana and R Uribe, 'Autopoiesis: The Organization of Living Systems, Its Characterization and a Model' (1974) 5(4) *BioSystems* 187. It was first transferred into social science by Luhmann: see Niklas Luhmann, *The Differentiation of Society*, tr Stephen Holmes and Charles Larmore (Columbia University Press, 1982) ch 6. Luhmann was a theoretical sociologist who studied legal change, among many other subjects, and expanded the area of systems theory. For a discussion of Luhmann's work in the study of legal change see Arthur J Jacobson, 'Autopoietic Law: The New Science of Niklas Luhmann' (1989) 87(6) *Michigan Law Review* 1647.

71 Jacobson (n 70) 1647.

72 Ibid.

73 The application of autopoietic theory to law is most associated with Niklas Luhmann and Gunther Teubner. See Gunther Teubner (ed), *Autopoietic Law: A New Approach to Law and Society* (Walter de Gruyter, 1988); Jacobson (n 70). For a debate on Teubner's theoretical approach see Erhard Blankenburg, 'The Poverty of Evolutionism: A Critique of Teubner's Case for "Reflexive Law"' (1984) 18(2) *Law and Society Review* 273. For Teubner's response, see Gunther Teubner, 'Autopoiesis in Law and Society: A Rejoinder to Blankenburg' (1984) 18(2) *Law and Society Review* 291 ('Autopoiesis in Law and Society'). For an overview of criticisms of Teubner's explanations see Anthony Beck, 'Is Law an Autopoietic System?' (1994) 14(3) *Oxford Journal of Legal Studies* 401, 409–16.

internal considerations which govern the development of law and this development is relatively unaffected by the social and economic environment.[74] While the legal and economic systems are 'autopoietically closed' there is still an inter-relationship between the law and economy as they are still indirectly affected by their external environments. However, the nature of this relationship is one of 'co-evolution': law affects economic behaviour, but in turn, economic behaviour affects the law. The relationship of law and economic behaviour is likely to be asynchronic so that one may not necessarily immediately affect the other but over a longer period of time, legal and economic developments influence each other.

The idea of an autopoietic, self-generating legal system appears to sit well with the jurisprudence of the common law where legal decisions are justified by past decisions and present decisions serve as a reference for future decisions. It seems to emphasise the closed nature of the legal system and therefore its relative autonomy but it also recognises that closed systems interact with their environments. As a result of socio-legal evolution, legal systems, being self-referential, operate autonomously in the sense that they cannot interact directly with other autopoietic systems. However legal systems are able to formulate rules and decisions with reference to an internal legal representation of social reality. They construct legal models of the social world with which they are able to interact internally. These models do not replicate the outside world but reconstruct reality to fit the internal elements of the legal system.[75]

As discussed earlier in this Part, the utilisation of memetics attempts to explain how an 'ultra-Darwinian' approach can be adopted in social sciences and law. It is suggested in this paper that even if the Darwinian mechanisms of variation, selection and inheritance cannot be neatly applied to social sciences including law, a Darwinian evolutionary approach is still useful because it provides a theoretical framework for explanations such as why particular complex outcomes occurred; how these changes were affected by environmental developments; what modifications were made to previous forms; why a suboptimal outcome may have eventuated; and why legal change may have occurred quickly or slowly. In these broad terms there are similar corresponding arguments and explanations that are applicable to both biological and social and institutional evolution. Most importantly, an evolutionary approach tells us that history matters and it is critical to examine the localised factors that were associated with legal change.[76]

74 Deakin and Carvalho expressed the relationship between the legal and economic systems as '[e]ach system, the legal and the economic, forms the environment of the other; each one, through its own internal dynamic of self-reproduction, constructs an image both of itself and of the systems external to it. But a unity of viewpoints is impossible so long as systems remain autopoietically closed': Simon Deakin and Fabio Carvalho, 'System and Evolution in Corporate Governance' (Working Paper No 150/2010, European Corporate Governance Institute, April 2010) 7 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1581746>.

75 Teubner, 'Autopoiesis in Law and Society' (n 73) 293, 296–7.

76 Aldrich et al (n 1) put it that '[o]verall, Darwinism by itself is insufficient to provide full and complete answers, but it provides a general framework in which additional and context specific explanations may be placed': at 593.

III THE CHARACTERISTICS OF DARWINIAN LEGAL EVOLUTION

As noted in Part II, the term 'legal evolution' can be used in a number of different ways. This paper adopts the meaning of legal evolution that utilises evolutionary theories and concepts associated with Darwin to explain the nature of legal change and its relationship to the wider environment. The Darwinian mechanisms of variation, selection and inheritance explain how the process of 'descent with modification' occurs in biological species. An 'ultra-Darwinian' approach suggests that these mechanisms also apply to social evolution and this occurs by means of replicators which were described by Dawkins in his book *The Selfish Gene* as 'memes'.[77]

Legal change can be seen as an example of cultural transmissions by means of memes. Whether the detail of evolutionary ideas applicable to biological species can be literally applied to the analysis of jurisprudence and legal history is a question of some considerable controversy.[78] But even if one does not accept an 'ultra-Darwinian' approach, the idea of generalising Darwinism does not entirely rest on the requirement that the detailed mechanisms of social and biological evolution are the same or similar nor does it provide complete explanations of legal change. It does however provide a theoretical framework within which historical study may be undertaken and further explanations provided.[79] Used in this 'soft' Darwinian sense, 'legal evolution' may provide a theoretical explanation of legal change that recognises the conflicting tendencies apparent in biology of 'the restraining push of tradition and the liberating pull of transformation'.[80] It is based around the central idea that the law interacts with its changing environment in a manner that is broadly similar to the ways in which biological species interact with their environments in accordance with Darwinian evolutionary theories. This is not to say that evolutionary theory presents a comprehensive and determinist narrative that does away with the need to engage in detailed historical study. Rather it creates a 'distinctive kind of conversational setting' as a way of perceiving and describing how legal change occurred.[81]

An evolutionary perspective further recognises that there may be complex causal relationships between specific legal outcomes and economic or social developments. Over a long period of time, legal evolution inter-relates with social

77 See above Part II for a discussion of memes.

78 Hutchinson (n 6) discussed the competing approaches of 'ultra-Darwinians' such as Richard Dawkins and Daniel Dennett who seek to extend to social sciences the central role played by natural selection and 'traditional Darwinians' who accept that while natural selection has a role to play, it is not necessarily the only dynamic at work: at 35–42.

79 Aldrich et al (n 1) 591–3.

80 Hutchinson (n 6) 2.

81 Elliott (n 6) 93.

and economic change so that each affects the other in an ongoing, reciprocal and dynamic way as each evolves.[82] Fögen suggested that a 'co-evolutionary' model was useful for describing this relationship between law and its environment. Societies are based on a balance of social systems which include the economy, legal system and political institutions. Each relies on and is related to the others and so in modern sophisticated societies, these structural relationships generally facilitate an interactive co-evolution.[83]

This does not mean that change in one system will necessarily affect other systems in predictable ways as their relationship may be described as 'chaotic'.[84] What may at first appear to be relatively trivial could ultimately turn out to have an unexpected and major influence on how law ultimately evolves. Equally, what may appear at the time to be of considerable importance may turn out to be a relatively minor occurrence. This is similar to biological evolution and can often result in unexpected '[o]dd arrangements and funny solutions'.[85] An evolutionary approach to legal history envisages that as history unfolds, choices are required to be made at various junctures and these choices present possible alternative paths from which one prevails, often as a result of particular circumstances, accidents or contingencies.

A Darwinian legal evolutionary perspective implies that just as in the case of the evolution of biological species, law interacts with the external environment as it moves away from an existing point rather than progresses towards a predestined optimal state. In this sense it provides a 'genealogical' perspective which seeks to link the present situation with earlier forms and a sequence of events so the present can be seen as a 'carrier of history'.[86] In this way existing law is adapted from materials already to hand[87] to meet changing circumstances rather than being completely redesigned. It therefore disputes the teleological[88] generalisation

82 Milhaupt and Pistor (n 30) described the relation between legal and economic development as 'a *rolling relation* between law and markets, which serve as two points in a continuous feedback loop': at 28 (citations omitted).

83 Fögen (n 56) 18 [15].

84 In the sense used by Reisch (n 13) 4–9.

85 Gould so described the panda's thumb: Stephen Jay Gould, *The Panda's Thumb: More Reflections in Natural History* (WW Norton, 1st ed, 1980) 20 ('*The Panda's Thumb*'). Using a phrase which he attributes to Michael Ghiselin, Gould wrote that he sees this evolutionary outcome not as ideal but as a 'contraption, not a lovely contrivance' that served its purpose: at 24.

86 See above n 11.

87 David (n 11) 207.

88 A 'teleological' view suggests that developments are due to the purpose they fulfil so that the way the law has developed to its present state is shaped by its functionality. It is implicit in a teleological view that the current position tends to be the most functional, as less functional alternatives have somehow been discarded by the forces of history which act as if by design. Teleological approaches have been described as '"project[ing] backward from the end of the story"': Deakin and Wilkinson (n 35) 34, quoting Harris, *Industrializing English Law* (n 22) 14.

that legal change will generally tend to move towards greater efficiency.[89] An implication of a genealogical perspective is that there will generally be considerable diversity of corporate forms both across and within national jurisdictions rather than convergence towards a supposedly superior model which may signal the 'end of history' as posited by Hansmann and Kraakman.[90] The complex dynamics involving corporations and their socio-economic and political environments will produce a range of different governance structures and organisational architecture reflecting local histories and conditions rather than the adoption of a universal model that ultimately prevails everywhere because of its demonstrable inherent efficiency.[91]

Hutchinson described the common law's development not as 'an evolutionary stairway to juridical heaven' but as 'a rutted and rough road that has innumerable twists and turns and no particular destination; any particular route taken has been chosen from among the countless and constantly proliferating possibilities for change'.[92] An evolutionary approach therefore recognises that suboptimal situations may arise and persist. This may occur because of historical contingencies, path dependencies[93] or because laws may have been efficient enough to survive at an earlier time but may no longer be well suited to later changed environments. The way in which historical contingencies influence change is generally unpredictable or 'chaotic'.

The process of legal change can therefore better be seen as not a gradual movement towards a superior and more just system, but as indeterminate in accordance with the evolutionary concept of 'punctuated equilibrium'.[94] Punctuated equilibrium describes the process of evolution as characterised by long periods of little change punctuated by sudden periods of major changes.[95] This appears to be the case with legal change. Sudden change occurs in legal evolution in response to major social, political or economic developments and the concept of punctuated equilibrium is a

89 These two contrasting theoretical models have been debated since Aristotle introduced the teleological method as a means of explaining the inherent purpose and direction of nature. For a discussion of these opposing views in the context of economic theory see Paul A David, 'Historical Economics in the Longrun: Some Implications of Path-Dependence' in Graeme Donald Snooks (ed), *Historical Analysis in Economics* (Routledge, 1993) 29.

90 See above n 34.

91 Aoki (n 34) 178–83. Ahlering and Deakin (n 32) also reject the claim that there is 'a uniquely successful path to legal and economic development'. Rather, 'laws have been matched to national conditions' which results in enduring institutional diversity. The writers suggest that 'the timing of industrialization with regard to the emergence of core legal institutions of market economies' is the critical causal factor: at 903.

92 Hutchinson (n 6) 15.

93 Roe, 'Chaos and Evolution' (n 13) provides an example of how path dependence can result in an inefficient outcome brought about by long-forgotten historical factors and why inefficiency may persist: at 643–4.

94 Eldredge and Gould noted this phenomenon in relation to fossil records in the appendix to Niles Eldredge, *Time Frames: The Evolution of Punctuated Equilibria* (Princeton University Press, 1989) 193. The concept was adopted by social scientists such as Baumgartner and Jones. See Bryan D Jones and Frank R Baumgartner, 'Punctuations, Ideas, and Public Policy' in Frank R Baumgartner and Bryan D Jones (eds), *Policy Dynamics* (University of Chicago Press, 2002) 293.

95 Fögen (n 56) described this as 'periods of "calm" (stasis) and periods of relative "unrest"': at 15 [8].

more accurate description of legal evolution than the idea of a smooth incremental progression towards an optimal outcome. Deakin and Wilkinson noted that it is an essential feature of the common law system that judges are required to adapt a precedent to a new use while maintaining the appearance of merely applying an existing rule. This may create the misapprehension of a smooth progression to an efficient outcome. In fact, the former meaning of the rule and the context in which it first emerged are put aside as the old rule is adapted and moulded to meet the new needs.[96]

IV THE LEGAL EVOLUTION OF THE JOINT STOCK, SEPARATE LEGAL ENTITY AND LIMITED LIABILITY CONCEPTS

This Part presents an analysis, from a Darwinian evolutionary perspective, of the development of the three fundamental concepts of company law: joint stock, separate legal personality and limited liability. This analysis is based on the notions that the long-term history of company law exhibited 'evolutionary' characteristics in the sense described above in Part III and that the evolution of these legal concepts was interrelated with changes in the economic environment. The analysis put forward in this Part seeks to present a case study of how a Darwinian evolutionary perspective can provide a useful theoretical framework as a setting in which the broad long-term development of legal concepts may be examined and explained in a broader context.

It may be helpful from the outset to trace the 'memetic' strands embedded in the modern limited liability company as this will provide an overview of its evolutionary trajectory and place the development of the fundamental corporate concepts discussed below in the broader context of the development of the corporate form. It also enables descriptions to be provided of terms such as 'company', 'corporation' 'partnership' and 'joint stock' which are necessary to understand the following discussion.

The first strand stems from the corporation which from medieval times came into existence by means of lawful authority which was by authority of Parliament or by Royal Charter. The main features of the early corporations were that they were treated, as far as possible, as natural persons and were regarded as artificial entities distinct from their members.[97] From medieval times, corporations were used for public benefit purposes such as local government administration, guilds, universities and hospitals. By the early 16th century, 'regulated' corporations

96 Ibbetson noted 'the inventing of the new is rarely combined with the discarding of the old': DJ Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford University Press, 2001) 294.

97 Holdsworth, 'English Corporation Law' (n 26) 406.

came to be used for commercial purposes especially as large monopoly trading enterprises.[98] As discussed below, regulated companies were the immediate predecessor of the joint stock company which emerged in the second half of the 16th century.[99]

Up until the late 17th century the terms 'corporation' and 'company' could be used interchangeably as incorporation by authority of the state was the only means by which a pooled investment enterprise, known as a 'company', could come into existence. Hence large corporations of the time were described for example, as the East India Company or the Muscovy Company. The term 'corporation' referred to the state-sanctioned legal process of incorporation by which the enterprise came into existence as a legally recognised entity, while the term 'company' loosely referred to the commercial purpose of the enterprise which was to provide for a large number of shareholders trading in common.[100] The financial mechanism which enabled pooled investment enterprises to operate and flourish was the commercial practice of providing for joint stock which involved the division of a corporation's capital into units of stock or shares. This enabled the extent of the interest of a shareholder to be precisely determined as a proportion of the corporation's total stock or share capital.

The second strand within the modern limited liability company stems from early partnerships. These were enterprises that were not incorporated or authorised by the state but came into existence by agreement of the partners. They were therefore governed by contract law on the understanding that each partner was an agent of the other partners. The term 'partnership' was first used to describe an enterprise with relatively few partners who were usually known to each other and generally all took part in management of the business. Because the identity of co-partners was an important part of their agreement, there were usually restrictions on the ability of partners to sell their partnership interests.[101]

In the late 17th century major constitutional and financial changes occurred which included the development of the unincorporated joint stock company. Such companies proved popular because the demand for joint stock enterprises by entrepreneurs and investors far exceeded the number of corporations that could successfully negotiate the difficulties and cost of the incorporation process. A particular difficulty was the ability of vested interests to oppose the granting

98 M Schmitthoff, 'The Origin of the Joint-Stock Company' (1939) 3(1) *University of Toronto Law Journal* 74, 82–3, quoting FW Dendy, 'Introduction' in FW Dendy (ed), *Extracts from the Records of the Merchant Adventurers of Newcastle-Upon-Tyne* (Andrews, 1895–9) vol 2, xi.

99 Schmitthoff (n 98) 88.

100 Ibid 85–7.

101 PW Ireland, 'The Rise of the Limited Liability Company' (1984) 12 *International Journal of the Sociology of Law* 239, 239–40.

of new incorporation charters.[102] The boom in the creation of unincorporated joint stock companies after 1688 corresponded with the establishment of stock exchanges which facilitated trading in the shares of both incorporated and unincorporated joint stock companies.[103]

Unincorporated joint stock companies developed as a form of partnership because they came into being by contractual agreement rather than by a formal incorporation process. At the same time the agreement sought to adopt the main features of corporation charters including a joint stock capital structure and provision for large numbers of shareholders. This required the appointment of a board of directors to undertake the management of the company, the holding of shareholder meetings and the right of shareholders to freely transfer their shares without requiring the approval of other shareholders, as was usually the case with traditional small partnerships. While unincorporated joint stock companies were a type of partnership in a legal sense, they were widely described as 'companies' in a commercial sense so during the 18th and first half of the 19th centuries the term 'company' was used to describe both incorporated and unincorporated joint stock companies. The term 'partnership' was generally used to denote a small enterprise with few partners who were unable to freely sell their partnership interests because of restrictions placed in their partnership agreements.[104]

The first modern companies Act was introduced in 1844 ('*1844 Act*').[105] It provided for the incorporation and registration of companies and differentiated between 'companies' that were required to be registered under the Act and 'partnerships' which were not registered. Partnerships comprising more than 25 persons were required to register as companies so that all joint stock companies were required to incorporate and register thus making them subject to the various publicity requirements of the Act. The model company envisaged by the Act largely corresponded to the unincorporated joint stock company as it was formed by agreement of the incorporators and had default internal rules based upon those of pre-1844 unincorporated joint stock companies. Subsequent amendments to the Act, most notably in 1856,[106] enabled small partnerships and individual proprietors to incorporate and register as companies with limited liability so the term 'company' from this time referred to 'limited liability company' and encompassed what were previously 'joint stock companies', now described as 'public' companies and companies with few shareholders that were similar to

102 Armand Budington DuBois, *The English Business Company After the Bubble Act, 1720–1800* (Commonwealth Fund, 1938) 13, 169.

103 A detailed description of how stock exchanges operated can be seen in SR Cope, 'The Stock Exchange Revisited: A New Look at the Market in Securities in London in the Eighteenth Century' (1978) 45(177) *Economica* 1.

104 See PW Ireland (n 101) 240.

105 *Joint Stock Companies Act 1844*, 7 & 8 Vict, c 110 ('*1844 Act*').

106 *Joint Stock Companies Act 1856*, 19 & 20 Vict, c 47 ('*1856 Act*').

partnerships with restrictions placed on the transfer of their shares, described as 'proprietary' or 'private' companies.

The modern limited liability company can be seen as a hybrid or workable contraption comprising elements of the early corporation, the unincorporated joint stock company and partnerships. The internal rules governing a particular company depended on whether the company was a public or private entity.

A *The Joint Stock Concept*

The concept of joint stock was the financial mechanism which enabled large scale business enterprises to be formed comprising a large number of stock (or share) holders each contributing to the capital of the enterprise. Joint stock involved the division of a corporation's capital into units of stock or shares so the extent of the interest of a shareholding could be readily determined as a proportion of the corporation's total stock or share capital. The development of joint stock was an important commercial development because it enabled companies to raise the very large amounts of capital necessary for long-distance trade. Shareholders were encouraged to invest by the prospect of a distribution of profits according to the amount of stock held and the ability to sell all or part of their holding. Up until the late 17th century, all joint stock companies were corporations. After this time joint stock companies could be either incorporated or unincorporated.

An early form of joint stock was used by so-called 'regulated' companies which evolved from guilds and were adapted for trading purposes from the early 16th century. Regulated companies were an evolutionary model that represented an intermediate step between guilds and joint stock companies.[107] They were known as 'regulated' companies because they were regulated or governed by extensive rules set out in their Crown charters which gave them separate legal entity status, governance structures which are readily recognised in modern corporations and usually monopoly rights to carry on trade in designated geographic areas. Membership of regulated companies was largely confined to those who were members of particular merchant organisations or were skilled or knowledgeable in the particular activities of the company. A feature of regulated companies was that members could trade privately on their own account or in syndicates, so in effect they operated as umbrella organisations for groups of merchants who had business interests that related to the activities of the company.[108]

The earliest joint stock companies evolved from regulated companies and came into existence from the mid-16th century coinciding with the growth of long-distance sea trade. At first they were corporations, meaning they were created by

107 Schmitthoff (n 98) 81–2.

108 Ibid 81–4.

Royal Charter or Act of Parliament. The essential feature of joint stock companies was that there was a common stock rather than interests held in syndicates and members could not trade on their own accounts.[109] The development of the joint stock concept played an important role in making the early chartered companies attractive investments because it enhanced the liquidity of their shares and so enabled large amounts of capital to be raised.[110] Shares became a relatively liquid investment because they could be freely traded to others, especially after the development of early stock exchanges in the late 17th century.

The evolution of the joint stock company from the regulated company can be seen in the early history of the East India Company which was granted a charter in 1600. At first, the East India Company was a 'regulated' company in that it was comprised of a loose association of merchants who privately carried on trade with the East Indies. They formed a company because it provided a means whereby capital could be pooled, costs shared and ownership and control were separated so directors and skilled administrators played important roles in managing the company. This form of company evolved into the joint stock company with the division of its capital into stock or shares of a designated value. Members at first generally subscribed to joint stock in separate subordinate organisations or syndicates within the company rather than in the company as a whole. These investments were at first in particular voyages, with profits divided upon completion of each voyage, so members could choose whether or not to invest in a future voyage. The joint stock concept was extended to a number of voyages over a specified period of years and later during the mid-17th century it became usual for joint stock to become permanent.[111] For some time during the 17th century, several of these profit-share practices coexisted within different syndicates. In some cases the entire capital was divided at the end of a voyage, in others, the initial investment was returned and the profits reinvested in the next voyage or the profits were divided and the capital retained by the company for the specified term of the joint stock. Private trading within the East India Company lasted for nearly the entire 17th century before being prohibited.[112]

This early development of the joint stock corporation demonstrates that there

109 Ibid 91 (citations omitted). See also at 88–92.

110 The early success of the East India Company in raising large amounts of capital indicates that investors were seeking new forms of investment. In 1613 it raised £429,000 to finance four voyages and in 1617 it raised £1.7 million to finance seven voyages. At this time it had 934 shareholders and owned 36 ships: Charles P Kindleberger, *A Financial History of Western Europe* (Oxford University Press, 2nd ed, 1993) 191.

111 In the case of the East India Company, per-voyage joint stock was used between 1600 and 1613, term of years' joint stock was used between 1613 and 1657 after which time joint stock became permanent: Ron Harris, 'The Formation of the East India Company as a Cooperation-Enhancing Institution' (Conference Paper, Israeli Economic Association Annual Meeting, December 2005) 26–7, 32–3, 45–6 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=874406> ('The Formation of the East India Company'). See also Schmitthoff (n 98) 91–2.

112 Schmitthoff (n 98) 88–91. Harris, *Industrializing English Law* (n 22) 24–5. See also Harris, 'The Formation of the East India Company' (n 111) 45; John Micklethwait and Adrian Wooldridge, *The Company: A Short History of a Revolutionary Idea* (Phoenix, 2003) 31.

was a reciprocal interrelationship between various elements such as the evolution of the joint stock concept, the political and economic developments associated with mercantilist government policies, the increased wealth of the merchant class seeking further investment opportunities and the adoption of investor-friendly governance practices which engendered trust and so encouraged investment. Each of these factors made possible, facilitated or influenced the others. Investors were encouraged by the development of the joint stock concept, limited liability of shareholders and participatory governance practices such as elections of directors by shareholders, the regular provision of financial information and the right of investors to opt out of investing in particular voyages through the initial use of per-voyage joint stock. These voluntarily adopted practices served as strong signals by insiders that outsider investors would be fairly treated.[113] The ability of joint stock companies to raise large amounts of capital enabled the government to pursue mercantilist policies, which pitted countries against each other in intense economic and military rivalries, at a time when government finances were insufficient.

The evolution of the early joint stock companies from the medieval form of corporation that was used for particular public benefit purposes can be described as 'genealogical' rather than 'teleological' because the new form of corporation was linked to an earlier form and was the result of the interplay of historical factors to meet a political and economic need rather than of progress towards a predetermined design. The early development of the joint stock company took place almost entirely outside the law, being principally the result of private arrangements that were made to encourage capital-raising by corporations that served government purposes. The joint stock company was an economic institution that provided an effective mechanism which encouraged cooperation and trust between the various parties in the absence of effective regulatory law, by providing for internal constraints on promoters and directors such as allowing for company performance to be monitored and shareholder participation in the appointment of directors.[114]

The period after 1688 saw major political and economic changes, most notably a political settlement was reached that established the constitutional supremacy of Parliament. An important result of these major historical political and constitutional developments was a fiscal revolution which saw greatly increased financial activity including major growth in lending to government, a boom in joint stock company formations and investment and the establishment of stock

113 Harris, 'The Formation of the East India Company' (n 111) 32–5.

114 For a full discussion of the early joint stock company from an institutional perspective, see Phillip Lipton, 'The Evolution of the English Joint Stock Company to 1800: An Institutional Perspective' (Research Paper No 19, Department of Business Law and Taxation, Monash University, 10 May 2016) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1413502>.

exchanges.[115] There was a greater capacity and willingness to invest in joint stock enterprises which resulted in the incorporation by Parliament of a large number of companies that carried out a wide range of commercial activities.[116] An indication of significantly increased share trading was the first publication of stock market prices in 1692.[117] The most important of these companies was the Bank of England which was established in 1694 to act as the government's banker and in particular, to finance the growth of the Royal Navy during a time of frequent wars and international rivalries.

During this period, major political and economic developments interacted with evolving and innovative commercial practices leading to the development of a new form of commercial enterprise: the unincorporated joint stock company. This development involved the adaption of elements from two existing enterprise forms: the chartered corporation and traditional partnership. There was no relevant law that recognised this hybrid form so entrepreneurs filled a vacuum by adapting partnerships so as to imitate chartered corporations by allowing for large numbers of investors who were able to freely trade their shares on the newly emerging stock exchanges. This adaption enabled the uncertain and costly incorporation process to be bypassed while allowing for the creation of large numbers of joint stock companies. The unincorporated joint stock company can therefore be seen as both the product of and a stimulus to the new financial environment created after the 1688 constitutional crisis was resolved.

The new financial environment engendered a higher degree of business confidence and financial innovation resulting in a greatly expanded investor class which was more prepared to take up shares in a wide range of joint stock enterprises that included both chartered corporations and privately formed

115 For discussions of economic and financial developments after 1688, see Henry Roseveare, *The Financial Revolution: 1660–1760* (Longman, 1991); Larry Neal, 'How It All Began: The Monetary and Financial Architecture of Europe during the First Global Capital Markets, 1648–1815' (2000) 7(2) *Financial History Review* 117.

116 Scott described the histories of 63 joint stock corporations which, before 1720, were engaged in diverse activities including foreign trade to many parts of the world, colonisation, planting in Ireland, drainage of marshlands and mines, fisheries, mining, treasure salvage, provision of water supply, postage, street lighting, manufacturing, banking and insurance: William Robert Scott, *The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720* (Cambridge University Press, 1910–11) vols 2–3.

117 John Houghton, *A Collection for Improvement of Husbandry and Trade* (1692–1703) (a periodical that contained essays, book reviews and various price lists) contained the prices of eight company shares in 1692, however this figure had increased to 63 companies in 1694: SR Cope (n 103) 18. North and Weingast noted that the total value of stock markets in England grew from less than £1 million in 1690 to around £15 million in 1710: Douglass C North and Barry R Weingast, 'Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England' (1989) 49(4) *Journal of Economic History* 803, 826, citing PGM Dickson, *The Financial Revolution in England: A Study in the Development of Public Credit, 1688–1756* (Macmillan, 1967) app C. Atiyah referred to an estimate that some £50 million was invested in joint stock companies by 1720: PS Atiyah, *The Rise and Fall of Freedom of Contract* (Clarendon Press, 1979) 32, citing E Lipson, *The Economic History of England* (Adam and Charles Black, 6th ed, 1956) vol 3, 217.

unincorporated companies that had evolved outside the law.[118] Unincorporated joint stock companies were common in industries such as insurance where there were entrenched interest groups that made it difficult if not impossible to obtain incorporation charters because they saw competing corporations as a threat. They played an important role in the development of stock exchanges by providing greater depth of listed companies and expanding the possible avenues of investment. The unincorporated joint stock company was therefore a product of the changes to the financial environment and, it in turn, also contributed to furthering economic and financial changes.

The development of the unincorporated joint stock company from the late 17th century can also be seen as a genealogical evolutionary process rather than one leading inevitably to the most efficient corporate and legal structures. The economic and political environment after the constitutional reforms of 1688 created a need for joint stock enterprise from promoters and investors, but this need could not be met by traditional formal incorporations alone. The bureaucratic infrastructure dealing with incorporations in Parliament and by the Privy Council was inadequate to meet the increased demand for pooled investment entities and the incorporation process conferred substantial rights of opposition on vested interest groups enabling them to oppose and block incorporation applications they perceived to be against their interests. The unincorporated joint stock company evolved to meet this increased demand for pooled investment enterprises. It was the product of evolving commercial practice and the adaption of existing legal forms rather than direct legal changes. This new type of business enterprise appeared complex and cumbersome and did not represent a teleological progression towards a predestined optimal form, rather, it was an inelegant form that was efficient enough to serve its purpose.

The *Bubble Act 1720* ('*Bubble Act*')[119] was the first major statutory development in the evolution of company law. Its main stated purpose was to prohibit the formation of unincorporated joint stock companies. The *Bubble Act* remained in force for over 100 years and shows that legal change does not necessarily play a functional role in assisting broad economic or social change. From the second half of the 18th century, major economic and social developments occurred that were associated with the Industrial Revolution. The history of company law during this period

118 North and Weingast (n 117) link the fiscal revolution and growth of public and private capital markets in the late 17th century with the evolution of political institutions after the Revolution of 1688 which resulted in Parliamentary supremacy and an independent judiciary. The Crown was therefore no longer able to renege on debts or arbitrarily expropriate property for its own benefit as had previously occurred. This resulted in a significant increase in the security of private property rights and led to the almost immediate growth of impersonal capital markets: at 824–8. For a critique of this argument, see David Stasavage, 'Credible Commitment in Early Modern Europe: North and Weingast Revisited' (2002) 18(1) *Journal of Law, Economics, and Organization* 155. Stasavage argued that enhanced government credibility is also affected by other factors such as representation of government creditors in political institutions and the state of partisan politics, especially the emergence of cross-issue coalitions.

119 *Bubble Act 1720*, 6 Geo 1, c 18 ('*Bubble Act*').

presents a difficulty or a puzzle for functional, teleological-based explanations. This is because the purpose of the *Bubble Act* to prohibit unincorporated joint stock companies did not represent a step towards the design of the company law system we have today. In this sense the law did not 'progress' as it did not appear to be designed to facilitate economic change but rather hindered it, so from a functionalist perspective, it stands as an aberration that is difficult to explain. The English historical experience during the period of the *Bubble Act* indicates that financial and economic institutions may still develop or even flourish despite the existence of laws that appear to discourage the formation of companies and the absence of investor rights, legal protections and effective enforcement. The history of the *Bubble Act* provides evidence that law by itself may not necessarily play an important functionalist role in economic development and the absence of legal rights and protections may be compensated by a range of economic, social and cultural factors which are conducive to a particular evolutionary path that may be unexpected or unpredictable.

An analysis of this period from an evolutionary perspective is better able to account for the major economic developments that took place despite the apparent obstructions imposed by the *Bubble Act* on the formation of unincorporated companies. It would appear that in some cases, legal change may occur as a result of historical political factors that are driven by particular powerful interest groups who may have immediate objectives which are opposed to other economic or political interests and may in fact be harmful to the broader longer term needs of society.[120] The period of the *Bubble Act* did not necessarily represent progress towards the present forms of business organisation but rather reflected a number of historical contingencies of that time that included the predominance of mercantilism[121] in public policy, the competition between traditional wealthy interests and emerging business groups, the burgeoning national debt and the share speculation of 1720 which culminated in the collapse of the South Sea Company.[122]

The significant development of the joint stock company during the period of the *Bubble Act* also shows the importance of the distinction between the law in the

120 Milhaupt and Pistor (n 30) argued that a fundamental flaw in the functionalist perspectives stems from a failure to take account of the human interaction and political dimensions by which law is developed and used: at 21–2.

121 The term 'mercantilism', while not having a precise meaning, refers to economic and trade policies commonly adopted between the 16th and 18th centuries aimed at strengthening state power at the expense of rival powers. For a discussion of the various meanings that have been given to mercantilism see Steve Pincus, 'Rethinking Mercantilism: Political Economy, the British Empire, and the Atlantic World in the Seventeenth and Eighteenth Centuries' (2012) 69(1) *William and Mary Quarterly* 3.

122 There have been many explanations for the passing of the *Bubble Act*. Some have seen it as a response to excessive speculation. See, eg, Bishop Carleton Hunt, *The Development of the Business Corporation in England: 1800–1867* (Harvard University Press, 1936) 6–9. Other explanations have emphasised political economy and vested interest factors. See, eg, Henry N Butler, 'General Incorporation in Nineteenth Century England: Interaction of Common Law and Legislative Processes' (1986) 6(2) *International Review of Law and Economics* 169, 171–3; Harris, *Industrializing English Law* (n 22) 68–70.

books and the law in action. In this case the law in the books severely discouraged unincorporated companies. The law in practice largely turned a blind eye to such companies for most of the century or so during which the Act remained operative. Entrepreneurs and their legal advisers were able to utilise this regulatory vacuum to creatively construct the deed of settlement company which was a more sophisticated version of the unincorporated joint stock company. This form of business organisation comprised elements of corporations, partnerships and trusts. It evolved from the partnership form of business enterprise and was legally a type of partnership. Under a trust deed, described as a deed of settlement, its internal governance rules were similar to those of chartered corporations. They provided for large numbers of shareholders, freely transferrable shares, limited liability and a board of directors with broad powers of management who acted as trustees.[123]

This adapted form met the needs of businessmen in industries such as insurance, banking and public utilities for a form of joint stock company that bypassed the traditional legal incorporation processes. Paradoxically, unincorporated companies developed a high degree of sophistication and complexity as commercial forms while being largely unrecognised and ignored by the law. In a broad sense, company law developed long-standing principles and concepts during this period by way of commercial practice rather than formal law. The evolution of company law was therefore more strongly influenced by how the law was practiced (or ignored) rather than by the details of cases and statutes.

The deed of settlement company was developed by entrepreneurs and their lawyers in order to provide the unincorporated company with the main commercial features of a corporation, most notably, the free transferability of its shares, limited liability and the separation of shareholders from the company while bypassing the complex incorporation process. The legal basis of the unincorporated joint stock company was partnership law because it was established by agreement of the shareholders and a central feature was the concept of profit sharing. Up until the end of the 19th century, company law was still seen as a branch of partnership law.[124] The appointment of trustees or directors under a deed of settlement involved the application of agency law allowing directors to act as agents of the company. The internal relationships within the company were based on a contract comprised of the deed of settlement. This deed also established trust relationships based on equitable principles designed to overcome the lack of a clear separate legal entity

123 Lindley defined such companies as 'associations of persons intermediate between corporations known to the common law and ordinary partnerships, and partaking of the nature of both': Nathaniel Lindley, *A Treatise on the Law of Partnership: Including Its Application to Joint-Stock and Other Companies* (William Maxwell, 1860) vol 1, 4. See also Paddy Ireland, 'Property and Contract in Contemporary Corporate Theory' (2003) 23(3) *Legal Studies* 453, 457–61.

124 For example, Sir Nathaniel Lindley's company law text, published in 1889: Sir Nathaniel Lindley, *A Treatise on the Law of Companies: Considered as a Branch of the Law of Partnership* (Sweet and Maxwell, 5th ed, 1889).

distinct from its shareholders which was an important feature of incorporated entities. Despite these cumbersome features and adaptions, unincorporated joint stock companies largely succeeded in practical terms to replicate the essential features of incorporated entities by modifying partnership law and introducing concepts of trust law. Governance structures, the relationship of shareholders and directors, the free transferability of shares, the corporate right to sue, the liability of shareholders to pay calls and limited liability were based on commonly used provisions found in Acts of incorporation and charters.

The deed of settlement company evolved in a genealogical way insofar as it adapted to changed legal and economic circumstances by bringing together existing concepts to create a largely new hybrid form of business organisation. This new form of business organisation appeared to be prohibited under the *Bubble Act*. However, the *Bubble Act* was not enforced for most of the time it was in operation and so the deed of settlement company filled a gap and came to be widely used as a privately arranged vehicle of pooled investment. The development of this type of company demonstrates a genealogical process where there is a link between a legal prohibition, concepts formed in the past and a willingness of investors to invest in joint stock enterprises. The joint stock concept was adapted in a new way that incorporated several other legal elements and these concepts were combined so as to form a new type of business organisation that was a 'carrier of history'.[125] Evolutionary processes often result in unexpected '[o]dd arrangements and funny solutions'.[126] The deed of settlement company appears to meet this description.

This adaption of several existing legal forms and concepts to meet a new commercial use was neither inevitable nor predetermined. Rather it was a particular commercial response to a number of political, economic and legal contingencies that occurred in England during this period. These included the political factors which led to the passing of the *Bubble Act*, the growth of stock markets, the development of the insurance and banking industries and the rapid development of infrastructure which increased demand for joint stock enterprises. Quite different interactions of legal change and economic and political developments could feasibly have taken place. This can be seen when comparing the development of joint stock companies and their regulation in other countries.[127] The English deed of settlement company was an unusual amalgam of concepts which seems to have had no close foreign equivalents.

The evolution of the deed of settlement company in the 18th century was an

125 See David (n 11).

126 Gould, *The Panda's Thumb* (n 85) 20. Gould explained this evolutionary characteristic in relation to biological evolution. The panda's thumb is not anatomically a finger but an enlargement of bone previously part of the panda's predecessor's wrist described by Gould (using words he attributes to Michael Ghiselin) as a 'contraption, not a lovely contrivance': at 24.

127 See, eg, Michael Lobban, 'Corporate Identity and Limited Liability in France and England 1825–67' (1996) 25(4) *Anglo-American Law Review* 397.

important development because it was a form of business enterprise that was privately established in the way of partnerships but differentiated from them by having separate functions performed by directors and shareholders and joint stock which allowed for transferable shares. This type of company became widely used and was the model form of registered company envisaged by the companies Acts of the mid-19th century and remains so to this day. The private nature of the unincorporated joint stock company may be one of the main reasons behind the traditional primacy of shareholders in the Anglo-American governance model and the notion that the main objective of the corporation is to maximise shareholder returns.[128]

B *Separate Legal Personality*

One of the incidents of incorporation of the early joint stock companies was that they were recognised to some extent as legal persons in their own rights. However, the extent to which a corporation was separate from its shareholders was not entirely clear. Writing in 1793, Stewart Kyd defined a corporation as 'a collection of many individuals, united into one body'.[129] This statement suggests that a corporation was nothing more than the individuals who comprised it in much the same way as a partnership. In 1874, Seward Brice stated that the central legal characteristic of a company was 'its existence separate and distinct from the individual or individuals composing it'.[130] This change in the conception of a company can be seen in the wording introduced in the *Companies Act 1862* ('*1862 Act*')[131] which implicitly stated that a company formed under the Act was separate from its incorporators. The *Joint Stock Companies Act 1856* ('*1856 Act*')[132] described shareholders as forming *themselves* into a company,[133] implying that the company was comprised of its members, whereas the *1862 Act* spoke of shareholders forming a company, suggesting that the company was separate from

128 Where shareholder interests are paramount, the interests of other stakeholders such as employees, customers and the community generally may be insufficiently taken into account by boards. A shareholder primacy focus may impede corporate social responsibility: see Richard Mitchell, Anthony O'Donnell and Ian Ramsay, 'Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labor Law' (2005) 23(3) *Wisconsin International Law Journal* 417; David Rönnegard and N Craig Smith, 'Shareholder Primacy as an Impediment to Corporate Social Responsibility' in Maria Cecilia Coutinho de Arruda and Boleslaw Rok (eds), *Understanding Ethics and Responsibilities in a Globalizing World* (Springer, 2016) 43.

129 Stewart Kyd, *A Treatise on the Law of Corporations* (J Butterworth, 1793) vol 1, 13.

130 Seward Brice, *A Treatise on the Doctrine of Ultra Vires: Being an Investigation of the Principles Which Limit the Capacities, Powers, and Liabilities of Corporations, and More Especially of Joint Stock Companies* (Stevens and Haynes, 1874) 2, citing *Dartmouth College v Woodward*, 17 US (4 Wheat) 518, 636 (1819) (Marshall CJ).

131 *Companies Act 1862*, 25 & 26 Vict, c 89 ('*1862 Act*').

132 *1856 Act* (n 106).

133 Ibid s 3.

its members.[134] Clearly there had been a significant change in the separate legal personality concept during the mid-19th century.

The evolution of the separate legal personality concept involved the interaction of company law and commercial practice. The changes in commercial practice that took place, especially from the 1870s, included the widespread use of private companies, the increasingly common practice of issuing shares with relatively low par value and unpaid liability on shares and the development of new financing techniques such as preference shares and debentures. These commercial developments had major impacts on the nature of companies and how the law operated in relation to them. The *1856 Act* established a largely unrestricted and permissive legal regime which provided ample scope for businessmen to utilise and shape the law to meet their requirements.[135] While there was very little legislative change in the decades after 1856, company law continued to significantly develop as business practice became more sophisticated in its utilisation of the company form. An evolutionary analysis of the development of the separate legal personality concept recognises that the law in the books presents only a small part of the picture. It is also necessary to examine the ways in which the commercial community responded to the law and how it operated in practice.

The evolution of the separate legal personality concept was a major aspect of the gradual separation of company law from its origins as a branch of partnership law as the concept of the company as a separate legal entity is the main feature distinguishing companies and partnerships. The separate legal personality concept evolved over much of the 19th century as it adapted in an incremental way to changes in the economic and financial environment. This evolution involved common law and legislative developments in conjunction with changes in commercial practice. The legal idea that a company was separate from its shareholders reflected the commercial reality that shareholders of joint stock companies increasingly held portfolios of share investments and regarded shares as a liquid, tradable investment. The relative liquidity of shares made them more attractive as investments and so enabled promoters and entrepreneurs to potentially raise large amounts of capital. As share markets attracted more trading, more enterprises were encouraged to list their shares which in turn made them more liquid. The increasingly transient nature of many shareholdings as share trading became more frequent made clearer the commercial distinction between traditional partnerships, where partners generally participated in management and were prepared to be locked-in for long periods of time, and joint stock companies in which shareholders usually did not take part in management

134 *1862 Act* (n 131) s 6. This observation was made by Paddy Ireland, Ian Grigg-Spall and Dave Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14(1) *Journal of Law and Society* 149, 150.

135 M Rix, 'An Economic Analysis of Existing English Legislation Concerning the Limited Liability Company' (MSc (Econ) Thesis, University of London, 1936) 6.

and were often willing to buy and sell their shares.

The application of the principle that a company is a separate legal entity distinct from its shareholders is now often described as the 'principle in *Salomon's* case' implying that the concept originated or was first stated in that case or at least that the case significantly developed the concept. The separate legal personality concept had in fact largely developed well before the famous case of *Salomon v A Salomon & Co Ltd* ('*Salomon*')[136] at the end of the 19th century.[137] This case was therefore not the major turning point in the history of company law marking the beginning of modern company law as it is widely thought to be.[138] *Salomon's* case was generally seen at the time as determining the specific issue of whether virtual 'one man' companies were permitted to be registered and to operate under the *1862 Act*.[139] The ultimate decision of the House of Lords, that a 'one man' company was a separate legal person distinct from its shareholders, who were further protected by limited liability, overturned the decision of the Court of Appeal presided over by Lord Lindley, who was the leading authority on company law at the time. It was only by remote chance that Salomon was permitted to bring his appeal to the House of Lords funded as a pauper litigant.[140]

The private company[141] had become widespread by the mid-1880s and the number of registered private companies increased very rapidly.[142] From a policy point of view, it would therefore have created great difficulty for important sectors of the business community had the House of Lords struck down the legitimacy of the one man company.[143] The House of Lords' judges in *Salomon's* case adopted a strict literal approach to the interpretation of the *1862 Act*, however the conclusion they arrived at was, wittingly or unwittingly, in accordance with common commercial practice, given the widespread use of the private company by the 1890s. The principle in *Salomon's* case later took on a broader life of its own as a landmark

136 [1897] AC 22 ('*Salomon*').

137 See Phillip Lipton, 'The Mythology of *Salomon's Case* and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective' (2014) 40(2) *Monash University Law Review* 452, 455–64 ('The Mythology of *Salomon's Case*').

138 See, eg, Paul Redmond, *Corporations and Financial Markets Law* (Thomson Reuters, 7th ed, 2017) 174. For a discussion that questions the landmark status of Salomon's case see Rob McQueen, 'Life without *Salomon*' (1999) 27(2) *Federal Law Review* 181, 181–4.

139 PW Ireland (n 101) 255.

140 See GR Rubin, 'Aron Salomon and His Circle' in John Adams (ed), *Essays for Clive Schmitthoff* (Professional Books, 1983) 99, 101–2.

141 The term 'private company' was not used by the legislation until the early 20th century. In the sense used here, a 'private company' refers to a company controlled by one person or with a relatively small number of shareholders thereby making it similar in its internal organisation to a traditional partnership. For a discussion on the nature of private companies: see Ron Harris, 'The Private Origins of the Private Company: Britain 1862–1907' (2013) 33(2) *Oxford Journal of Legal Studies* 339, 352–5 ('The Private Origins of the Private Company'); Lipton, 'The Mythology of *Salomon's Case*' (n 137) 464–7.

142 Rob McQueen, *A Social History of Company Law: Great Britain and the Australian Colonies 1854–1920* (Routledge, 2016) 233–8 ('*A Social History of Company Law*'). See also Harris, 'The Private Origins of the Private Company' (n 141).

143 Rix (n 135) 43.

case that has left a highly conservative imprint on company law which few judges have been prepared to depart from even where a number have acknowledged on occasion the difficulties caused by the application of the principle.[144] The application of *Salomon's* principle has been particularly problematic in the context of corporate groups where it has drawn considerable criticism.[145] This problem was highlighted in Australia by the James Hardie asbestos compensation inquiry which found that the James Hardie group used a complex restructuring to unfairly limit present and future tort liabilities.[146]

The development of the separate legal entity concept can be seen as a genealogical process that occurred in incremental steps while interacting with the changing investment and financial environment of the 19th century. In this way, the evolution of the concept can be perceived as an adaption of a legal form that took the path that it did, not because it was inevitable or progressing to an ideal form, but because of a process similar to natural selection in biology that enabled it to 'succeed' because it was better suited to its environment than alternative possibilities such as the partnership which was comprised of its members and was not separate from them. The concept adapted or utilised earlier legal elements in a sequence that linked the evolving concept to its past. The origins of the separate legal entity concept can be traced back to the early medieval corporations,[147] but it was during the 19th century that the concept evolved from shareholders forming *themselves* into a company comprised of them, to shareholders forming a company that was entirely distinct from them.

The evolution of the separate legal entity concept involved changes to case law on matters such as the legal nature of a share, the liability of directors for company

144 See, eg, *Albacruz (Cargo Owners) v Albazero (Owners)* [1977] AC 774, 807 (Roskill LJ); *Adams v Cape Industries plc* [1990] 1 Ch 433, 544 (Slade LJ) ('*Cape Industries*'); *Re Southard & Co Ltd* [1979] 1 WLR 1198, 1208 (Templeman LJ); *Atlas Maritime Co SA v Avalon Maritime Ltd [No 1]* [1991] 4 All ER 769, 779 (Staughton LJ); *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549, 558–9 (Rogers AJA).

145 There is a vast academic literature, particularly in the US, critical of the law dealing with corporate groups. See, eg, Jonathan M Landers, 'A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy' (1975) 42(4) *University of Chicago Law Review* 589; Richard A Posner, 'The Rights of Creditors of Affiliated Corporations' (1976) 43(3) *University of Chicago Law Review* 499; Phillip I Blumberg, 'Limited Liability and Corporate Groups' (1986) 11(4) *Journal of Corporation Law* 573; Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100(7) *Yale Law Journal* 1879; Phillip I Blumberg, 'The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities' (1996) 28(2) *Connecticut Law Review* 295; Ian M Ramsay, 'Allocating Liability in Corporate Groups: An Australian Perspective' (1999) 13(2) *Connecticut Journal of International Law* 329; Lipton, 'The Mythology of *Salomon's Case*' (n 137) 480–6.

146 DF Jackson, *Special Commission of Inquiry into the Medical Research and Compensation Foundation* (Report, September 2004) <https://www.dpc.nsw.gov.au/publications/special-commissions-of-inquiry/special-commission-of-inquiry-into-the-medical-research-and-compensation-foundation/>. See especially at 171–5, where it was noted that a board meeting discussed the relevant legal and ethical issues raised by the proposed restructure. See Peta Spender, 'Weapons of Mass Dispassion: James Hardie and Corporate Law' (2005) 14(2) *Griffith Law Review* 280; Edwina Dunn, 'James Hardie: No Soul to Be Damned and No Body to Be Kicked' (2005) 27(2) *Sydney Law Review* 339; Helen Anderson, 'Parent Company Liability for Asbestos Claims: Some International Insights' (2011) 31(4) *Legal Studies* 547; See Lipton, 'The Mythology of *Salomon's Case*' (n 137) for a discussion of how the separate legal entity principle as it applies to corporate groups is at odds with the objectives of tort law.

147 Holdsworth (n 26) 405–6.

debts and the nature of the relationship of the board of directors and the general meeting of shareholders. The concept was further reinforced by commercial practice which increasingly differentiated companies from partnerships. The trend in many industries towards increased use of low par value shares and the common practice of issuing preference shares and debentures sought to protect shareholders of limited liability companies to a greater extent than was possible in the case of providers of capital to partnerships.

The development of the separate legal entity concept was therefore part of a complex historical process where events and developments are linked and connected to the past while at the same time adapted to better suit a changing economic and financial environment. Rather than seeing *Salomon's* case as an inevitable and climactic step leading to the modern present; where the separate legal entity concept and limited liability are necessary attributes of the modern corporation, *Salomon's* case can rather be seen as part of an indeterminate historical process that could conceivably have had a number of possible alternative outcomes resulting in a different legal position today. For example, a plausible alternative outcome may have been that the separate legal entity concept could have been less rigidly applied and subject to a greater willingness by courts to pierce the corporate veil. Such an outcome could have enabled greater regard to be placed on the economic and social implications of applying the separate legal entity principle.[148] The result may have been a much less convoluted and fairer case law dealing with piercing the veil, especially in relation to corporate groups.

An evolutionary perspective recognises that suboptimal outcomes may arise and may persist. Soon after the decision, *Salomon's* principle was applied to corporate groups to hold that a holding company and subsidiary are separate legal entities from each other and other companies in a corporate group. The early cases where *Salomon's* case was applied indicated that the principle was subject to evidence that a company did not act on its own behalf as an independent entity but for and on behalf of those who brought it into existence.[149] In most cases of a holding company and subsidiary, the board of the subsidiary is comprised of nominees of the holding company and it is the intention of the holding company that the subsidiary acts on its behalf or in accordance with its instructions. As the major reason for establishing a subsidiary is usually to carry out the purposes of its holding company, it is feasibly quite open in most cases for the courts to hold that a subsidiary acts on behalf of its principal, the holding company, and so bypass the separate legal entity principle on the basis of the existence of an agency relationship or apply one of the exceptions to the principle in *Salomon's* case to

148 Deakin and Wilkinson (n 35) noted that the common law system based on precedent lends itself to the adaption of existing legal concepts to meet new needs thus giving the law an appearance of continuity and progress towards an efficient outcome: at 34–5.

149 See, eg, *Rainham Chemical Works Ltd (in liq) v Belvedere Fish Guano Co Ltd* [1921] 2 AC 465, 475 (Lord Buckmaster).

pierce the corporate veil.[150] However the courts have generally been reluctant to pierce the corporate veil or to construe the existence of an agency relationship between the holding company and subsidiary.[151] The principle in *Salomon's* case has been applied in cases such as *Adams v Cape Industries plc*[152] as the courts have been especially reluctant to pierce the corporate veil in cases involving tort liabilities.[153]

The application of *Salomon's* principle to corporate groups in cases involving tort creditors has been heavily criticised and is arguably a suboptimal legal outcome.[154] This occurred because of two historical 'accidents'. Firstly, the House of Lords overturned the Court of Appeal's decision to hold that a company is a separate legal entity distinct from its shareholders in the case of a one-man company. Secondly, this decision was later applied to company groups. This was not an inevitable legal outcome as there were very few corporate groups at the time of *Salomon's* case and so these were unlikely to have been contemplated by the House of Lords judges.

The early application of *Salomon's* principle to corporate groups may have been appropriate at the time. There was a wave of mergers in Britain in the late 19th and early 20th centuries which was mainly aimed at reducing competition.[155] The group of merged businesses typically operated as a loose confederation of autonomous enterprises. The holding company of the group usually had a large board comprised of representatives of each of the merged enterprises who were mainly concerned with the interests of their particular businesses rather than the combined interests of the group as a whole and tended not to interfere in the operations of other businesses in the group. In this context, the application of *Salomon's* principle to differentiate between the company as a whole and its shareholders was appropriate.

The application of the principle in *Salomon's* case to corporate groups became more problematic as groups became more integrated. Subsidiaries were used to serve the interests of the group and holding companies were able to redraw the boundaries of liability within the group. The application of the principle also became suboptimal in an era of mass torts and very large corporate groups which

150 The agency argument has succeeded in a small number of cases. See *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116; *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852; *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679.

151 For empirical studies in the UK, see Alan Dignam and Peter B Oh, 'Disregarding the *Salomon* Principle: An Empirical Analysis, 1885–2014' (2019) 39(1) *Oxford Journal of Legal Studies* 16. For empirical studies in Australia, see Ian M Ramsay and David B Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19(4) *Company and Securities Law Journal* 250, 265.

152 *Cape Industries* (n 144).

153 Ramsay and Noakes (n 151) 265; Dignam and Oh (n 151) 39.

154 See above n 146.

155 See PL Payne, 'The Emergence of the Large-Scale Company in Great Britain, 1870–1914' (1967) 20(3) *Economic History Review* 519, 519.

often operated in many countries. Mass tort liabilities in corporate groups give rise to complex economic and social issues related to the broad questions at the heart of tort law of who should bear the losses stemming from wrongful or careless behaviour and how can such behaviour be discouraged.[156] It is highly unlikely that these issues can be appropriately resolved by the strict application of the principle in *Salomon's* case to tort cases involving corporate groups where the important economic and social consequences that arise are not directly addressed.

The evolution of the separate legal personality concept in relation to corporate groups during the 20th century was the result of historical 'accidents' that effectively made various choices along a historical path. The current law dealing with corporate groups and tort liability was but one possibility among a number of feasible alternatives and was the result of various choices made along a historical path which was more a rutted and winding track reflecting its chaotic history and chance rather than an efficient progression towards the most appropriate outcome. As mentioned above, the present law has been widely criticised as suboptimal from economic efficiency or social fairness points of view and so we should be open to change the law to better meet these objectives as it does not represent a satisfactory and inevitable end point.

C *Limited Liability*

In much the same way as the development of the separate legal personality concept, the introduction of limited liability in 1855 and 1856[157] also illustrated the complex interrelationship of legal change and economic developments, in particular far-reaching changes associated with the Industrial Revolution. Up to its statutory introduction, the concept of limited liability was the result of ad hoc statutes and charter provisions and the practical and procedural difficulties faced by company creditors who sought to enforce payment of corporate debts against debtor company shareholders.[158]

During the 1850s there was considerable debate surrounding the introduction of limited liability into the companies legislation. This reflected the complex economic, social and political environment of the mid-19th century. A diverse range of social and economic arguments were put forward and keenly debated by various interest groups.[159] These complexities indicate that the introduction of

156 For examples of articles critical of the application of *Salomon's* principle to corporate group tort liability see above nn 145–6.

157 *Limited Liability Act 1855*, 18 & 19 Vict, c 133; *Joint Stock Companies Act 1856*, 19 & 20 Vict, c 47.

158 Phillip Lipton, 'The Introduction of Limited Liability into the English and Australian Colonial Companies Acts: Inevitable Progression or Chaotic History?' (2018) 41(3) *Melbourne University Law Review* 1278, 1286–9 ('The Introduction of Limited Liability into the English and Australian Colonial Companies Acts').

159 McQueen, *A Social History of Company Law* (n 142) ch 3; Lipton, 'The Introduction of Limited Liability into the English and Australian Colonial Companies Acts' (n 158) 1289–97.

limited liability cannot be simply explained in functionalist terms as a 'rational' and inevitable legal change which responded to the widely-felt needs of business interests and so was instrumental in bringing about economic progress.

The debate over limited liability leading up to its statutory introduction was initiated by a group of social reform advocates who were concerned to bridge social divisions and encourage working class investment in employers' businesses.[160] Economists and political philosophers saw the debate as concerning an aspect of free trade policy. Opponents of its introduction argued that limited liability threatened commercial morality because it enabled debtors to avoid paying their debts and encouraged undesirable speculation and company failure.[161] Among business interest groups, there was a polarisation of views on limited liability.[162] Some groups were strongly in favour and other groups, sometimes in the same city, were strongly opposed. Many owners of established industrial concerns with wealthy family connections were opposed to limited liability because they had no need to raise capital from external sources and may have perceived joint stock enterprise as a potential threat that would encourage greater competition. Other interest groups were in favour of limited liability. These included those associated with joint stock companies and especially the rising investor class.

Limited liability was unexpectedly introduced by the *Limited Liability Act 1855*. This enactment was sudden and represented a sharp change in the law.[163] It was intended to be only a temporary measure grafted onto the existing *1844 Act*[164] and so contained a number of existing requirements for registered joint stock companies such as the need to have at least 25 shareholders and a minimum par value of shares and paid up capital. The *1856 Act* removed the capital requirements and reduced the required number of members to at least seven. It is unclear why these far-reaching changes occurred during a short period of time in 1855 and 1856, but it appears to involve a number of social, economic and political factors as well as historical contingencies, particularly Robert Lowe, a strong laissez-faire advocate, becoming Deputy President of the Board of Trade and pushing

160 McQueen, *A Social History of Company Law* (n 142) ch 3.

161 Lipton, 'The Introduction of Limited Liability into the English and Australian Colonial Companies Acts' (n 158) 1293.

162 In 1854, the report of the Royal Commission on Mercantile Laws described the contradictory evidence it heard as a 'great contrariety of opinion': *First Report of the Commissioners Appointed to Inquire and Ascertain How Far the Mercantile Laws in the Different Parts of the United Kingdom of Great Britain and Ireland May Be Advantageously Assimilated and Also Whether Any and What Alterations and Amendments Should Be Made in the Law of Partnership as Regards the Question of the Limited or Unlimited Responsibility of Partners* (Report, 1854) 5.

163 PL Cottrell, *Industrial Finance, 1830–1914: The Finance and Organization of English Manufacturing Industry* (Methuen, 1980) 54.

164 *1844 Act* (n 105).

through the 1856 legislation.[165]

An evolutionary perspective suggests that there was a co-evolutionary dynamic at work whereby legal change and economic development associated with the Industrial Revolution, interacted with and influenced each other. Just as the introduction of limited liability eventually led to increased use of the limited liability company, so the changing economic and investment environments led to the development of a political setting in which the investor class was more influential and so was conducive to legal change that ultimately made limited liability freely available to both joint stock and 'private' companies.

The introduction of limited liability and the ways in which the concept has come to be commercially applied today were the result of a number of historical contingencies and not part of an inevitable process. There was strong opposition from some influential sectors of the business community and there were a large number of historical factors and chance events that could feasibly have worked out in different ways. At various points, alternative paths presented themselves and historical choices were made. For example, the 1867 Select Committee[166] heard strong criticism of the *1862 Act* and especially limited liability from a number of those who appeared before it to argue for the reintroduction of the 1844 disclosure requirements and the removal of limited liability. The Committee declined to make such recommendations on the grounds that such changes may have discouraged initiative in business.[167] Instead the *1856 Act*, based on laissez-faire principles and adopting a minimalist regulatory approach, became entrenched and continues to this day as the basis of modern company law.[168]

Limited liability is generally seen as an essential characteristic of the modern-day

165 Several factors have been put forward to explain why limited liability was introduced in the 1850s. The introduction of limited liability has been seen as the 'victory of investing classes over the industrialists': JB Jefferys, 'Business Organisation in Great Britain, 1856–1914' (PhD Thesis, University of London, 1938) 53. Others view the introduction of limited liability as the result of political tensions stemming from the unpopular Crimean war: Colin Mackie, 'From Privilege to Right: Themes in the Emergence of Limited Liability' [2011] (4) *Juridical Review* 293, 296–300. Alternatively, some authors have considered the introduction of limited liability to be a product of the application of laissez-faire policies to commercial regulation: Stewart Jones and Max Aiken, 'British Companies Legislation and Social and Political Evolution during the Nineteenth Century' (1995) 27(1) *British Accounting Review* 61. Jones and Aiken drew upon the early 20th century analysis of AV Dicey, *Lectures on the Relation between Law and Public Opinion in England during the Nineteenth Century* (Macmillan, 1905). A critique of their argument was made by Stephen P Walker, 'Laissez-Faire, Collectivism and Companies Legislation in Nineteenth-Century Britain' (1996) 28(4) *British Accounting Review* 305.

166 *Select Committee on Limited Liability Acts: Together with the Proceedings of the Committee, Minutes of Evidence, Appendix, and Index* (Report, 28 May 1867).

167 McQueen, *A Social History of Company Law* (n 142) 166, 271. Cottrell (n 163) described this period of the 1860s and 1870 as a 'lost opportunity' as the legislation was still quite new and vested interest groups and commercial practice developed around it had not yet become entrenched: at 61–2. See also Rix (n 135) 43.

168 Rix (n 135) 268. McQueen argued that this has created an 'asocial' framework of corporate regulation which places a higher priority on shareholder interests than long term community interests: McQueen, *A Social History of Company Law* (n 142) 174–5.

corporation.[169] This tends to lend an aura of inevitability around the concept and a strong reluctance to tamper with it. However, as discussed above, the application of limited liability to corporate groups has been the subject of considerable criticism, especially in cases involving large numbers of tort creditors.[170] The separate legal personality and limited liability concepts operate in related and complementary ways. The liabilities of particular companies in a corporate group are separate from the liabilities of other companies in the group including its holding company. Further, the effect of limited liability is to prevent a holding company or other member of a group incurring liability for the debts of other companies in the group in which they hold shares. The application of limited liability in these circumstances can be seen as the development of a suboptimal law as it does not take into account the complex economic and social issues raised where mass torts are committed by entities within large corporate groups and it allows corporate groups considerable scope to allocate internal funding and determine for themselves the boundaries of liability within the group.[171]

V CONCLUSION

Evolutionary theories and concepts have been used in a wide range of social sciences. A number of writers have over a long period of time also used evolutionary ideas in the study of legal change. 'Legal evolution' in the sense used in this paper is based on the idea that Darwinian evolutionary concepts and theories that sought to explain the evolution of biological species can be usefully applied to analyse legal change and its relationship to developments in the social, political and economic environments. This is not to say that legal evolution is necessarily subject to precisely the same mechanisms as operate in the biological sphere. Nor can we use evolutionary theory in a deterministic or predictive way. It does however, provide a theoretical framework from which a detailed historical study may be made of legal change and its inter-relationship with the broader environment. Hutchinson noted that both biological and legal evolution are 'a strange mix of universal predictability … and local unpredictability' which creates a tension between tradition and transformation so that each is able to make the best of their changing environments.[172]

The adoption of an evolutionary perspective in the study of law enables us to identify

169 Armour et al, 'What Is Corporate Law?' (n 19) 5. Easterbrook and Fischel explained the economic rationale for limited liability: Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52(1) *University of Chicago Law Review* 89, 93–7.

170 See above nn 145–6.

171 Blumberg, 'Limited Liability and Corporate Groups' (n 145) 616–19. Blumberg argued strongly against the application of limited liability to corporate groups. 'The extension of layers of limited liability to the tiers of subsidiaries within corporate groups lacks most of the theoretical justification that has been advanced in defense of the rule. Accordingly, reconsideration of the rule is in order, particularly since application of limited liability to corporate groups appears to have been accidental': at 626.

172 Hutchinson (n 6) 273.

a number of broad characteristics of legal change. Legal evolution recognises that the interrelationship of law and the economic and social environment is complex and dynamic and therefore calls into question functionalist approaches that suggest a simple linear relationship of cause and effect.[173] An evolutionary perspective suggests that the evolution of social systems is interrelated and occurs in a 'co-evolutionary' way where each system influences and affects the others in a constantly changing dynamic. An evolutionary approach implicitly emphasises a moving away from an earlier state and so rejects the teleological idea that legal change inevitably progresses towards a design determined by its functionality. An evolutionary process recognises that suboptimal outcomes may occur and persist due to particular historical factors and that complex local historical factors result in diversity of forms. These evolutionary characteristics and implications of legal change challenge functionalist perspectives that assume legal change inevitably progresses towards the most efficient outcome and less efficient laws or legal systems will ultimately disappear. Examples of functionalist perspectives noted in Part II are the legal origins thesis, the law and economics 'survival of the fittest' argument and the 'end of history' thesis. These functionalist arguments have aroused considerable debate and this article seeks to contribute to this debate by challenging the conclusions put forward in them.

Evolution theory therefore suggests that 'history matters' in explaining why the law developed as it did and the present law can be understood as being a 'carrier of history' that is linked to its past through a series of connecting events.[174] Because of the importance and complexity of historical contingencies and chance happenings, legal change is unpredictable and not an inevitable process as many feasible outcomes are generally possible and various choices can be made. As a result, suboptimal outcomes may occur and persist because of specific local conditions. An evolutionary perspective therefore invites critical analysis of law because it sees legal outcomes as the result of historical circumstances and contingencies that could feasibly have worked out quite differently. Law should therefore be analysed objectively and if possible improvements are identified, it should be reformed accordingly rather than the assumption be made that the law invariably fits its most functional design and should generally not be interfered with.

This article has presented an overview from an evolutionary perspective of the development of three fundamental concepts of company law: joint stock, separate legal personality and limited liability. A particular legal problem that involves these concepts occurs where tort liabilities arise which are caused by a company within a corporate group. In particular, tort creditors may have a claim against a particular company in the group but it may have been insufficiently funded by

173 For examples of functionalist approaches, see above nn 32, 34.

174 See above n 11.

its holding company to meet all the claims of its creditors. In some cases, the holding company may deliberately redraw corporate boundaries within the group to achieve this result.[175] The holding company and other companies in the group are effectively protected by the separate legal personality of each member of the corporate group and then further protected by limited liability which prevents a shareholder becoming liable for the debts of the company. The analysis presented in this article shows that the evolution of the fundamental concepts of company law was marked by historical contingencies, short-term factors and chance occurrences that could quite feasibly have turned out differently. If we recognise that this has been the case in the way the law of corporate groups has evolved and it is widely believed that the present law is unfair or inefficient, an evolutionary perspective encourages consideration of how the law can best be changed.

175 Collins discusses the 'capital boundary' problem: Hugh Collins, 'Ascription of Legal Responsibility to Groups in Complex Patterns of Economic Integration' (1990) 53(6) *Modern Law Review* 731, 736–8.