Chapter 2.

The *Salomon* principle

Introduction

In the previous chapter we considered how the modern company grew of out of the law on unincorporated associations, how it used ideas long identified with town corporations created by Royal Charter, how it evolved from the joint stock company, and how shareholders in companies were granted limited liability by statute. One key element of the modern company, however, remained outstanding: the principle of separate corporate personality which was created by the House of Lords in *Salomon v A Salomon & Co Ltd* (1897). We will refer to this principle as "the *Salomon* principle". We will begin with a close reading of the *Salomon* litigation.

The *Salomon* litigation

The history of Aron Salomon
Aron Salomon manufactured boots on Whitechapel High Street in London's East End.

The decision at first instance: Broderip v Salomon

The decision of the Court of Appeal

The decision of the House of Lords: Salomon v A Salomon & Co Ltd

Conclusions on the *Salomon* litigation

In 1897, in a remarkable piece of judicial intervention in the economic life of the country, it was considered convenient to permit the company to have its own legal personality.[1]

[1] *Saloman v. A. Saloman & Co. Ltd* [1897] A.C. 22.

This was a development which was described by Prof. Kahn-Freund as being a "calamitous decision".[2]

The effect of the Salomon litigation on company law

The central technical-legal question surrounding the modern nature of the company is this: how did the company come to possess the traits of distinct legal personality which it enjoys today? The answer to that question is simple at one level: the decision of the House of Lords in *Saloman* tells us that companies have such distinct personality. That answer is perfectly correct, so far as it goes. One thing that should strike any reader of that decision, however, is the evident certainty among the members of the House of Lords that they were right. Their lordships' speeches make little reference to any pre-existing caselaw nor to any contemporary ideas or sources. Given the determination of the Court of Appeal in *Smith v. Anderson* only eighteen years previously that the company remained a species of trust, one would have expected a more explicit discussion of the causes of this reversal in judicial policy.

An alternative analysis (alternative, that is, from any of the judges in the *Saloman* litigation) would have been to say that the company is a cypher for the personality of Saloman and not at all a distinct person. This perception of companies as merely avatars behind which real people carried on their activities has a provenance in the common law. In a decision of Lord Pollexfen C.J. in 1684, his lordship had criticised the joint stock company as being the "invisible merchant that no one knows where to find … [which] in judgment of law has neither soul nor conscience and yet forsooth are traders".[3] Between the seventeenth century and the late nineteenth century there had been a profound judicial reconsideration of the desirability of the company. Companies were seen as being persons and therefore occupying a lifeworld of their own outwith the lifeworlds of the members, employees, creditors. The decision in *Saloman* was built on a logic which was itself built on an ideology of the company as a sentient, if artificial, economic actor.

Lifting the corporate veil

The lodestar of company law has remained the integrity of the separate personality of the company: the corporate veil will only be lifted in the most extreme of circumstances.[4] *The result is a lack of clarity in the precise legal rights of the shareholders and their inter-action with the board of directors.*

Benefits and problems flowing from the *Salomon* principle

[2] Kahn-Freund (1944) 7 MLR 54.
[3] (1684) *Sandy's Case*, from Cobbett, *State Trials*, X, 371, quoted in Cooke *op cit.*, 65.
[4]

The benefits of the principle

The main benefit which flows from the *Salomon* principle is one of efficiency. Whereas previously a business organised as a partnership could only create contracts in a very complicated way – involving each partner becoming a party to that contract, and involving the hidden nature of the rights and obligations of individual partners – as soon as it is recognised that a company is a distinct, legal person in itself then the company can create contracts in its own name. as a result, the process of creating contracts with businesses became much simpler. The parties needed only to create one single contract with a human being who was authorised to create that contract on behalf of the company. In practice, in relation to large contracts, it is usual to have the people authorised to create contracts either identified in the articles of association of the company or agreed by a formal decree of the board of directors. The corporate personality of companies therefore makes trade simpler when it involves complex commercial organisations.

The second benefit is a more personal one from the perspective of those human beings who are inside the company. For an entrepreneur (or sole trader) like Aron Salomon, the benefit is that his own personal property can be protected from the failure of the business. If an entrepreneur dealt as a sole trader, then he would face the risk that all of his own property (his money, his house, his car, and so on) would be lost if the business failed. By organising his business as a company, the entrepreneur puts distance between his personal property and the company's property, so that only the company's property will be lost if the business fails.

The problems with the principle

The central problem with the *Salomon* principle is an ethical one. It is the inverse of the second benefit, discussed immediately above, when seen from the perspective of people dealing with the company from the outside. If Aron Salomon's property is protected then people dealing with the company have only got the company's own assets available to them if the company goes into insolvency. This means that an entrepreneur in the position of Aron Salomon may give less care and attention to the need to deal honestly and fairly with third parties because the entrepreneur faces no great personal risk of loss, beyond wounded pride and the hope of a profitable business (except what is said below about fraudulent trading). Similarly, other shareholders in a company bear no personal risk of loss if the company fails because the limited liability which is granted by our company law by definition limits their personal liabilities. When we add all of this together, we arrive at a position whereby the entire economy is peopled by companies whose shareholders and management bear little direct personal responsibility or loss if those companies should fail. The ethics of that economy become questionable if no-one faces the risk of open-ended, personal loss.

The risks which shareholders and entrepreneurs do face

Of course, the shareholders do face the risk of losing their investments in the company. The entrepreneur faces loss of reputation with investors and other traders. What they do not face is the loss of their personal property. There are criminal liabilities for fraudulent and wrongful trading, and so the human beings cannot simply use the company as a shield for any criminal activity nor for any deliberate attempt to defraud third parties.

The legacy of *Salomon* today

As Roger Cotterrell points out, a company occupies a different moral position from the individual in that stigma attaching to the company for its actions will not necessarily translate directly into stigma attaching to any individual.[5] While, for example, the possibility of companies committing crimes has been accepted by English law, it is not such an obvious link to attach stigma for criminal or more generally "immoral" activities either to directors, employees or shareholders of companies. The company-as-cypher enables individuals to hide behind the facade of corporate personality.

I own a number of pairs of trainers which bear the "Salomon" brand. The logo is two semi-circles entwined so as to form a stylised letter "S". Aron Salomon manufactured boots in the East End of London in the 19th century and his plight gave rise to the birth of one of the foundational principles of modern company law. in the 21st century, there is a company which manufactures boots. As befits the 21st century they are sold over the internet as well as in shops; they bear a corporate logo and names which play heavily on the technological advances which are said to embody (Gore-Tex fabric, "3-D" soles designed to cope specifically with rough terrain, and so on); and they have a clear brand image of people running healthily in sunlit mountains. Companies have been legal persons ever since 1897, but today they have another aspect of personality as well: they have an image, and a reputation. Companies' brands tell of technological advances, reliability, energy, fun, reassurance, thrills, or whatever. The seed planted by the *Salomon* case continues to mature in a way that embodies a virtual life for our companies as tools of businesses who want to market themselves to other people, real and virtual.

[5] Cotterell, *The Sociology of Law*, 2nd edn., (London: Butterworths, 1992), 126.