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Ownership and Control in the Entrepreneurial Firm: An International History of Private Limited Companies

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Ownership and Control in the Entrepreneurial Firm: An International History of Private Limited Companies

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Abstract

We use the history of private limited liability companies (PLLCs) to challenge two pervasive assumptions in the literature: (1) Anglo-American legal institutions were better for economic development than continental Europe's civil-law institutions; and (2) the corporation was the superior form of business organization. Data on the number and types of firms organized in France, Germany, the UK, and the US show that that the PLLC became the form of choice for small- and medium-size enterprises wherever and whenever it was introduced. The PLLC's key advantage was its flexible internal governance rules that allowed its users to limit the threat of untimely dissolution inherent in partnerships without taking on the full danger of minority oppression that the corporation entailed. The PLLC was first successfully introduced in Germany, a code country, in 1892. Great Britain, a common-law country followed in 1907, and France, a code country, in 1925. The laggard was the US, a common-law country whose courts had effectively killed earlier attempts to enact the form.

JEL codes: N8, G3, O16, K22

Keywords: limited company, partnership, corporation, legal regime, common law, civil law

Introduction

The links between the history of capitalism and the rise of the corporation are deep. Whether the focus is on financial or industrial capitalism, the story most often features large-scale enterprises as critical agents of economic transformation. Such enterprises could not have existed without a legal framework that allowed owners to lock in capital and delegate managerial responsibility while at the same time limiting the risks that investors bore. Hence the capitalist transition in turn depended on a legal transformation that is typically reduced to a narrative of the rise of the corporation. This view of history has been so pervasive and influential that the corporation in its ideal form (low cost of formation, concentrated management chosen by an elected board of directors, limited liability, and freely traded equity) has generally been assumed to be the superior form of business organization. Moreover, because corporations that approximated the ideal flourished in the US and the UK, this view of history has confirmed a second widely held assumption: that Anglo-American legal institutions afforded businesses support and protection superior to that offered by countries on the European continent. To a large extent both of these assumptions were products of the "American century," when the US economy was both dominant and dominated by corporations.

Based on a broader survey of historical experience we take issue with such a simplification of the relationship between business law and economic change. Although multi-owner firms have grown in number and size since the early nineteenth century, they have been plagued with governance problems, and the corporation has not been a panacea. As a result, even in the US, most business associations continued to organize as partnerships for at least a century after the spread of general incorporation laws. During the late nineteenth and early twentieth centuries European governments created an alternative business form—what we call the private limited liability company (PLLC). Whenever a variant of this form became available—in Germany in 1892, Britain in 1907, and France in 1925—it quickly swamped the corporation in popularity. For all practical purposes, US firms did not have a similar option until the second half of the twentieth century.[1]

Although their specific features vary across countries, PLLCs are all joint stock, limited liability enterprises. They cannot raise capital from the public and their securities cannot be traded in organized markets, but in compensation for these restrictions they benefit from low fees and minimal disclosure requirements. Limited liability might seem to be a sufficient advantage to explain why PLLCs were preferred to partnerships, and low fees and low disclosure requirements might well explain their popularity relative to corporations. We argue, however, that these common characteristics, while important, cannot in and of themselves account for the form's rapid spread. Instead, the PLLC's success owed to its capacity to expand the range of governance options. As we show, the PLLC's precise impact (whether it mainly displaced corporations or partnerships) depended on the specific legal context in which it was introduced. Thus the legal and legislative history of other forms of business association is also quite important for explaining the PLLC's popularity.

To develop this argument, we offer an alternative understanding of the determinants of organizational choice that conceives of business people as trading off one

[1] As we will describe below, the states of Pennsylvania, Michigan, New Jersey, and Ohio enacted enabling legislation for a type of PLLC in the 1870s and early 1880s, but adverse court decisions limited the form's appeal and it did not spread to other states.

kind of contracting problem against another.[2] Although the corporate form solves the main disadvantage of partnerships—that they can be dissolved too easily—its hierarchical structure allows managers to steer returns toward themselves at the expense of stockholders. Business people who wish to avoid the cost of managerial knavery must either modify the standard articles of incorporation in ways so substantial as to give up key features of the corporate form or choose another form of organization. In the case of large-scale enterprises, most owners want their investments to be tradable and hence organize corporations. But most small- and medium-size enterprises (SMEs) have few owners and their equity does not trade; hence their organizers may be less willing to incur the corporation's disadvantages. During the nineteenth century the only way that owners of SMEs in the US and Britain could avoid these drawbacks was by bearing the costs of partnerships. In France and Germany the availability of a third alternative, the limited partnership, enabled business people to moderate the terms of the tradeoff to some extent. The advantage of PLLCs was that they gave entrepreneurs much greater flexibility to mix and match the attributes of partnerships and corporations.

This article is part of a larger effort in which we are engaged to move beyond publicly traded corporations and study the impact of the legal environment on privately held companies. Although the law and finance literature has focused on the former, the legal environment is likely to matter more for SMEs, on whom the fixed costs of complying with the legal requirements of the corporate form are likely to weigh more heavily. In this article we argue that the PLLC had important benefits for SMEs and trace its emergence and diffusion in Germany, Britain, France, and the US over the past two

[2] This paper focuses on the organizational choices made by members of multi-owner firms. Hence we set aside questions related to the legal rules governing single-owner enterprises and also decisions that affect whether or not an enterprise has multiple owners.

centuries. We first lay out the rationale for our focus on the PLLC and then explore alternative hypotheses to account for differences across the four countries in the popularity of the form. We pursue this agenda by compiling a record of the organizational choices available in each country and how these options changed over time, by gathering preliminary estimates for each country of the take-up rate of PLLCs, and by assessing the impact of the PLLC on the use of alterative organizational forms. Finally, we show that business people did indeed exploit the flexibility of the form by presenting examples of actual PLLC contracts from each country.

We have chosen our four countries because they were all economically successful and all key legal innovators. The French and German civil and commercial codes formed the basis of business law in many countries in Asia and South America, as well as elsewhere in Europe; the UK is widely recognized as the birthplace of the common law; and the US, another important common-law country, is credited with democratizing the corporation. Following these four countries over the last two centuries presents a number of challenges because differences in their legal systems and the political process of legislative change make collecting comparable evidence difficult and sometimes impossible.[3] Nevertheless, the multilateral comparative approach has allowed us to uncover deep flaws in country-specific accounts of the legal evolution of business forms. More importantly, it has enabled us to challenge the idea that the standard of comparison for business law should be the US or the UK.

[3] For instance, the early passage of the income tax in the US means that we have very good data on the stock of firms taking different organizational forms beginning around 1916. Similar data exist for Germany after 1887, but they do not become available for France until the second half of the twentieth century. The requirement that businesses organizing under the commercial code register with a local authority means that we have very good data on the flow of new multi-owner firms for France and Germany over long periods of time. For the US and UK it is possible to track the flow of corporations, but not partnerships which were common law entities that did not even require a formal contract.

The Advantage of the PLLC

The presumption that the corporation is the superior form of business organization derives from the idea that only the corporation can support the capital deepening—in particular, the growth of fixed assets in production—required for modern economic growth.[4] By contrast, it has generally been assumed that the main alternative form, the partnership, is too evanescent to provide the lock-in of capital necessary to sustain long-term investments. Because partnerships were legally dissolved by the death of a principal, and because the courts interpreted them to be essentially at will, partners always faced significant risk that their firm's assets would have to be liquidated at a loss. As a result, they were reluctant to make firm-specific, or otherwise illiquid investments.[5] Moreover, partnerships had other disadvantages as well, including unlimited liability, collective management, and only a weak ability to shield the firm's assets from its owners' doings.[6]

If the advantages of the corporation over the partnership were as great as the literature suggests, one should observe the former displacing the latter as soon as general incorporation laws were passed. As we have already suggested (and will demonstrate in greater detail below), this did not happen; in 1900 corporations were not the dominant

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[4] See, for examples, Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge: Harvard University Press); and Nathan Rosenberg and L. E. Birdsall, Jr., *How the West Grew Rich: The Economic Transformation of the Industrial World* (New York: Basic Books, 1986).

[5] Margaret M. Blair, "Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century," *UCLA Law Review*, 51 (Dec. 2003), pp. 387-455. For a contrary view, see Larry E. Ribstein, "Why Corporations?" *Berkeley Business Law Journal*, 1 (Fall 2004), pp. 183-232.

[6] On limited liability, see Susan E. Woodward, "Limited Liability in the Theory of the Firm," *Journal of Institutional and Theoretical Economics*, 141 (Dec. 1985), pp. 601-11. On entity shielding, see Henry Hansmann, Reinier Kraakman, and Richard Squire, "Law and the Rise of the Firm," *Harvard Law Review*, 119 (March 2006), pp. 1333-1403. For a theoretical discussion of the disadvantages of collective management, see Armen A. Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," *American Economic Review*, 62 (Dec. 1972), pp. 777-95; and Oliver Hart, *Firms, Contracts, and Financial Structure* (New York: Oxford University Press, 1995).

organizational form in any of our countries. Of course, it is possible that the continued popularity of partnerships resulted from restrictive general incorporation statutes and regulations, not problems with the corporate form itself. For example, it is possible that fees and other costs associated with taking out corporate charters were high enough to discourage use of the form or that reporting requirements or laws mandating the public disclosure of business information imposed a sufficiently onerous burden on firms to suppress the number of corporations.[7] As we show, however, only in Germany, and there only after 1884, did such regulations inhibit the formation of corporations.

A more likely possibility is that the corporate form was not as advantageous as the literature would lead us to believe. The two major advantages of the corporate form—concentrated management and perpetual life—brought with them significant costs.[8] Because the only members of a corporation who could make decisions on behalf of the firm were officers who had been duly elected by its shareholders, any coalition that determined the election of officers also controlled the firm. The coalition could then use its power to benefit its members at the expense of other shareholders, and there was little that the minority could do about it. They could not make the majority change its policies; nor could they force the firm to dissolve. The problem was especially serious in corporations whose capital stock was closely held because members of such firms could not readily exit by selling their shares.

[7] Today, of course, tax rules have significant effects on businesses' organizational choices. Prior to the mid twentieth century, however, most taxes were low, and to the extent that there were differences in the treatment of corporations, they were of minor importance. As a result, for the purposes of this article we largely set aside tax issues.

[8] For a more extensive discussion of these costs, see Naomi R. Lamoreaux and Jean-Laurent Rosenthal, "Corporate Governance and the Plight of Minority Shareholders in the United States before the Great Depression," in *Corruption and Reform: Lessons from America's Economic History*, ed. Edward L. Glaeser and Claudia Goldin (Chicago: University of Chicago Press, 2006), pp. 125-152; and Lamoreaux and Rosenthal, "Contractual Tradeoffs and SMEs' Choice of Organizational Form: A View from U.S. and Frnech History, 1830-2000," NBER Working Paper (2006).

The choice of organizing a business as a corporation rather than a partnership thus entailed tradeoffs. For some types of businesses, the costs associated with the partnership's inability to lock in capital (we call this the problem of untimely dissolution) were higher than those associated with the cost of the dominant shareholders' misbehavior in corporations (the problem of minority oppression). All other things being equal, those businesses would prefer to organize as corporations than as partnerships. For other businesses, however, the situation was just the reverse. In a world where there were only two organizational choices, therefore, significant numbers of both partnerships and corporations should coexist.

If this argument is correct, then the advantage of the PLLC would be its ability to mitigate the starkness of the choice between partnerships and corporations. The idea here is that the greater flexibility of the PLLC form allowed business people to combine aspects of both partnerships and corporations—to trade off some additional risk of minority oppression for less untimely dissolution or vice versa. Although, as we will see, the particular attributes of the form differed somewhat across countries, as a general rule organizers of PLLCs everywhere had an extraordinary degree of contractual flexibility. They could write provisions into their articles of association that balanced the risks of oppression against the possibility of stalemate and the costs of untimely dissolution against the dangers of lock-in. To induce members of the firm to make enterprise-specific investments, for example, they could make dissolution difficult. But they could also protect minority owners who made such investments by giving them veto power in some circumstances. Moreover, they obtained all this flexibility without giving up important advantages of the corporation, such as limited liability, legal personality, and entity shielding.

The basic argument we are proposing can be illustrated with the aid of Figure 1, where the horizontal axis indicates the size of the firm (here proxied by the number of investors), and the vertical axis the firm's profits as a fraction of what its earnings would be if it did not have to bear any of these transaction costs. The solid line represents the proportion of this Coasian maximum that representative partnerships of different sizes would be expected to earn. It is drawn steeply downward sloping to capture the idea that the probability of untimely dissolution is a rapidly increasing function of the number of partners. The thin dashed line represents the corporation. We have drawn the line upward sloping to capture the idea that the corporate form is more advantageous for large firms than for small, but the shape of the line does not matter all that much. It could be flat or even downward sloping, so long as it does not slope downward as steeply as the partnership line (a possibility that is highly unrealistic, given that we observe relatively few large firms organizing as partnerships). As we have drawn the diagram, the partnership and corporation lines cross at firm sizes of around five investors. Firms smaller than this size will organize as partnerships, because their profits will be higher than if they adopt the corporate form. Firms with more than five investors will organize as corporations for analogous reasons.

Now imagine that firms are given a third choice. They can also organize as PLLCs, represented by the gently downward sloping thick dashed line. Because founders of PLLCs can reduce the risk of untimely dissolution without increasing that of minority oppression as much as in corporations, the form's advantage over partnerships appears at much lower firm sizes (in the diagram, around three investors), and the PLLC remains the optimal form of organization until the corporation overtakes it at relatively large firm sizes (at about seven investors). In the absence of the PLLC, some of the firms in the range of three to six members would have chosen to be partnerships, and some would have chosen to be corporations. The PLLC, in other words, "eats" both partnerships and corporations.

The foregoing analysis assumes that all forms of organization are easy and cheap to adopt. Partnerships and PLLCs certainly were, but it is important to consider the possibility that fees and regulatory restrictions made the corporate form relatively expensive. We can modify the diagram to capture these costs by shifting the corporation line to the right and making it rise more steeply (see Figure 2). Under this alternative scenario, which as we will see mimics the German case after 1884, the PLLC still surpasses partnerships at the same size of firms as before, but in the absence of the PLLC, partnerships are the preferred organizational form for firms with seven or less partners. The PLLC's introduction would mean a great reduction in the number of partnerships, but not of corporations—that is, PLLCs would eat partnerships more than corporations. Overall, however, the ratio of PLLCs to total enterprises should be pretty similar under this scenario to what it was in the case where incorporation was cheap.

One could get similar results by shifting the partnership line up and to the right. Such a shift might arise either because of the existence of intermediate forms like the limited partnership or because business people could write enforceable contractual clauses that limited partners' ability to exit. The more general point to emphasize here is that both the share of corporations in multi-owner firms and the popularity of PLLCs will depend on the preexisting set of legal rules governing alternative forms of business organization.

Organizational Forms Before the PLLC

In all four of our countries the main alternative to the corporation before the enactment of enabling legislation for the PLLC was the ordinary partnership. In France and Germany, however, business people had other choices that mitigated the starkness of the tradeoff between partnerships and corporations. The existence of these additional choices reduced the appeal of the corporate form and, to some extent, affected the take-up of the PLLC. Nonetheless, as we will show, the basic analysis still holds.

In France, as in the rest of our countries, corporations could not be formed in the early nineteenth century without specific permission from the government. However, the *Code de Commerce* of 1807 offered business people two options besides the ordinary partnership (or *société en nom collectif*). The limited partnership (*commandite simple*) allowed some partners to enjoy the protection of limited liability so long as they did not play an active role in management. In addition, business people could organize *commandites par action*, limited partnerships in which the shares of the limited partners were tradable. An active market in these shares enabled *commandites par action* to secure many of the advantages of corporations without obtaining special government permission.[9]

[9] Naomi R. Lamoreaux and Jean-Laurent Rosenthal, "Legal Regime and Contractual Flexibility: A Comparison of Business's Organizational Choices in France and the United States during the Era of Industrialization," *American Law and Economics Review*, 7 (Spring 2005), pp. 28-61.

German law, which was heavily influenced by French thinking, offered businesses essentially the same choices. If they did not want to form an ordinary partnership (*Offene Handelsgesellschaft* or OHG), they could become a simple limited partnership (*Kommanditgesellschaft* or KG), or a limited partnership with tradable shares (*Kommanditgesellschaft auf Aktien* or KGaA). After 1861 most German states agreed to adopt a common code of business law (the ADHG or *Allgemeine Deutsche Handelsgesetzbuch*), so the basic characteristics of these forms were the same across states.[10]

The additional contracting freedom that the various *commandite* forms gave business people in France and Germany improved to some extent the terms of the tradeoff they faced between untimely dissolution and minority oppression. On the one hand, limited partnerships were set up for specific terms, and the limited partners could not withdraw before the expiration of the contract. Hence the risk of untimely dissolution was less than in an ordinary partnership. On the other hand, because silent partners could not participate in the firm's management, they were susceptible to exploitation by the general partners. The extent of this problem was less than in a corporation, however, because silent partners could retrieve their capital at the end of the contract if they felt abused.[11]

In Britain and the US business people did not have access to these alternative forms. In Britain there was no enabling statute for limited partnerships until 1907—long

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[10] The first common business law for the Reich was passed in 1898, but the ADHG covered most aspects of business organization at issue here. For more detail see Guinnane et al. 2007,Op cit.

[11] Philippe Merle, *Droit commercial; sociétés commerciale* (6th edn.; Paris: Dalloz, 1998); Michel De Juglart and Benjamin Ippolito, *Les sociétés commerciales : cours de droit commercial.* Paris: Montchrestien, 1999); *Protection des minoritaires: sociétés ne faisant pas appel public à l'épargne* (Paris: éditions Francis Lefebvre, 2001), p. 140.

after the passage of general incorporation laws—and the courts effectively blocked all efforts to create limited or sleeping partnerships contractually.[12] The situation was similar in the US. Although most states passed laws during the 1820s and 1830s permitting the formation of limited partnerships modeled on the *commandite*, the courts construed these statutes so narrowly that they never provided a useful alternative to ordinary partnerships.[13]

Perhaps because of the lack of alternatives, Britain and the US led the way in the passage of general incorporation laws. In Britain lobbying by opponents, particularly competitors who sought to prevent rivals from obtaining corporate privileges, had made corporate charters a rare and expensive commodity until the second quarter of the nineteenth century. But then the political tides changed. Parliament empowered the Board of Trade to charter corporations more freely and in 1844 enacted legislation providing for general incorporation without limited liability and in 1855-56 with limited liability. The 1862 Companies Act that consolidated prior legislation emphasized the contractual nature of the corporation. It included a set of default articles of association (called Table A) that incorporators could adopt in full, reject altogether and draft their own articles of association, or adopt in part, substituting alternative provisions as desired.[14]

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[12] Innovations such as the (unincorporated) joint-stock company made investors' shares more liquid, but could not overcome the central defects of the partnership, which they still were at law. One possible alternative, the trust, did not evolve sufficiently before the advent of general incorporation to provide business people with a real choice. The Companies Act of 1844, which introduced general incorporation, legislated the end of the unincorporated company. It declared unregistered joint-stock companies illegal and prohibited the formation of partnerships with more than 25 members. See Ron Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720-1844* (Cambridge: Cambridge University Press, 2000).

[13] Lamoreaux and Rosenthal, "Legal Regime and Contractual Flexibility."

[14] Harris, *Industrializing English Law*; and Bishop Carleton Hunt, *The Development of the Business Corporation in England* (Cambridge: Harvard University Press, 1936).

In the United States the federal Constitution left incorporation to the states. Massachusetts and New York passed general incorporation laws for manufacturing as early as 1809 and 1811 respectively, as part of a patriotic effort to stimulate domestic industry during the Jeffersonian embargo. Over the next four decades the number and coverage of such laws increased dramatically. Although many states, especially in New England, had been quite liberal in granting charters by special legislative act, efforts to democratize corporate privileges—to make them available to all rather than a favored few—spurred the passage of general incorporation laws. By the early 1850s most states had made obtaining a corporate charter for most types of businesses a simple administrative process.[15]

Until France adopted full general incorporation in 1867, the government had granted corporate charters sparingly. Only 642 corporations were authorized between 1800 and 1867.[16] By way of comparison, in Massachusetts 2,062 corporations were chartered by special act between 1800 and 1862.[17] For most of this time, the demand for general incorporation had been muted in France by the availability of the share *commandite* form. In 1857, however, a financial crisis brought complaints about abuses by the share *commandites*' general partners to a crescendo, and the government enacted a new law that made it more costly to organize such enterprises. Once the crisis abated, the

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[15] See Pauline Maier, "The Revolutionary Origins of the American Corporation," *William and Mary Quarterly*, 50 (Jan. 1993), pp. 53-58; and W. C. Kessler, "A Statistical Study of the New York General Incorporation Act of 1811," *Journal of Political Economy*, 48 (Dec. 1940), pp. 877-82; Hurst, *Legitimacy of the Business Corporation*, pp. 13-57; Susan Pace Hamill, "From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations," *American University Law Review*, 81 (Oct. 1999), pp. 81-180.

[16] Charles E. Freedeman, *Joint-Stock Enterprise in France, 1807-1867: From Privileged Company to Modern Corporation* (Chapel Hill: University of North Carolina Press, 1979); and Freedeman, *The Triumph of Corporate Capitalism in France, 1867-1914* (Rochester, NY: University of Rochester Press, 1993).

[17] William C. Kessler, "Incorporation in New England: A Statistical Study, 1800-1875," *Journal of Economic History*, 8 (May), pp. 43-62.

restrictions proved burdensome, spurring efforts to secure more liberal incorporation rules. New legislation in 1863 permitted firms with a maximum capital of 20 million francs to organize as corporations without receiving special permission from the state. However, the burdens placed on directors and managers by the law of 1857 remained, and were even to some extent increased by the requirement that directors own at least 5 percent of the equity. The act of 1867 removed the limit on capitalization and subjected both corporations and share *commandites* to the same (more liberal) regulations. In particular, the burdens of responsibility on directors were reduced and the minimum ownership requirements eliminated.[18]

In Germany the ADHG created a uniform law of corporations, but left the matter of general incorporation to the member states. The Hanseatic cities were the first to allow general incorporation. The North German Confederation (led by Prussia) followed in 1870, and the provision was carried over into Reich law in 1871.[19] Two types of pressures played a role in the shift to general incorporation. First, governments recognized that tight control of corporate charters had not prevented the creation of large-scale enterprises because business people were able to use the device of the *KGaA* successfully to raise capital on the market. For example, the Disconto-Gesellschaft took the form of a *KGaA* during the years 1856-67, when it was also the largest bank in Germany.[20] Second, prior to general incorporation some states had been relatively liberal in granting corporate charters, often seeking tax revenue or other favors from corporations that would be legally sited in their territory but actually do most of their

[18] Freedeman, *Joint-Stock Enterprise in France*, pp. 132-35.
[19] Nobert Horn, "Aktienrechtliche Unternehmensorganisation in der Hochindustrialisierung (1860-1920)," in *Recht und Entwicklung der Grossunternehmen im 19. und frühen 20. Jahrhundert*, eds. Norbert Horn and Jürgen Kocka (Götting: Vandenhoeck & Ruprecht, 1979), p. 128 and note 22.
[20] Carsten Burhop, *Die Kreditbanken in der Gründerzeit* (Stuttgart: Franz Steiner Verlag, 2004), p. 84.

business elsewhere in the *Zollverein*. State governments learned the hard way that a restrictive policy would not prevent corporations operating in their territories but rather that it would only lead to their being chartered in another German state.[21]

The Slow Take-Up of the Corporation

Regardless of the timing of the passage of general incorporation laws, if the corporation was the obviously superior form that the literature makes it out to be, we should observe that such legislation led everywhere to large increases in the number of corporations. In both France and Germany, however, the corporation proved to be much less popular than in the US or the UK. On the eve of World War I there were still only about 5,000 corporations in Germany and 13,000 in France, compared to almost 63,000 in the UK and over 250,000 in the US.[22] Moreover, as we will show, even in the US and Britain the majority of multi-owner firms continued to organize as partnerships rather than corporations.

Figure 3 displays the distribution of new firms taking multi-owner forms in France for the period 1852-1978.[23] The passage of the 1867 general incorporation act led to a surge in the number of firms organizing as corporations, but except for a brief boom during the late 1870s, corporations never accounted for more than 10 percent of new firms taking multi-owner forms before World War I. Partnerships became relatively less common during this period, though they still accounted for at least 60 percent of new

[21] Rondo Cameron, "The Founding of the Bank of Darmstadt," *Explorations in Entrepreneurial History*, 8 (Issue 3, 1956), pp. 112-130.
[22] Freedeman, *The Triumph of Corporate Capitalism in Franc*e, p. 21; Susan B. Carter, et al., *Historical Statistics of the of the United States: Earliest Times to the Present*, *Millennial Edition* (Cambridge: Cambridge University Press, 2006), Series Ch1-18.
[23] *Compte Général de la Justice* and *Annuaire Statistique de la France*. Figures for the years 1914-1918 were interpolated using totals for Paris collected at the Archives de Paris.

registrations. Moreover, some of the drop in their use reflected the renewed popularity of the *commandite simple* at the end of the nineteenth century. *Commandites par action* suffered a permanent decline, but even they did not completely disappear, although they might be considered inferior substitutes for the corporation. Schneider, the large iron and steel works, remained a *commandite par action* until the 1960s, and Michelin is still one today.

The relatively small number of corporations organized in France after the passage of the 1867 law does not seem to have been the result of high fees or a heavy regulatory burden. The taxes that firms paid did not differ across organizational forms until after World War II, and the additional disclosure requirements that corporations had to meet were modest because the stringent requirements of the 1857 law were removed. After 1907 corporations that raised capital from the public had to issue a prospectus and file a copy of their articles of association, a list of their initial shareholders, and the minutes of their first shareholders' meeting. But partnerships also had to register a list of their members and file a copy of their articles of association. Registration fees were essentially the same across organizational forms. Although it was more common for corporations to have their articles of association notarized (a process that cost one percent of capital), this extra step was not required by law.[24]   It is likely, therefore, that the limited take-up of corporations is explained by the availability of *commandite*, which offered firms some protection against untimely dissolution without imposing as much risk of minority oppression as the corporation.

[24] Archives de Paris, Tribunal de Commerce, Enregistrement des sociétées ($D^{32}U^{3}$).

The organizational forms adopted by new firms registered in Prussia from 1867-1932 are displayed in Figure 4.[25] The passage of a general incorporation law brought a brief upsurge in the corporation's popularity as Prussian entrepreneurs quickly took advantage of their new freedom.[26] As in France, however, the corporation did not replace the ordinary partnership, which continued to dominate the registration of multi-owner firms. For every new corporation formed, there were at least 16 new partnerships of all types in 1882 and as many as 41 in 1892. The KG also remained a popular form of organization for new firms. Indeed, when an ordinary partnership changed its legal form, the new entity was more likely to be a KG than a corporation.

The number of new corporations was particularly large during the "*Gründerboom*" of 1871-73, when the rapid payment of the indemnity imposed after the Franco-Prussian war produced a short-lived stock-market bubble.[27] Many of the new enterprises reflected over-heated expectations or outright fraud, and the collapse of the bubble brought a number of them down. Of the 1,005 corporations formed during the

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[25] All-German statistics on forms of enterprise begin in 1887. Before then only Prussia published much information on the matter. Our detailed data on new firms comes from the *Königlich Preussischer Staats-Anzeiger* pre-1871 and continues as the *Reichsanzeiger* after 1871. This was a weekly publication of legal notices that include the summaries of commercial enterprises. We have entered the complete matrix of formations, dissolutions, and transformations for all firm types for January of years ending in "2" or "7" for the period 1867-1932 and for all months in 1891 and 1892. There do not seem to be major issues of seasonality in the number or types of firms formed, judging from those two years. Prussia comprised a large majority of the population, territory, and economic activity of the *Reich* formed in 1871. Of the 4712 corporations existing in Germany in 1912, 2619 were in Prussia. Another 384 were in Bavaria, 454 in Saxony, and 140 in Württemberg (Bayern 1913, p.22*). Prussia's share in corporations is slightly less than its weight in Germany's overall population, and even smaller in proportion to its share of GNP.

[26] For a detailed look at the corporations formed in Prussian during the first few years of the new regime, see Ernst Engel, "Die erwerbsthätigen juristischen Personen im preussichen Staate. Insbesondere die Actiengesellschaften," *Zeitschrift des Königlichen Preussischen Statistischen*, Bureaus 15 (1875).

[27] Burhop, *Die Kreditbanken in der Gründerzeit*, p. 25. Burhop (Abbildung 1) reports a stock market index (1870=100) that rose to a peak of 186 in November 1872 and fell below 100 by May 1875.

period 1867-1873, 123 were in liquidation by September 1874, and another 37 were in bankruptcy.[28]

Fallout from the bubble's collapse led in 1884 to legislation aimed at enhancing the power of shareholders and preventing abuses in the formation of new enterprises. One set of reforms strengthened the role of the supervisory board (*Aufsichtsrat*) and required firms to provide more detailed reports on their financial condition.[29] Other changes raised the minimum size of a share ten-fold, to 1,000 Marks, and forbade new corporations from operating until all their shares had been subscribed. Firms that converted to the corporate form could not list their shares on the stock market for one year after the reorganization.[30]

The 1884 law undoubtedly made the corporate form less attractive to entrepreneurs, and the number of incorporations never again exceeded 400 per year for the rest of the century.[31] Some enterprises that one would expect a priori to be organized as corporations retained another form. Jürgen Kocka and Hannes Siegrist report that 15 of the 100 largest industrial enterprises in Germany in 1887 were *Personengesellschaften* (either partnerships or single-owner firms). In 1907, the number was still 7 out of 100.[32]

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[28] Eduard Wagon, *Die finanzielle Entwicklung deutscher Aktiengesellschaften von 1870-1900 und die Gesellschaften mit beschränkter Haftung im Jahre 1900* (Halle:Verlag Gustav Fisher 1903), p. 3

[29] There was no external auditing of corporations until 1931; the supervision committee was supposed to act as a sort of internal auditor.

[30] *Gesetz, betreffend die Kommanditgesellschaften auf Aktien und die Aktiengesellschaften, vom 18. Juli 1884* / Mit Erlauterung von Paul Kayser (Berlin: H. W. Müller , 1884).

[31] As Timothy W. Guinnane has pointed out, the changes strengthened the role of the Great Banks in company formation with the result that profits from such activities were increasingly captured by bankers. See "Delegated Monitors, Large and Small: Germany's Banking System, 1800-1914," *Journal of Economic Literature*, 40 (March 2002), pp. 104-105. Caroline Fohlin also stresses the effect of the 1884 changes, but her focus is on the implications for banks. See "Regulation, Taxation, and the Development of the German Universal Banking System, 1884-1913," *European Review of Economic History*, 6 (Aug. 2002), pp. 221-54.

[32] Jürgen Kocka and Hannes Siegrist, "Die hundert größten deutschen Industrieunternehmen im späten 19. und frühen 20. Jahrhundert," in *Recht und Entwicklung der Grossunternehmen im 19. und frühen 20. Jahrhundert : Wirtschafts-, sozial- und rechtshistorische Untersuchungen zur Industrialisierung in*

Even today, some of the most important German firms are organized as partnerships or one type or another. Merck's German headquarters company is a KGaA, for example.[33] While today, taxes play an important, and sometimes determining, role in entrepreneurs' choices about legal structure for their firms, this was not the case prior to World War I.

British and American entrepreneurs did not have any real alternative to the corporation besides the ordinary partnership. Hence it is not surprising that they adopted the corporate form more rapidly than their French or German counterparts. Yet even in Anglo-Saxon countries the majority of firms continued to organize as partnerships for many decades after the passage of general incorporation laws. In the US competition among states for charters during the late nineteenth and early twentieth centuries eroded most regulatory restrictions on corporations and kept the cost of securing a charter low.[34] New incorporations rose twentyfold between 1870 (when several thousand corporations were already being chartered each year) and 1925.[35] Nonetheless, data from the US Census of Manufacturers reveal that as late as 1900—that is, more than half a century after most states passed general incorporation laws—partnerships still constituted more than 60 percent of multi-owner firms in the manufacturing sector. Although the proportion of manufacturing firms organized as partnerships fell during the early twentieth century as the scale of enterprise rose, dropping to about 40 percent by 1920, it did not fall much further until after World War II. According to Internal Revenue

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Deutschland, Frankreich, England und den USA, eds. Norbert Horn and Jürgen Kocka (Göttingen: Vandenhoeck & Ruprecht, 1979), pp. 80-81, Tables 1 and 2.

[33] The general partner is an OHG owned by the Merck family. Other large partnerships in Germany today include Henkel KGaA and the Oppenheim banking firm.

[34] Arthur K. Kuhn, *A Comparative Study of the Law of Corporations with Particular Reference to the Protection of Creditors and Shareholders* (New York: Columbia University, 1912); Christopher Grandy, "The Economics of Multiple Governments: New Jersey Corporate Chartermongering, 1875-1929," unpublished Ph.D. diss., University of California, Berkeley, 1987.

[35] George Heberton Evans, Jr., *Business Incorporation in the United States, 1800-1943* (New York: National Bureau of Economic Research, 1948), p. 34.

Service (IRS) data, as late as 1947 partnerships constituted fully 40 percent of manufacturing enterprises taking multi-owner forms, and their proportion of firms in the economy as a whole exceeded 60 percent (see Table 1). Only in the aftermath of the war, when there were substantial tax advantages to organizing as corporations, did the proportion of partnerships begin a steep decline.[36]

Although there are no similar datasets for Britain, available estimates show partnerships to be similarly persistent. In 1872 the Committee on Partnerships considered the practicality of requiring registration of trade partnerships. An interested witness who appeared before the committee estimated that 200,000 to 300,000 firms would be affected. A more conservative estimate from 1885 put the number of "important partnerships" in the economy at about 100,000 and calculated that limited liability companies accounted for at the most 5 to 10 percent of "important business organizations," excluding one-man concerns. The few other surveys and estimates that are available indicate that the percentage of large enterprises in the iron and steel and shipping industries that were organized as corporations increased during the last two decades of the nineteenth century. In the cotton industry there was a similar increase in the early twentieth century. Hence, even in sectors dominated by large firms, it took fifty years or more after the enactment of general incorporation for the corporate form to dominate. Estimates of the organizational forms adopted by SMEs are both scarcer and less reliable, yet it seems quite safe to conclude that most such enterprises were still partnerships at the time of the introduction of the PLLC in Britain.[37]

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[36] Lamoreaux and Rosenthal, "Contractual Tradeoffs"; Carter, et al., *Historical Statistics of the of the United State*, Series Ch1-18; W. Elliot Brownlee, *Federal Taxation in America: A Short History* (New York: Cambridge University Press, 1996), pp. 89-129.
[37] James B. Jefferys, *Business Organisation in Great Britain, 1856-1914* (New York: Arno Press, 1977).

In none of our four countries, therefore, is the historical record consistent with the notion that the corporation is the superior form of organization. Relatively few corporations were formed in France and Germany, and even in the US and the UK the majority of multi-owner firms continued to organize as partnerships long after the corporate form was readily available. Only in Germany (and even there only after 1884) can the unpopularity of the form be blamed on regulatory restrictions. More generally, business people avoided the corporation because there were other organizational forms that better met their needs. In the UK and US entrepreneurs who did not want to worry about oppression chose to bear the cost of untimely dissolution and organize as partnerships. In France and Germany entrepreneurs had another option, the limited partnership, that gave them more protection against untimely dissolution without forcing them to bear as much risk of oppression as the corporation. Thus even fewer French and German firms found the corporation an attractive alternative.

The GmbH and its Take-up in Germany

The passage of enabling legislation for PLLCs in Germany was a direct consequence of the 1884 reforms, which made the formation of new AGs so costly that many thought they had contributed to the growing concentration of economic power in Germany. Demands for change included calls for revising the AG as well as for the creation of a new form of enterprise. Formal consideration of the latter possibility began in 1888 when the Prussian Minister of Commerce asked the German Commercial Association to discuss the desirability of new corporate forms at its next meeting. After consultation with this and other interested groups, the Ministry of Justice circulated a draft version of a law creating the *Gesellschaft mit beschränkter Haftung* (company with limited liability, later usually abbreviated GmbH). The Reichstag enacted the law in 1892, modifying the form slightly when the new commercial code (HGB) was introduced in 1898.[38]

Two or more business people could create a GmbH simply by entering legally valid articles of association (*Gesellschaftsvertrag*) in the relevant commercial register. A GmbH had to have an issued capital (*Stammkapital*) of at least 20,000 Marks.[39] This capital could be divided into shares (that did not have to be of equal value), but no share could be less than 500 Marks. An important difference between a GmbH and an AG was that transfer of a share in a GmbH required a notarial contract. As a result, the cost of transfers was higher, and shares could not trade on stock markets.[40] Otherwise, the law imposed few constraints on the organizers of a GmbH. For example, a GmbH could have a supervisory committee, but unlike an AG it was not required to have one. All that a GmbH needed was one or more managers (*Gesellschaftsführer*), who might but did not have to be shareholders. Because the managers represented the firm legally, their names had to be entered in the commercial registry. By law stockholders had an unequivocal right to dismiss managers whenever they wanted.[41]

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[38] Werner Schubert, "Die Gesellschaft mit beschränkter Haftung. Eine neue juristische Person," *Quaderni fiorentini per la storia del pensiero guiridico moderno*, 11/12 (1982), pp. 589-629.

[39] In 1892, 20,000 Marks equaled £1,000, or about $4860. This was a large sum; per-capita GDP in Germany in 1892 was 470 Marks. Walther G. Hoffmann, *Das Wachstum der deutschen Wirtschaft seit der Mitte des 19. Jahrhunderts* (Berlin: Springer-Verlag, 1965), p. 248, Table 1.

[40] The GmbH's shares are called *Anteilen* rather than *Aktien*, the term used for shares in a corporation. The terminology reflects the intention that ownership in a GmbH would not be traded in active markets as with the AG. Some writers refer in English to the GmbH's owners as "quota holders" rather than "shareholders" to capture the German distinction. See, for example, Henry P. De Vries and Friedrich K. Jünger, "Limited Liability Contract: The GmbH," *Columbia Law Review* 64 (May 1964), pp. 866-86. We think "quota-holder" is too awkward to justify any clarity it might bring.

[41] Max Hachenburg, *Staub's Kommentar zum Gesetz, betreffend die Gesellschaften mit beschränkter Haftung* (4th edn; Berlin: Gettentag, 1913), 441-42. For a more complete description of the GmbH form,

Most important organizational matters were left to the firm's owners, although the law did stipulate some default rules, allowing the articles of association to be brief and simple. A GmbH could be formed for a limited period of time or without a specified term; in either case investors were protected against the threat of untimely dissolution by a default rule that required the approval of three-quarters by value of the shares to wind up the firm. Under the default rules, however, this protection came at the cost of an increased risk of minority oppression similar to that of a corporation. Each 100 Marks of invested capital was to be treated as a single vote, and simple majorities carried in elections for managers and for most corporate decisions, making it possible for owners representing 51 percent of the capital to impose their will on those owning 49 percent. But these were only default provisions. Organizers could agree to other rules on these matters, trading off more risk of untimely dissolution against less danger of minority oppression, if they so chose.

Looking again at Figure 4, which reports estimates of the choices made by new firms that registered in Prussia at five-year intervals starting with 1867, we can see that the GmbH's popularity grew slowly during its first decade of existence. By 1912, however, about one-third of new firms took the form, and by 1932 GmbHs accounted for about half of all new registrations. As expected, the advent of the GmbH had little effect on the proportion of new firms organized as AGs. Both before and after the 1892 legislation corporations were extremely rare; only about 20 were formed in Prussia each January between 1872 and 1912, despite considerable economic growth over the period.

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see Timothy W. Guinnane, et al., "Putting the Corporation in its Place," *Enterprise and Society*, forthcoming.

Because of the high cost of incorporation, only those businesses for which the form offered significant advantages were likely to take out charters.[42]

The GmbH also had little effect on the *Kommandit*, which remained a reasonably constant eight percent of all registrations. Instead, the GmbH's primary impact, as our theory would predict, was to provide limited liability and a share-capital structure to firms that otherwise would have decided to forego these advantages and organize as partnerships, either because the costs associated with forming an AG were too high or because of the greater risk of minority oppression that organizing as an AG or a KG entailed. The share of ordinary partnerships fell steadily after the GmbH was enacted, dropping in Prussia from nearly 90 percent in 1892 to less than 40 percent four decades later, and it is reasonable to assume that the effect on partnerships would have been even greater if the minimum capital requirement for GmbHs had not been set so high. In 1913 about one-third of all Prussian GmbHs had precisely the threshold 20,000 Marks of *Stammkapital*.[43]

The Private Limited Company in Britain

The story of the advent of the PLLC in Britain was remarkably similar to that in Germany. Mounting complaints that promoters were swindling external investors led Parliament to pass the Companies Act of 1900 regulating public offerings of securities. The law required each company issuing shares to publish a prospectus that would provide

[42] Not surprisingly, few AGs converted to GmbHs. Once a firm had born the costs of organizing as a corporation, it probably did not make much sense to give up the form.
[43] The smallest size category of GmbHs accounted over time for an increasing proportion of firms taking the form. In 1904, 40 percent of all GmbHs operating in Prussia had a *Stammkapital* of 20,00 to 50,000 Marks. By 1913, the percentage was 58. *Statistisches Jahrbuch für den Preussischen Staat* (Berlin, 1915), Vol. 12, Table VII.B1, p. 221, and Table VII.B2, p. 222.

investors with detailed information about the enterprise. It restricted companies' ability to allocate shares to organizers or others who did not pay for them fully in cash, required the public registration of mortgages and other charges as a means of protecting unsecured creditors, and mandated the circulation of audited balance sheets at annual meetings of shareholders. Finally, it subjected directors to personal liability if they failed to conform to its provisions.[44]

Although the purpose of the law was to protect investors in publicly held companies, it raised the costs of organizing all types of corporations, whether they issued shares to the public or not. Like its 1884 predecessor in Germany, the law made the corporate form less attractive, especially to SMEs, leading to a drop in the number of companies registered from 5,082 in 1897 and 4,849 in 1900 to 3,343 in 1901 and 3,725 in 1904.[45] It also provoked mounting protests from the business community. Parliament finally responded in 1905 by setting up the Loreburn/Warmington Committee to consider additional changes to the law. The recommendations of that committee led Parliament to enact an amendment to the Companies Act in 1907 creating the private limited company.[46]

It is interesting to note that the new form was not modeled on the GmbH. Although the committee that had proposed the 1900 reforms had collected comparative information on organizational forms, in the case of Germany it was mainly interested in the AG. It obtained only a brief description of the GmbH and did not recommend

[44] Companies Act 1900 (63 & 64 Vict. c. 48).
[45] UK Board of Trade, *General Annual Report under the Companies (Winding-up) Act of 1890* (London; 1897-1904).
[46] Companies Act 1907 (7 Edw. 7 c. 50).

enabling legislation for the PLLC.[47] Intriguingly, the Loreburn/Warmington Committee, which did consider and recommend such legislation, made no reference in its report to the GmbH as a useful form, or even as a model to avoid. It took a different approach and recommended features that were indigenously British.[48]

The 1907 Act distinguished public from private companies and subjected the former to stricter rules and higher disclosure requirements than the latter. According to Section 37(1) of the Act, a private company "means a company which by its articles" 1) restricts the right to transfer its shares, 2) limits the number of its shareholders to fifty; and 3) prohibits any invitation to the public to subscribe for any shares or debentures of the company.[49] Whereas in Germany a company became private by organizing under a different law from a corporation, in Britain a company became private by including in its articles of association the above provisions.

Restrictions on the transferability of shares typically consisted of provisions that required the consent of the board or other shareholders or that mandated that the shares be offered to other members of the firm. Although such provisions increased minority shareholders' vulnerability to oppression, business people could adopt governance rules that redressed the imbalance of power. The organizers of a company could opt out of the default rule (one vote per share whenever a poll was required) by including a different provision in the original articles of association, so it was possible for minority shareholders to protect themselves by increasing their voting rights or requiring supermajority votes on issues for which such a rule was not mandated by law. Subsequent alterations to the articles of association required a supermajority of 75

[47] Parliamentary Papers, 1895 Vol. LXXXVIII (C. 7779), pp. 24-26.
[48] Parliamentary Papers, 1906 Vol. XLIV (Cd. 3052).
[49] Companies Act 1907, section 37.

percent, however, as did a voluntary winding up of the company. A company could be dissolved involuntarily by the court, but only for cause—for example, inability to pay debts or a finding that it was "just and equitable" to wind up the company.[50]

Figure 5 reports the proportion of new companies that organized as corporations (public companies) compared to those that organized as PLLCs (private companies). As the figure shows, the PLLC form was enormously popular almost immediately. The number of new firms that organized as public corporations averaged 4,102 from 1902 to 1906. It then dropped steeply to an average of 712 in 1912-16, 512 in 1922-26, 296 in 1932-36, and 37 in 1942-47. By contrast, the number of new firms that organized as PLLCs rose from average of 4,853 in 1907-12, immediately following the legislation, to 7,936 in 1922-26, to 12,350 in 1932-36. During the period 1922-26 PLLCs constituted fully 93 percent of new firms taking the company form.[51] Although our data do not allow us to compare the average size of firms organizing as PLLCs with that of firms organizing as public companies, we note that the change in the law was accompanied by an increase in the number of small firms registering as companies. In 1901 only 34.7 percent of newly formed companies had a registered capital of £5,000 or less. In 1908 the percentage was 47.4, and by 1936 it had risen to 76.2. The correlation between the increase in the number of PLLCs and the rise in the number of companies with less than £5,000 in capital suggests that there was a substantial take-up of the PLLC form by small enterprises.

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[50] Companies (Consolidation) Act, 1908 (8 Edw. 7 Ch. 69), section 129.

[51] UK Board of Trade, *General Annual Report under the Companies (Winding-up) Act of 1890* (London; 1900-1921); UK Board of Trade, *General Annual Report* (London, 1922-2000).

The SARL in France

Despite ongoing discussion of the desirability of reforming France's general incorporation law, little changed between 1867 and 1925. The end of World War I and the recovery of Alsace and Lorraine created an impetus for innovation, however. Business people in the recovered territories had been able to avail themselves of the GmbH form since 1892. There were at least 400 GmbHs operating in Alsace and Lorraine, and their owners showed little interest in converting to partnerships, *commandites*, or corporations.[52] Instead, they pressured Paris to enact an enabling law for GmbHs. In 1919 a bill that essentially translated the GmbH statute into French was introduced in the Assembly, but it faced staunch chauvinistic opposition and was withdrawn almost immediately: after four years in the trenches the victors did not want to imitate the losers. Although business people in Alsace and Lorraine were disappointed, the failure to pass a law galvanized more widespread support for reform. Local chambers of commerce throughout France urged the passage of some version of the legislation, and a new bill was introduced in 1921 to create the *Société à Responsabilité Limitée*.[53] For reasons that remain unclear, the bill lay dormant until 1925, when the Assembly approved it by a unanimous voice vote. After an expedited procedure, the Senate unanimously concurred. Whatever the politics that led to the adoption of the law, when French legislators finally acted, they charted a course that was substantially different from that of either Germany or Britain.[54]

[52] France, *Documents Parlementaires*, 3348 (Nov., 1921).
[53] 1921-1925 Documents Parlementaires. 1925-1966; Georges Ripert, Traité élémentaire de droit commercial 6. éd. Paris: Librairie Générale de Droit et de Jurisprudence, 1967-1970.
[54] The various proposals can be found in France, *Documents Parlementaires*, 3348 (Nov., 1921); and Georges Ripert, *Traité élémentaire de droit commercial* (6. éd.; Paris: Librairie Générale de Droit et de

Business people could create an SARL simply by entering legally valid articles of incorporation (*Statuts*) in the relevant commercial register. As in the German case there was emphasis on reducing disclosure and transactions costs. Hence although firms had to register, their articles of association could be drawn up private agreement—without the burden of notary fees. As in Germany there was a minimum capital, 25,000 francs, but given the low value of the franc, this constraint was not too onerous. The capital had to be divided into shares of 100 francs or more each.[55]

Unlike partnerships, SARLs were joint-stock firms. As a result, they were not dissolved by the death of an associate; the shares simply passed to the members' heirs. Nor could an SARL be dissolved simply by the desire of a member to withdraw. SARLs thus seem to have solved the main problem faced by French partnerships: impermanence. As was the case for the GmbH and the private company, shares of SARLs could not be publicly traded. The French went further, however, and subjected private sales of shares to the approval of other shareholders. The owners of a quarter of the shares could veto any trade. Unlike the German case, if a trade was approved, the sale could be finalized without recourse to a notary.[56]

On the surface shareholders in SARLs were more at risk of minority oppression than was the case for GmbHs in Germany or private companies in Britain, for SARLs had to follow strict one-share-one-vote rules. But if the managers were named in the articles of association, they could not be removed except through litigation. This ability to name

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Jurisprudence, 1967-1970), Vol. 1, 476-78. A defense of the SARL law can be found in France, *Documents Parlementaires*, Annexe 712, Session of 12-16-1924, pp. 691-99.

[55] During the inflationary 1920s, 25,000 francs was less than five times per capita income. Law of March 7, 1925, *Code de commerce, suivi des lois commerciales et industrielles, avec annotations d'après la doctrine et la jurisprudence et renvois aux publications Dalloz* (63. éd.; Paris, Libraire Dalloz, 1967), 800-06.

[56] For addition information on these and other provisions and for changes to the law enacted later in the twentieth century, see Guinnane et al., "Putting the Corporation in its Place."

or not name managers added flexibility to the form. Consider the case of an SARL with no dominant shareholder. Depending on how the company's articles of association were written, the firm could either be structured like a private corporation, where management could be voted out, or like a *commandite* simple, where the managers could not be removed without dissolving the firm. If all the members of the firm owned the same number of shares, an SARL could even be structured like a partnership, where all members had equal control rights.

As Figure 3 shows, once the form became available in 1925, SARLs very quickly accounted for the vast majority of new enterprises registered in France. The form seems to have been particularly attractive to firms that had small numbers of investors but whose capital requirements were much larger than those of most partnerships. In 1927, for example, 57 percent of the firms that organized as SARLs had only two associates, but the average capital of new SARLs was more than twice that of new partnerships (including limited as well as ordinary). SARLs were much smaller (in terms of capital) than the relatively few corporations that continued to form. In 1927, their average capital was less than a quarter that of new SAs, and only 10 percent of the SARLs organized in that year had a capital as large as the median SA formed in the same period. The median capital of new SARLs was 100,000 francs, four times the minimum required by the law.[57] Even though the capital of most SARLs suggest they would have been partnerships or commandites in the absence of legal innovation, firms in the largest two deciles were big enough that they would most likely have been corporations.

[57] Tribunal de Commerce, Greffe du Tribunal, Enregistrement des Sociétés, Serie D32U3, registers 110-113, 115-117, 169, Archives de Paris.

Germany, Britain, and France Compared

In order to compare the experience of these three countries with each other, we must adopt a uniform time frame and allow for differences in the type of data to which we have access. Measuring from the year in which the initial enabling legislation for PLLCs was passed, we use two different standards of comparison. The first, which we can calculate for all three countries, is the proportion of joint-stock firms that chose the PLLC form, where we count as joint-stock firms all corporations, limited partnerships with tradable shares, and, of course, PLLCs. The second, which we can only compute for France and Germany, is the share of all firms taking multi-owner forms that chose to organize as PLLCs.

By our first measure, the Prussian, British and French patterns look rather similar (see Figure 6). After the passage of enabling legislation for the PLLC, an overwhelming fraction of new joint-stock firms in all three countries chose this form. Nonetheless, this common pattern hides substantial differences among the three countries. In France the costs of organizing a corporation were much lower than in Germany, and the enactment of enabling legislation for PLLCs there had a much greater effect on the number of new corporations. Corporations were even more popular in Britain than in France, and, as we have seen, the advent of the PLLC practically wiped them out.

Although we do not have the data we need to include the British case in Figure 7, we know that the advent of the private limited company also reduced the number of partnerships, but not nearly to the same extent as in France. Partnerships also experienced a much less dramatic collapse in Germany than in France. Part of the explanation may be the more stringent minimum capital requirement for the GmbH. Firms with capitalizations below 20,000 Marks had no choice in Germany but to organize as partnerships, and as we have seen this constraint seems to have been binding. But part of the explanation may have been a unique feature of German law, which enabled members of any form to name a *Prokurist* who could speak authoritatively for the firm, giving the German OHG or KG some of the advantages of legal personality.[58] The *Prokurist* allowed ordinary (or limited) partnerships to solve one of the problems with this form of organization by concentrating all authority in one person.

In Germany the GmbH had little effect on the proportion of new firms that took the *Kommandit* form, whereas in France the advent of the SARL led business people to all but abandon limited partnerships. This result is not too surprising when one considers the position in these two countries of managers with only minority stakes in their enterprises. Because such managers had to worry about whether they would be pushed out by dominant shareholders, in Germany the GmbH had relatively little appeal compared to a KG because shareholders in a GmbH could dismiss a manager at will. By contrast, managers in a similar position in France could entrench themselves in an SARL by registering their names along with the firm's articles of association. Hence the SARL had a greater effect on the use of the *commandite* form than the GmbH had on the KG.

Across our three European countries, the extent to which the PLLC reduced the number of new corporations thus seems to have been inversely correlated with the prior attractiveness of the corporate form, which in turn depended on the cost of organizing as

[58] Otto Eggert, *Die Prokura nach dem Handelsgesetzbuche vom 10. Mai 1897 unter besondere Berücksichtigung der gegenüber dem Allgemeinen Deutschen Handelsgesetzbuche getroffenen Abänderungen* (Leipzig: Julius Klinkhard, 1902); and Max Friedrich, *Die Rechtstellung des Prokuristen im geltenden Recht (*Leipzig: Druck von Walter Wigand, 1905).

a corporation and the availability of alternative forms. Although more work on this point needs to be done, the effect of the PLLC on other organizational forms in France and Germany seems to have owed to specific features of the enabling legislation passed in each country, as well as to the specific features of the available alternatives. Why partnerships remained relatively popular in Britain is not so obvious. Their informal character may be one reason; in Britain partners did not have to register their firm or even express their relationship in a written contract. In addition, the lack of intermediate forms may have made conversion to a company, even a private one, a bigger legal step than was the case on the continent. It is also possible that the refusal of the common law courts to intervene in the internal affairs of business organizations may have made business people who were concerned about minority oppression less willing to forego the ability to exit at will.[59]

The US and the Conservatism of the Common Law

For all practical purposes US business people did not obtain the PLLC form or its equivalent until the second half of the twentieth century, when states began to modify their general incorporation statutes to allow SMEs the flexibility that Europeans took for granted. There was, however, an attempt to introduce the PLLC form in the US even earlier than in Germany. In 1874 Pennsylvania passed a statute that gave any three or more persons engaged in "any lawful business or occupation" the opportunity to organize as a "partnership association," a legal entity whose shares were not tradable but whose "capital shall alone be liable for the debts of such association." Similar enabling

[59] A. J. Boyle, *Minority Shareholders' Remedies* (Cambridge: Cambridge University Press, 2002).

legislation for partnership associations was soon adopted in Michigan (1877), New Jersey (1880), and Ohio (1881). Virginia also passed a statute in 1874 but repealed it in 1918.[60]

Partnership associations, like GmbHs and SARLs, could be formed simply by filing a document with a local (in this case county) official. They could only be dissolved before the end of their term by vote of a majority of the associates in number and value of interest and thus entailed less risk of untimely dissolution than ordinary partnerships. However, the flexibility that partnerships associations had to adopt voting rules that protected the interests of minority shareholders varied somewhat from state to state. Whereas associations in New Jersey and Ohio could adopt whatever voting rules they wished, an amendment to the Pennsylvania law specified that managers were to be elected by a majority in value of interest. Regardless, minority shareholders always had the ability to exit if they disagreed with the actions of the majority. Although individuals who purchased shares could only participate in the business of the association if a "majority of the members in number and value of their interests" so voted, any transferee not admitted to the business would be reimbursed for his or her shares at a price that was

[60] The origins of the law are murky, but its passage seems to have been triggered by a debate during the 1870s in Pennsylvania's constitutional convention over whether the state's general incorporation laws should be liberalized or made more restrictive. Pennsylvania also subsequently passed enabling legislation for another form of PLLC, the so-called registered partnership, whose provisions were even more liberal. Edward H. Warren, *Corporate Advantages without Incorporation* (New York: Baker, Voorhis & Co., 1929), ch. 4; L.I.M., "Notes: Business Associations in Pennsylvania," *University of Pennsylvania Law Review* 82 (Dec. 1933), p. 153; George E. Stransky, Jr. "The Limited Partnership Association in New Jersey," *Rutgers Law Review*, 10 (Summer 1956), pp. 701-2; James A. Matthews, Jr., "Comments: Business Associations—Registered Partnership, Partnership Association or the Corporation—Selection of the Suitable Form in Pennsylvania," *Villanova Law Review*, 2 (April 1957), pp. 386-87; Edward R. Schwartz, "The Limited Partnership Association—An Alternative to the Corporation for the Small Business with 'Control' Problems?" *Rutgers Law Review*, 20 (Fall 1965), pp. 30-33; Wayne M. Gazur and Neil M. Goff, "Assessing the Limited Liability Company," *Case Western Reserve Law Review* 41, no. 2 (1991), 393-94. These laws and subsequent amendments passed through 1899 are available in the microfilm collection *Session Laws of American States and Territories*. All references to specific legislation below refer to this collection and are cited simply by date.

either mutually agreed upon or, if no agreement could be reached, determined by the local Court of Common Pleas.[61]

Although passage of the Pennsylvania statute led an initial wave of firms to adopt the PLLC form, including some famous enterprises such as the Carnegie Steel Company, Ltd., the form did not spread beyond the initial group of states and even in these its use petered out within a couple of decades. In effect, the vaunted common-law courts killed the form. In a series of important cases, Pennsylvania courts determined that if the registration document filed by a partnership association was incorrect in some material respect, or if the list of the association's capital made it "difficult to judge of values" by lumping different items together, the association in effect had never formed and its members were fully liable for their enterprise's debts.[62] The Pennsylvania courts, in other words, gave creditors of insolvent partnership associations an invitation to litigate in the hopes that they would be able to demonstrate deficiencies in the registration document and collect from the individual members of firm.

What is particularly interesting about this series of decisions was that the rule for corporations was just opposite: their existence was presumed. The courts justified treating partnership associations differently from corporations by highlighting a couple of distinctions between the two forms. Although for convenience partnership associations were "clothed with many of the features and powers of a corporation," in a partnership association, unlike a corporation, "no man can purchase the interest of a member and participate in the subsequent business, unless by a vote of a majority of the members in

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[61] For additional information on this form of organization, see Guinnane, et al., "Putting the Corporation in Its Place."

[62] *Maloney v. Bruce*, 94 Pa. 249 (1880); *Eliot v. Himrod*, 108 Pa. 569, 580-81 (1885); *Appeal of Hite Natural Gas Co.*, 118 Pa. 436 (1888); *Vanhorn v. Corcoran*, 127 Pa. 255 (1889); *Sheble v. Strong*, 128 Pa. 315 (1889); *Gearing v. Carroll*, 151 Pa. 79 (1892).

number and value of their interests." Moreover, the state did not grant a partnership association a charter; its privileges rested entirely on the statement submitted at the time of registration. As a result, it was "competent" for a plaintiff suing for payment of a debt "either to point to a fatal defect" in the statement "or to prove that an essential requisite, though formally stated, is falsely stated."[63]

The conservative standard imposed by the Pennsylvania courts was exacerbated by the decentralized character of business law in the US. Organizational forms were governed by the states, not the federal government, though businesses often operated in many states at the same time. As a consequence, there was a great deal of uncertainty about how business forms developed in one state would be interpreted by the courts of another. In a Massachusetts case, for example, a Pennsylvania partnership association was held to be an ordinary partnership whose members bore full unlimited liability. In addition, for at least some purposes federal courts treated partnership associations as if they were partnerships.[64]

Although British businesses were spared the uncertainties of federalism, they too suffered from the conservatism of the common law. The longstanding hostility of the courts to limited partnerships may explain why a 1907 law enabling that form had little consequence.[65] By contrast, the 1907 statute for private limited companies was successful

[63] *Eliot v. Himrod*, 108 Pa. 569, 580-81 (1885). Similar strictures had essentially killed the limited partnership form in the US, and the lower court in this case had attempted to prevent partnership associations from suffering a similar fate by making the case that the legislature intended them to be treated like corporations rather than as limited partnerships. But the lower court was overruled on appeal.

[64] *Edwards v. Warren Linoline & Gasoline Works*, 168 Mass. 564 (1897); and *Great Southern Fire Proof Hotel Co. v. Jones*, 177 U.S. 449 (1900). See also L.I.M., "Business Associations in Pennsylvania," p.153; Stransky, "Limited Partnership Association in New Jersey," pp. 709-10; Warren, *Corporate Advantages Without Incorporation*, pp. 517-19.

[65] Only 144 limited partnerships were formed in the first year after the enabling law, but even this number was large compared to the future take-up of the form. The average annual number of new limited partnerships in the years 1911-20 was about 50, and in the decade 1921-30 only 37. UK Board of Trade,

because it was such a modest innovation. In effect all that the law did was exempt SMEs from the burdensome regulatory requirements that Parliament had imposed to prevent abuses by companies whose shares were publicly traded. Businesses that organized as private limited companies still benefited from a half century or more of case law on corporations.

For analogous reasons the modifications that many US states made to their corporation laws during the second quarter of the twentieth century were much more successful at providing business people with the advantages of the PLLC form than the early partnership association statutes had been. The impetus for the change seems to have come from the high level of personal relative to corporate income taxes in the post-World War II period.[66] To reduce their taxes business people increasingly chose to organize their enterprises as corporations rather than partnerships (see Tables 1 and 2), and this shift seems to have created the critical mass needed to push for changes that made the corporate form more suitable for SMEs.[67] The first significant break occurred in North Carolina in 1955. Imbedded in that state's new Business Corporation Act were several provisions aimed specifically at small, closely held firms, including one declaring that agreements among all the shareholders of such corporations shall not, regardless of their form or purpose, "be invalidated on the ground that [their] effect is to make the

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General Annual Report under the Companies (Winding-up) Act of 1890 (London, 1900-1921); UK Board of Trade, *General Annual Report* (London, 1922-1930).

66 Brownlee, *Federal Taxation in America*, pp. 89-129.

67 Certainly, during this period one finds for the first time a surge of law review articles and similar publications whose purpose was 1) to inform attorneys about the types of provisions they can imbed in corporate articles of association to protect investors, and 2) to push for new legislation increasing the flexibility of the corporate form. See especially the work of F. Hodge O'Neal, including "Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and By-Law Provisions," *Law and Contemporary Problems*, 18 (Autumn 1953), pp. 451-72; "Developments in the Regulation of the Close Corporation," *Cornell Law Quarterly* 50 (Summer 1965), pp. 641-62; "Close Corporations: Existing Legislation and Recommended Reform," *Business Lawyer* 33 (Jan. 1978), pp. 873-88; and *Close Corporations: Law and Practice* (Chicago: Callaghan, 1958), 2 vols.

parties partners among themselves." The North Carolina statute also contained a provision that made it possible for any stockholder to precipitate a judicial dissolution if the corporation's charter or any other written agreement among all the shareholders entitled "the complaining shareholder to liquidation or dissolution of the corporation at will or upon the occurrence of some event which has subsequently occurred."[68] In other words, North Carolina's law now permitted members of corporations to protect themselves against minority oppression by assuming a greater risk of untimely dissolution.

About a dozen other states passed similar statutes over the next thirty years. Still others modified their general incorporation laws in ways that increased the flexibility of the form and/or gave judges greater power to intervene in, and even dissolve, closely held corporations in which there were problems of internal dissension or minority oppression. Nonetheless, as late as the 1980s legal scholars were still voicing the opinion that much more needed to be done in the US to free "close corporations from the restraints of rigid corporate norms," to give members of these firms more flexibility to intermix attributes of both the partnership and corporate forms in organizing their enterprises.[69]

Legislation during Ronald Reagan's presidency reversed the tax calculus, and again these changes seem to have provided the impetus for legislative innovation. After the IRS determined in 1988 that firms organized as Limited Liability Companies (LLCs)

[68] O'Neal, "Developments in the Regulation of the Close Corporation," pp. 647-48.
[69] Kelvin H. Dickinson, "Partners in a Corporate Cloak: The Emergence and Legitimacy of the Incorporated Partnership," *American University Law Review*, 33 (Spring 1984), p. 600. See also O'Neal, "Developments in the Regulation of the Close Corporation," and "Close Corporations"; (Dickinson 1984; see also Robert W. Hillman, "The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations," *Minnesota Law Review*, 67 (Oct. 1982), pp. 1-88; and Mark R. von Sternberg, "The Close Corporation's Counterparts in France, Germany, and the United Kingdom: A Comparative Study," *Hastings International and Comparative Law Review*, 5 (Winter 1982), pp. 291-322.

under a Wyoming statute would be taxed as partnerships, other states quickly passed similar laws, explicitly writing the bills to conform to the terms of the ruling.[70] A second wave of statutes for Limited Liability Partnerships (LLPs) quickly followed.[71] The latter laws permitted all members of an ordinary partnership to limit their liability for the firm's future debts simply by filing appropriate notice. Although LLCs and LLPs are in many respects similar, the two forms differ in the way they trade off untimely dissolution and minority oppression. LLPs are more like partnerships in the sense that members can easily exit at will. LLCs are more like close corporations: Except where the firm's governing agreement explicitly provides for exit, members are stuck unless internal dissension or oppression becomes severe enough to secure the intervention of the courts.[72] In combination, these new forms greatly increased the contractual choices available to business people in the US. Moreover, other statutes enacted around the same time further expanded the menu of options. The most notable was Delaware's 1988 law on statutory business trusts which gave business people virtually complete contractual

[70] The original Wyoming law was essentially a private bill passed to accommodate a particular oil company. See Robert R. Keatinge, et al., "The Limited Liability Company: A Study of the Emerging Entity," *Business Lawyer* 47, no. 2 (1991-92), pp. 381-384; Peter D. Hutcheon, "The New Jersey Limited Liability Company Statute: Background and Concepts," *Seton Hall Legislative Journal* 18, no. 1 (1993), pp. 117-21; Gazur and Goff, "Assessing the Limited Liability Company," p. 390.

[71] Although the initial Texas legislation creating the LLP form was apparently "a response to astronomical losses threatening lawyers and accountants as a result of their partners' involvement in the savings and loan crises of the late 1980s," Fallany O. Stover and Susan Pace Hamill have argued that the rapid spread of the form to other states owed more to tax considerations. See "The LLC Versus LLP Conundrum: Advice for Businesses Contemplating the Choice," *Alabama Law Review* 50 (Spring 1999), pp. 813-47.

[72] Sandra K. Miller, "What Remedies Should Be Made Available To The Dissatisfied Participant in a Limited Liability Company?" *American University Law Review*, 44 (Winter 1994), pp. 465-536; Carter G. Bishop, "Unincorporated Limited Liability Business Organizations: Limited Liability Companies and Partnerships," *Suffolk University Law Review*, 29 (Winter 1995), pp. 985-1058; Larry E.Ribstein, 1996. "Limited Liability Companies: Possible Futures for Unincorporated Firms," *University of Cincinnati Law Review*, 64 (Winter 1996), pp. 319-68; Stover and Hamill, "LLC Versus LLP Conundrum."

freedom to organize their enterprises. The legislation did not even specify any default provisions.[73]

There is no information on the number of businesses that organized under the close corporate statutes passed during the third quarter of the twentieth century or that took advantage of the increased contractual flexibility offered by many states' modifications of their general incorporation laws. We do know, however, that the proportion of firms taking multi-owner forms that were organized as partnerships dropped from 60 percent in 1949 to 34 percent in 1979 (see Table 2). Although this decline could be taken as evidence that businesses responded to this liberalization by shifting toward the corporate form, the fall could also have resulted from the more favorable tax treatment afforded corporations during those years. We also know that business people displayed considerable enthusiasm for the new LLC form by the end of the twentieth century. According to the IRS, in 1993 (the first year for which figures are available) there were only about 17,000 LLCs in the US. By 1997 the number was nearly 350,000, and by 2002 it exceeded 946,000. There is no way of knowing what proportion of new firms organized as LLCs, but in 2002 LLCs constituted 12 percent of all multi-owner enterprises in the US economy, up from around considerably less than 1 percent in 1993. Most of this gain seems to have come at the expense of ordinary partnerships, whose proportion of the total declined from 22 percent in 1993 to 12 percent in 2002 (the share of limited partnerships actually increased from about 4 to 6 percent). By contrast, the proportion of multi-owner firms organized as corporations dropped only slightly, from 73 percent in 1993 to 70 percent in 2002. The relatively small decline in the proportion of corporations suggests that the changes states made to their incorporation

[73] See Hansmann, Kraakman, and Squire, "Law and the Rise of the Firm," p. 1397.

statutes after World War II did in fact considerably increase business people's contractual freedom, remedying most of the disadvantages of corporations that had enabled partnerships to remain so popular for so long.

The Contractual Flexibility of the PLLC

Insight into the motives that led business people to organize their firms as private limited liability companies can be gained by analyzing the provisions of the articles of association they drafted. We begin with three French SARLs that registered with the Paris Tribunal de Commerce on December 8 and 9, 1932.[74] These examples illustrate an important aspect of the PLLC, namely its chameleon-like ability to replicate other organizational forms and at the same time improve on them. In France the main source of that flexibility was a clause in the SARL statute, taken from the jurisprudence of commandites, whereby managers who were specifically named in the articles of association could not be removed without serious cause.[75]

Our first firm was an association of architects and real estate developers formed for the purpose of jointly carrying out real estate projects. The articles appointed two of the owners of les Constructeurs, as the firm was called, to be the initial managers, but also stipulated that after six months the managers would have to stand for election at a general shareholders' meeting. From then on the managers would serve as long as they had the support of the owners of a majority of the shares. Because the two initial managers owned only 392 of 1,000 shares, the other associates could challenge their power. This SARL was rather large. With eight owners and four times the minimum

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[74] Archives de Paris, Tribunal de Commerce, Enregistrement des Sociétés, $D^{32}U^{3}$ 3672

[75] See Charles Lescoeur, Essai historique et critique sur la législation des sociétés commerciales en France et a l'étranger, Paris : A Marescq Ainé, 1877, p. 204-5.

required capital, it would have been impractical to run it by unanimous consent. Hence its owners set it up like a corporation, though without the burden of a board of directors or an audit committee as would be required for an SA.

A second SARL, Coupax, was registered shortly after les Constructeurs ,. Formed to manufacture and commercialize a machine for the butchers' trade, it had three owners, one of whom was named manager. Although the manager had only 18 of 40 shares, he was effectively a dictator. The other associates were de facto silent partners; they contributed capital and some effort to the company, but they had no role in management. Major changes to the articles required the assent of the owners of three fourth of shares, so for all practical purposes the governing rules could not be altered without the consent of the manager. This SARL essentially reproduced the structure of a limited partnership with the advantage that the general partner's liability was limited.

The next day two associates registered our third firm,"Stores et Enseignes," which installed awnings and signage for Parisian businesses. One of the associates owned three fifths of the shares and hence, under the standard voting rules for SARLs, would have had dictatorial powers. However, the associates avoided this outcome by naming both owners managers in the contract. Because neither manager could legally be forced out without cause, they had to run the firm by unanimous consent. This SARL was effectively a partnership in which the consent of both partners was required to encumber the firm, but it was a partnership in which all the members had limited liability, and it was not subject to dissolution before the expiration of its term. Intriguingly, the articles included an additional provision that came into effect if one of the owners surrendered his shares to a relative. Then the shareholders' meetings would be run on a majority basis, except for changes to the statutes which still required unanimity.[76]

As these three examples show, by varying just one aspect of their articles of association—the ability to name a manager or not—French business people could use the SARL to improve upon alternative forms of organization, avoiding the regulatory burden of the corporation, eliminating the unlimited liability that one or more of the associates had to bear in partnerships, and reducing the problem of untimely dissolution in ordinary partnerships. They could also do a lot more than that, but we move on to a German example to highlight some of the additional ways in which the contractual flexibility of the PLLC could be exploited. Of course, just avoiding the regulatory burden of the corporation was even more valuable in Germany than in France.

The case involves a GmbH formed to take over and operate a manufacturer of ornamental embroidery for furniture in Nowawes, now part of Potsdam.[77] Emmo Pechatscheck, Jr. owned the original firm. Pechatscheck's mother, Helene, and two apparently unrelated investors, Berthold Thon and Walter Vockel, formed the GmbH to buy him out. Thon put in three fifths of the enterprise's 25,000 Marks of capital, while Vockel and Helene Peschatscheck put in one fifth each. Emmo, Sr., who was not an owner, was named manager. The default rules would have made Thon the firm's dictator, since he owned a majority of the shares. However, the articles of association included a provision requiring the unanimous consent of the owners to fire the business manager. Hence Emmo, Sr. could only be removed if his wife agreed. The associates

[76] This provision should not be interpreted as creating future burdens on the minority manager. Indeed, he still retained the ability to veto any change in the ownership structure (except for one which resulted from death of his partner).

[77] *Emmo Pechatscheck Mechanische Posamentenfabrik für Möbel und Konfektion, Gesellschaft mit beschränkter Haftung*. Before Notary Raphael Josephsohn, Potsdam, June 3, 1912.

also added provisions designed to protect the Pechatscheck family against the threat of untimely dissolution. Should they wish to withdraw, Thon and Vockel were obliged first to offer their shares to the father and son at a price determined by a mechanism included in the contract. This provision reassured the Peschatscheck family that the outside investors could not simply wind up the firm and walk away. Eliminating the capacity of the outsiders to force a dissolution also increased the family's bargaining power in the operation of the firm. In exchange, the Peschatschecks offered Thon and Vockel a larger share of the firm's profits and, in effect, guaranteed their investments. §4 declared that invested capital would earn a 5 percent return, a provision that was common in GmbH contracts. §7 gave Thon and Frau Peschatscheck each two fifths of the profits of the firm (over and above the 5 percent mentioned earlier). In addition, Helene Peschatscheck and her husband (who was not an owner of the firm!) guaranteed that Thon and Vockel's investments would always be equal to what they put in, plus the accumulated 5 percent—in effect allowing Helene Peschatscheck to withdraw earnings only when the firm was profitable.[78]

In this example (as in many others), associates adopted articles that made their firm quite different from what it would have been had they followed the default provisions in the GmbH law or organized as a partnership or a corporation. Although such complicated rules for the distribution of profits might have been feasible in a partnership or even in an AG, the restrictions on dissolution were not compatible with a partnership. A limited partnership with Thon and Vockel as the limited partners could have replicated the GmbH's organization from their point of view, but it would have left

[78] Wives needed their husbands' authorization to enter into contracts. This requirement raises a complex set of issues about marital property which we defer to future work.

the Peschatchecks with unlimited liability. Organizing an AG would have far more complicated and costly, and additional outside investors would have been needed to make up the minimum seven shareholders required by law. Moreover, it would not have been easy to protect the manager of an AG against dismissal.

The Peschatschecks benefited as well from another feature of PLLCs—the ability to restrict the transfer of their shares. A second example, this time from Britain, underscores the importance of this characteristic for SMEs. In 1927 the Mitchell family transferred its brick and tile manufacturing business to a new company, Thomas Mitchell & Sons (Guildford) Ltd., a private limited liability company.[79] The new firm had a capital of £22,000, divided into 22,000 shares of £1 each. Four members of the Mitchell family each received a quarter of the shares. The company accepted the standard articles of association listed in Table A of the Companies Act, but opted out of 45 clauses. Most of the clauses it rejected dealt with formalities concerning directors' and stockholders' meetings, procedures for nominating directors, and the like. A notable addition to the articles permitted the directors to refuse to transfer shares if the outgoing member failed to demonstrate to their satisfaction that the transferee was a responsible person or if they found the transfer not in the interest of the company. This provision enabled the Mitchells to preserve family control of their company.

Another British example involving a metal producer, the N. C. Zinc Oxide Company, shows how the decision to keep a company private gave owners a great deal of freedom to solve their contracting problems.[80] N. C. Zinc Oxide did not adopt Table A at all but created its own articles. It had two classes of shares. The 47,500 class A shares

[79] NA (National Archives), BT 31/29949/224123.
[80] NA, BT 31/32835/222120.

had a nominal value of £1 each. The 50,000 class B shares had a value of 1 shilling each. Class A shares were entitled to a preferred dividend of 7 percent. When additional profits were distributed, three quarters would go to class A shares and one quarter to class B shares. Henry Edwin Coley, who listed his occupation as technical investigator, held all of the B shares, in exchange for which he transferred to the company a license to manufacture zinc according to a certain patent. Lloyds Bank held 61 percent of the A shares, and the rest were held by 36 other shareholders, 25 of whom each had less than 1 percent of the shares. Each share had one vote, irrespective of its nominal value. As a result Coley controlled the company. In addition, the articles made Coley a director for life.

As this example illustrates, the contractual flexibility offered by the PLLC could be used by an entrepreneur to raise substantial capital from outsiders without losing control. It also enabled an outside financier to acquire securities that intermixed features of both debt (through the fixed dividend of its preferred share) and equity (because the same share claimed 75 percent of the residual return). N. C. Zinc Oxide's articles also created an incentive for the entrepreneur (Coley) to strive for a high level of profits because his return only began after the firm had earned at least £3325 and because beyond that level his profits could be handsome. The bank's large stake gave it veto power under the Company's Act over certain decisions, notably the amendment of the articles of association, and it seems the bank retained the capacity to sell out at a later time subject to the approval of the directors.[81]

[81] In principle almost all of these clauses could have been stipulated in the articles of a public corporation, but it seems likely that there were financial market constraints that precluded owners from adopting them. One possible exception, which we will explore in our ongoing research, is the use of securities that combined features of bonds and equity.

In the US entrepreneurs for the most part did not have the ability to improve upon the standard partnership and corporate forms until well after World War II. Nevertheless, articles drawn up by the partnership associations that formed after Pennsylvania passed its enabling statute in 1874 suggest that Americans too would have exploited the PLLC's additional contractual flexibility. For instance, organizers of the Cecil Paper Co., Ltd., were much more worried about minority oppression than untimely dissolution. They set an early dissolution date of slightly under three years from the date of their articles of association to provide them with an opportunity to exit. At the same time, they built additional safeguards into their agreement to keep controlling shareholders from expropriating the minority's profits. The stockholders were to meet twice a year to balance the books of the association and appraise the value of the business and of each member's share. If there was a difference of opinion, the value would be set by a ballot in which each member of the association would exercise one vote. In other matters, such as the election of directors, stockholders' votes were weighted by the value of their interest. Minority investors in the Cecil Paper Company were happy to let the majority run the firm, but they wanted to be sure that they got their fair share of the profits.[82]

By contrast, minority investors in the Carnegie Steel Company, Ltd., were far more worried about untimely dissolution than about minority oppression when they organized their partnership association in 1892. A few years earlier Andrew Carnegie had been so seriously ill that it appeared he would die, and his partners in the company's predecessor firms had faced the dire possibility that they would be bankrupted by the cost of settling his estate. The solution they had devised was to add a clause to their

[82] Articles of Association of the Cecil Paper Co., Ltd., 13 November 1881, Limited Partnership, Vol. 5 (LP5), Partnership Books, 1836-1955, Philadelphia City Archives.

partnership agreements giving the surviving associates the right to buy out Carnegie's interest at book value over an extended period of time (fifteen years). Any partner who wished to leave the firm faced the same terms; he had to sell his shares to the company at book value (payable in installments over a period that depended on the magnitude of the interest). Of course, the minority investors could have protected themselves against untimely dissolution by organizing the firm as a corporation, but Carnegie was not willing to go along. He wanted to be able to control who could be a member of the firm—to reward talented managers with ownership shares and to get rid of partners who did not share his strategic vision. Hence he imposed the famous "Iron Clad" contract. Upon the vote of three-quarters of the partners in number and value of shares, any member of the firm could be forced to sell out his interest in the company at book value. Carnegie then used his power in the firm to keep the company's book value was far below its market value, so the agreement had considerable bite.[83]

The demise of the partnership association meant that Americans for the most part lost this ability to trade off untimely dissolution against minority oppression and control the identity of members of their enterprises until late in the twentieth century. Although business people in the US could avoid the danger of untimely dissolution by organizing corporations, in most states the relative inflexibility of the corporate form meant that they could not do much to control the risk of minority oppression.[84] As late as 1945, for example, the New York State Court of Appeals struck down a corporate bylaw requiring

[83] Joseph Frazier Wall, *Andrew Carnegie* (New York: Oxford University Press, 1970), pp. 491-93; Harold C. Livesay, *Andrew Carnegie and the Rise of Big Business* (Boston: Little, Brown, 1975), pp. 171-72; James Howard Bridge, The *Inside History of the Carnegie Steel Company: A Romance of Millions* (Pittsburgh: University of Pittsburgh Press, 1991), pp. 336-38.

[84] For details, see Lamoreaux and Rosenthal, "Legal Regime and Contractual Flexibility." See also Guinnane, et al., "Putting the Corporation in Its Place."

stockholders' unanimous consent for the election of directors on the grounds that "the state, granting to individuals the privilege of limiting their individual business debts by forming themselves into an entity separate and distinct from the persons who own it, demand in turn that the entity take a prescribed form and conduct itself, procedurally, according to fixed rules."[85] Over the next couple of decades, as we have seen, many states would revise their general incorporation statutes to give business people greater contractual flexibility. As one member of the commission that drafted the new statute in Connecticut testified in a hearing held by the legislature's General Law Committee, it was just such rigidity that the proposed law aimed to overcome. After recounting a similar case where the Connecticut courts overturned a set of corporate bylaws written to prevent oppression, the commissioner praised the new statute for including "provisions whereby the by-laws or the certificate of incorporation may provide … for greater than a majority consent to any decision or the determination of any matters involved in the corporate affairs." The "most desirable thing" about the bill was "this flexibility," which "permits the little fellow to set up an organization and handle it in the way he intends without in any way sacrificing the rights of creditors or sacrificing any right of these particular individuals as between themselves."[86]

Conclusion

The history of the PLLC is not consistent with current trends in scholarship that make invidious comparisons between common-law and code-law countries. Neither the

[85] *Benintendi v. Kenton Hotel*, 294 NY 112, 118 (1945).
[86] Testimony of Harry L. Nair, Chairman of the Committee of Corporations of the State Bar Association, before the General Law Committee, 27 April 1959, Connecticut General Assembly, *Joint Standing Committee Hearings: General Law*, Part 3 (1959).

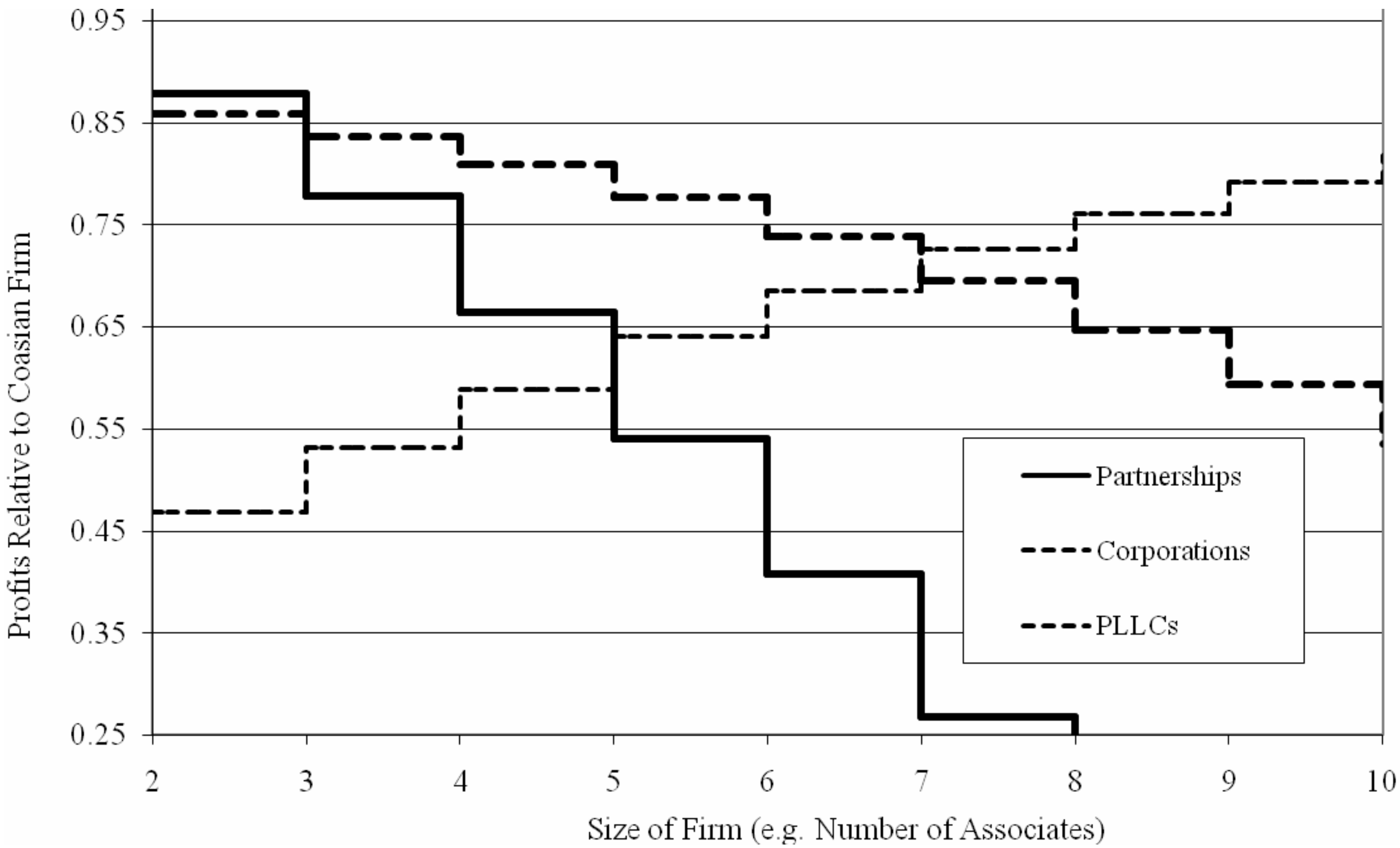
timing of the enabling legislation for the PLLC nor the rate of the new form's adoption fit this kind of black and white division of the world. Germany, a code country, was the first mover, but German firms were relatively slow to take advantage of the new form. When the UK, a common-law country, followed in 1907, British business people rapidly substituted the PLLC for the corporation, but partnerships remained a popular organizational form. France, a code country, was third in 1925. There the PLLC almost immediately became the form of choice, reducing the take-up of corporations and virtually eliminating the use of general and limited partnerships. In the common-law US, businesses did not obtain the equivalent of the PLLC form until the second half of the twentieth century, but then, as in France, they seem to have adopted it to the virtual exclusion of all non-joint-stock forms of organization.

Much of the variation across countries in the timing of the innovation owed to events and path-dependent processes that were specific to each case. The German reforms of 1884, themselves a reaction to abuses during the *Gründerboom* of 1871-73, made the corporation so unattractive to all but the largest firms that it stimulated a movement to provide SMEs with an alternative. In Britain liberal general incorporation laws made the corporate form increasingly attractive to SMEs in the second half of the nineteenth century. The restrictive 1900 Companies Act, a response to worries about abuses by large public companies, made the corporation less suitable to businesses that did not intend to sell their equities on the market and, as in Germany, led to enabling legislation for the PLLC. In France the story was very different. The recovery of Alsace and Lorraine from Germany brought into the country firms that were organized as GmbHs and unwilling to give up the advantages of the form. In the US it is likely that relative tax rates encouraged SMEs to incorporate and also to push for changes that would make the corporate form more suitable for their businesses.

In all of these cases the popularity of the PLLC casts doubt on the corporation's putative superiority. Even where the corporate form was most popular during the late nineteenth century (the UK and the US), it was adopted by far less than half of all multi-owner enterprises. Many owners of SMEs worried about the threat of minority oppression in the corporation to such an extent that they were willing to bear the partnership's substantial risk of untimely dissolution. Others saw untimely dissolution as the more costly threat and so organized their firms as corporations. Regardless, they had to choose the lesser of two evils. The PLLC got them off the horns of this dilemma by enabling business people to secure some of the advantages of corporations without taking on all of the form's disadvantages.

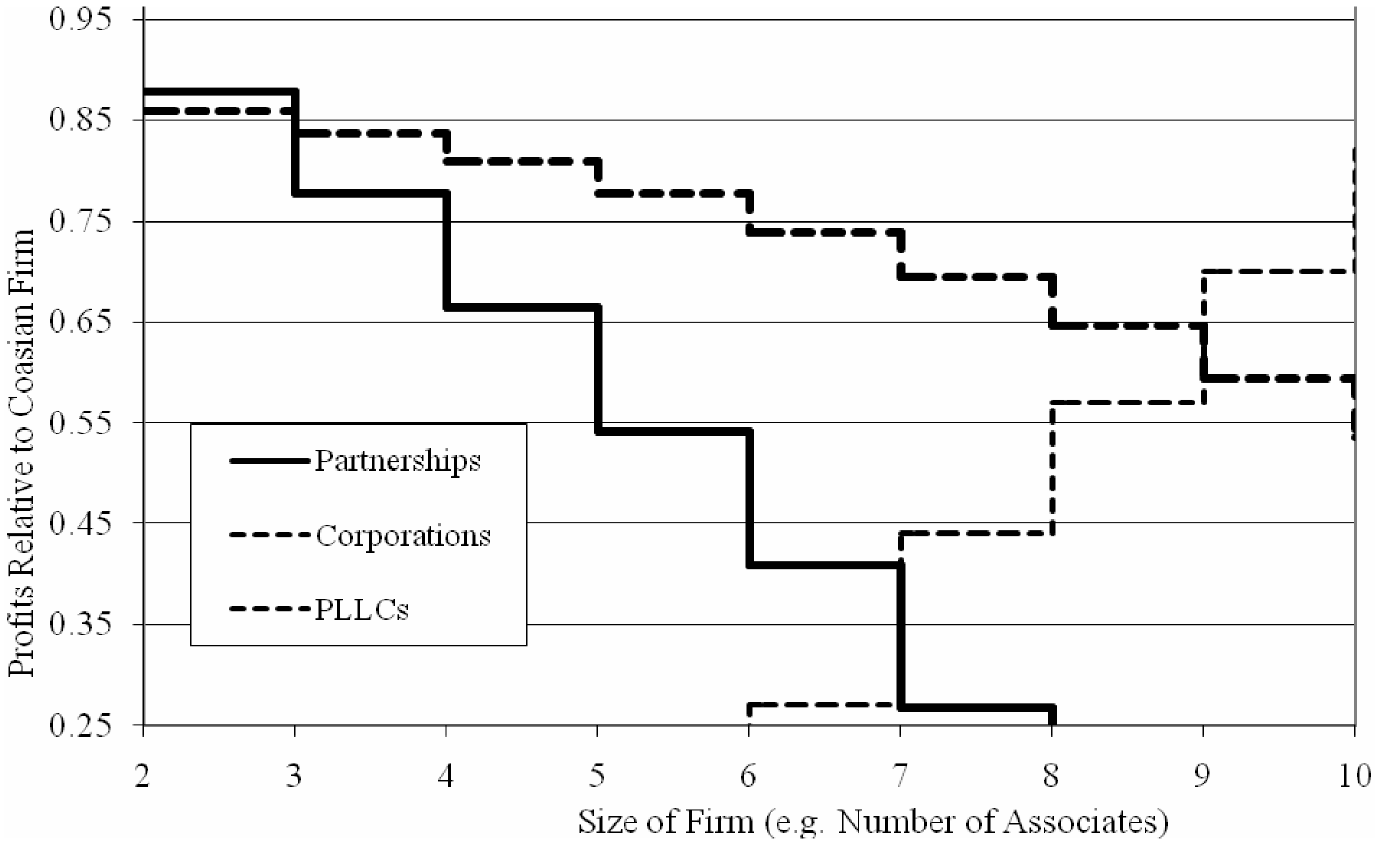
Because firms that organized as PLLCs could not issue equity to the public, our study has focused on the advantage of the form to SMEs. But we have come across numerous instances of large firms that chose to organize as PLLCs or even as some form of limited partnership. In still other cases large corporations modified their governance structure to obtain contractual features (multiple class shares, for example, or special advantages for large shareholders) that deviated in significant ways from the standard form idealized in the literature. Although historically the corporation and large-scale enterprises developed hand in hand, we caution against seeing the former as necessary for the latter. If Andrew Carnegie did not need the corporation to build the largest and most efficient steel company in the US, who did?

Figure 1: Impact of PLLC laws when incorporation is cheap



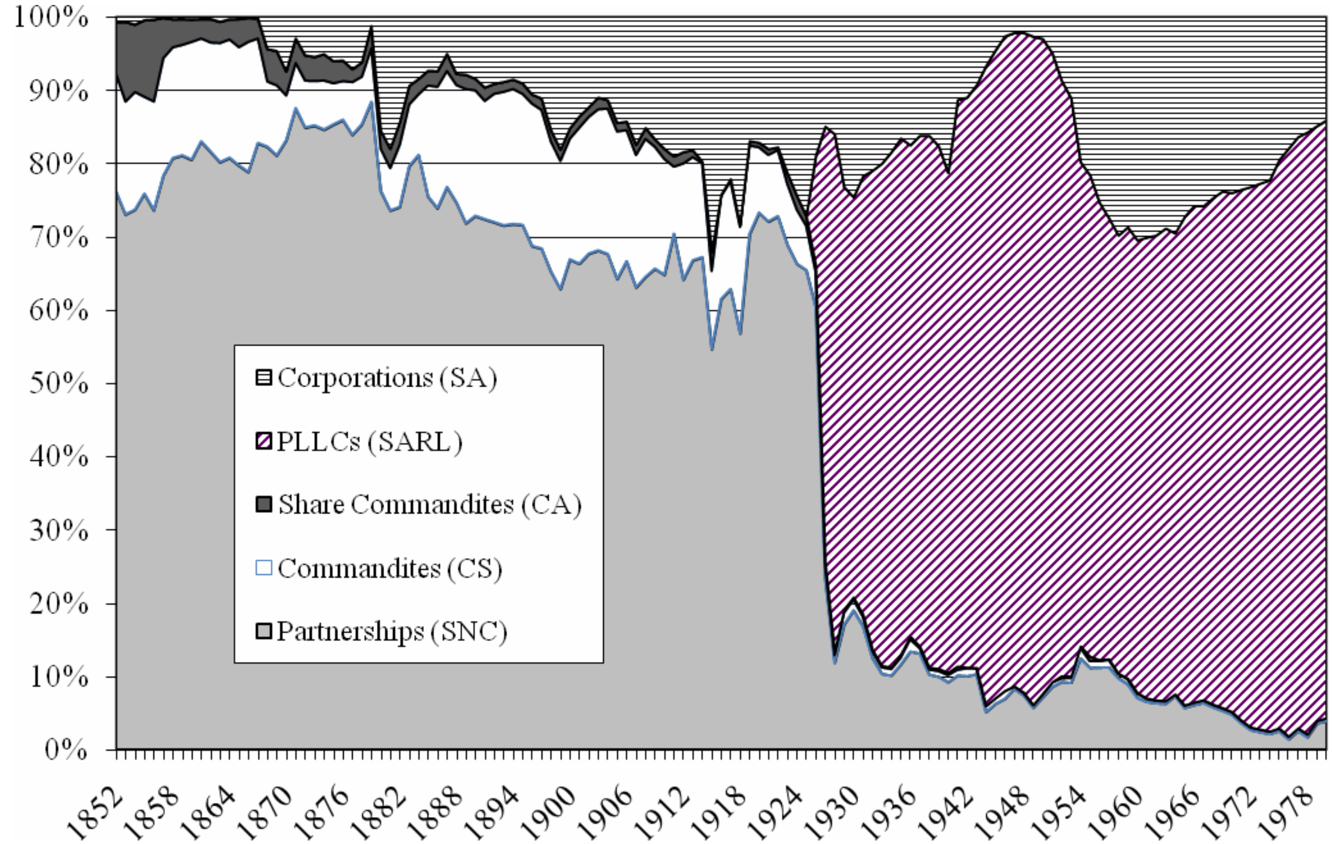
Note: The numbers in this figure are purely heuristic.

Figure 2: Impact of PLLC laws when incorporation is expensive



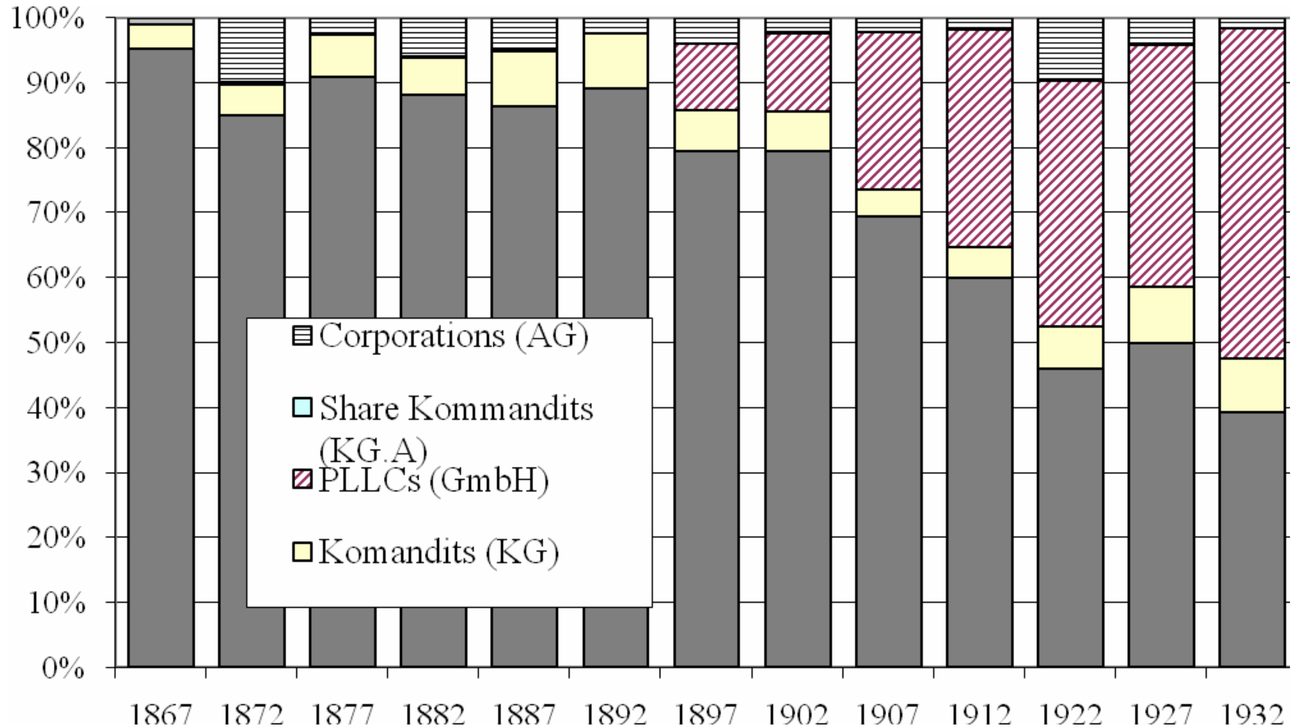
Note: The numbers in this figure are purely heuristic.

Figure 3: Distribution of new firms among multi-owner organizational forms, France, 1852-1978



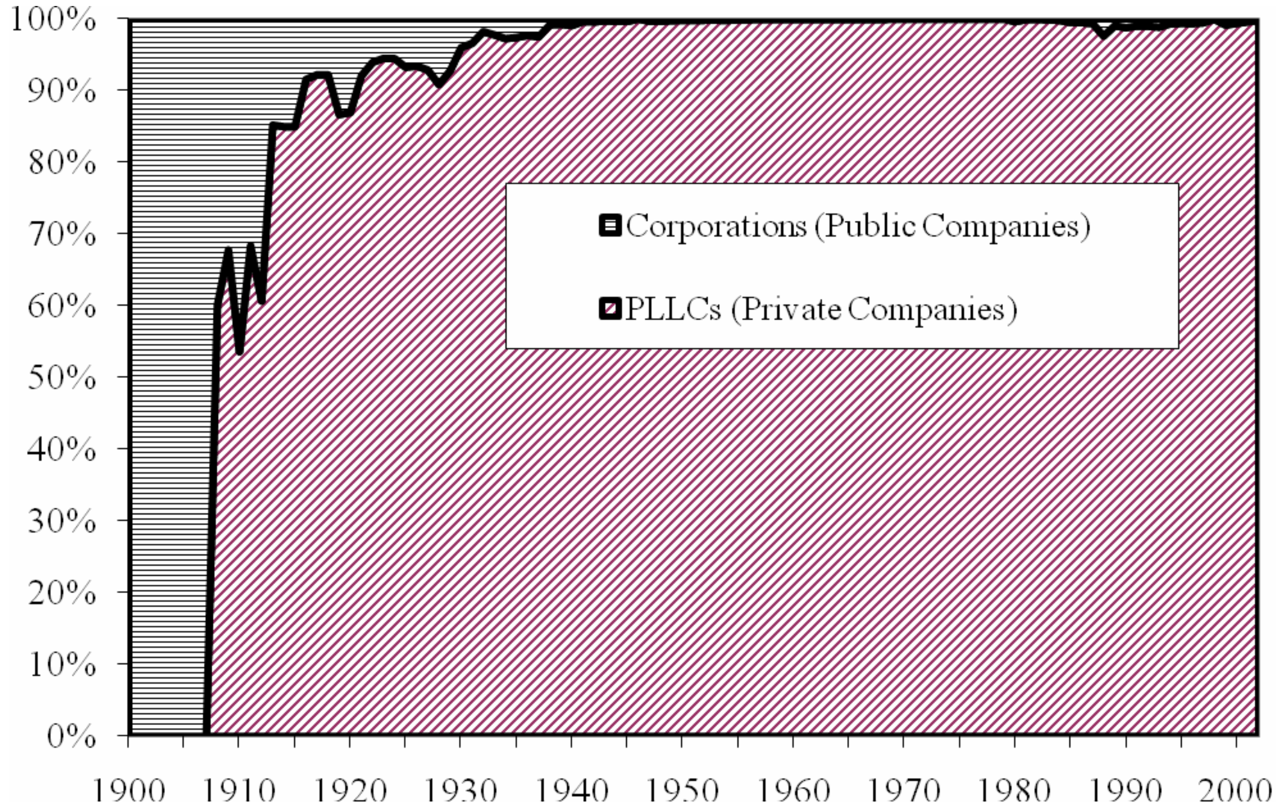
Sources and Notes: Annuaire de la Justice. Figures for the years 1914-1918 were interpolated using totals for Paris collected at the Archives de Paris.

Figure 4. Distribution of new firms among multi-owner organizational forms: Prussia, 1867-1932



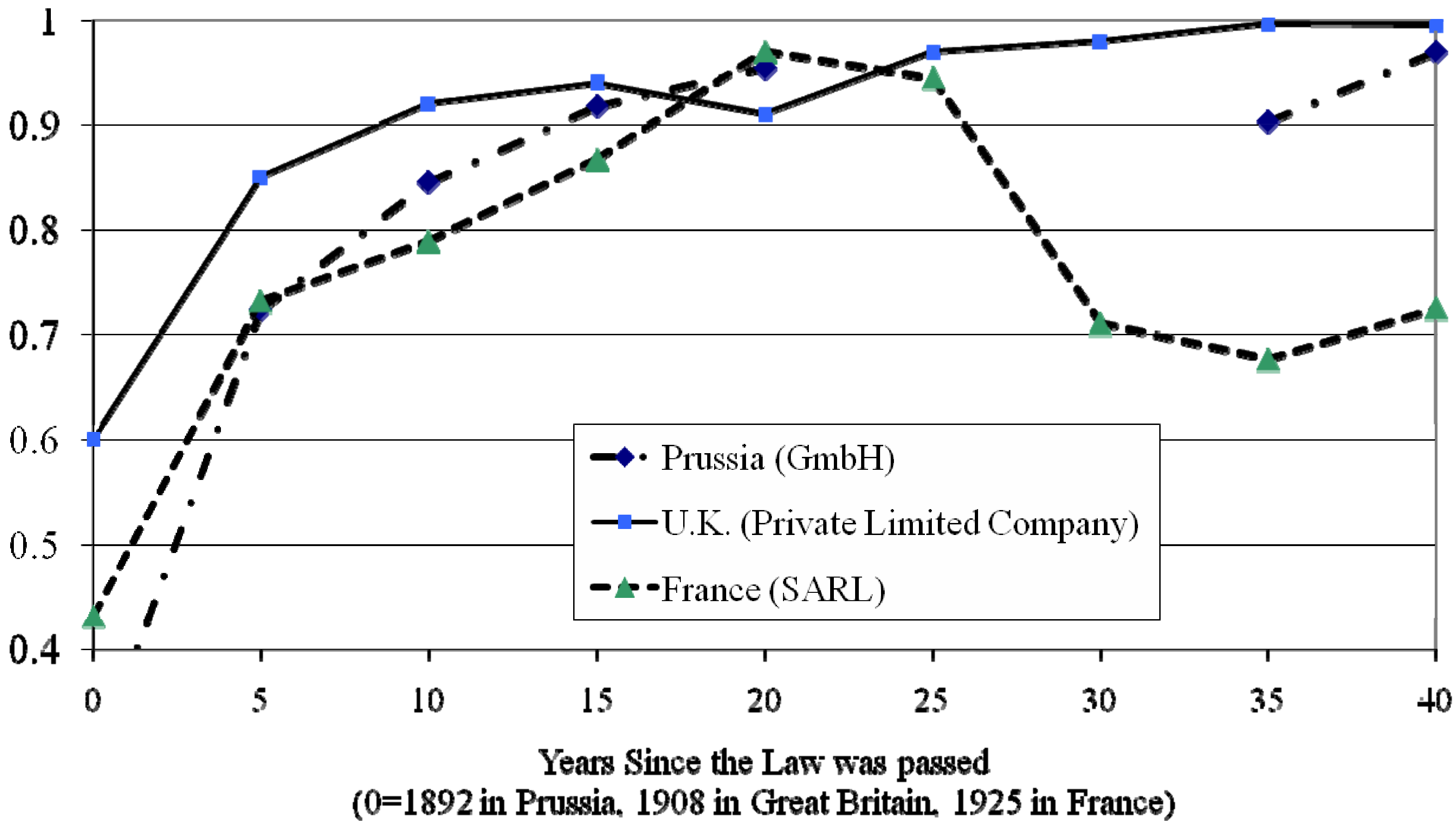
Sources and Notes: Data were compiled from the *Königlich preussischer Staats-Anzeiger* (until 1871) and the *Deutscher Reichsanzeiger und preussischer Staatsanzeiger* (after 1871). We counted every new firm announced by a commercial registry in January of each year reported. Note that the source pertains only to Prussia only

Figure 5. Ratio of new private to all new limited companies in Britain, 1900-2000



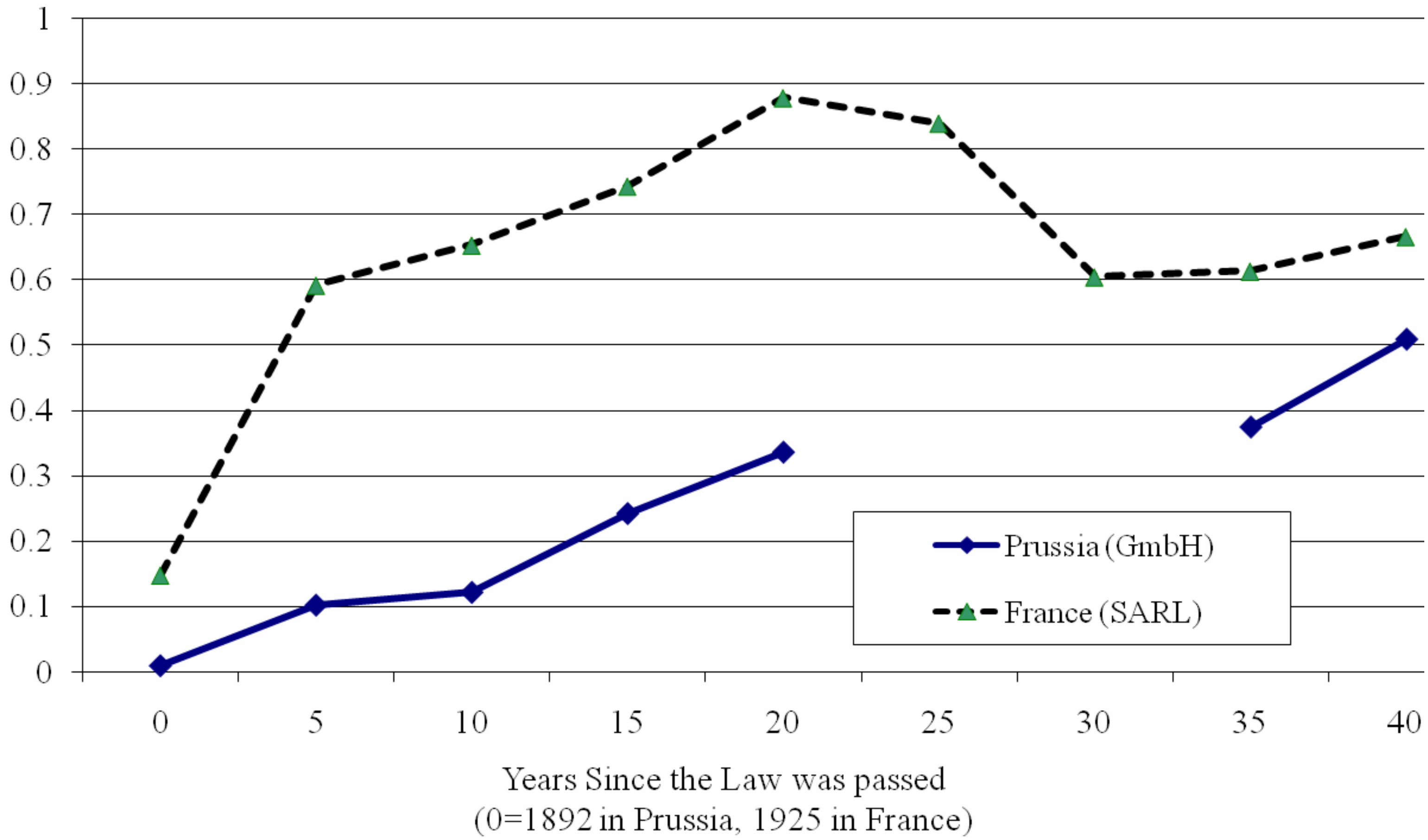
Source: UK Board of Trade, *General Annual Report under the Companies (Winding-up) Act of 1890* (London, 1900-1921); UK Board of Trade, *Report* (London, 1922-2000).

Figure 6: Share of all joint-stock companies that take the PLLC form



Sources: See Figures 3, 4, and 5.

Figure 7: Share of all new multi-owner firms that adopt a PLLC form



Sources: See Figures 3and 4.

Table 1. Distribution of partnerships and corporations in the US, by industry, 1947 and 1997

Industry	Year	Number of Partnerships	Number of Corporations	Corporations as Percent of Multi-Owner Forms
All	1947	888,862	551,807	0.38
	1997	1,758,627	4,710,083	0.73
Agriculture, Forestry,	1947	120,402	7,329	0.06
and Fishing	1997	127,060	163,114	0.56
Mining	1947	13,579	8,294	0.38
	1997	28,045	32,996	0.54
Construction	1947	52,592	20,287	0.28
	1997	72,098	487,783	0.87
Manufacturing	1947	74,978	112,184	0.60
	1997	40,022	325,045	0.89
Transportation, Communi-	1947	20,776	23,729	0.53
cations, and Utilities	1997	30,917	209,402	0.87
Wholesale and Retail Trade	1947	372,212	177,297	0.32
	1997	173,009	1,149,132	0.87
Finance, Insurance, and	1947	87,647	151,043	0.63
Real Estate	1997	974,223	744,545	0.43
Services	1947	130,954	45,975	0.26
	1997	310,990	1,592,854	0.84
Other	1947	15,722	5,669	0.27
	1997	2,263	5,201	0.70

Source: Susan Carter, et al., *Historical Statistics of the United States: Millennial Edition* (New York, 2006), Vol. 3, Tables Ch1-192.

Table 2. Distribution of organizational forms in the US, 1949 to 2002

Year	Partnerships	Corporations	LLCs
1949	61	39	--
1963	41	59	--
1979	34	66	--
1993	26	73	1
2002	18	70	12

Sources: Carter, et al., *Historical Statistics of the United States*, Vol. 3, Tables Ch 193-204; *SOI Bulletin*, various issues.

Note: The figures for ordinary partnerships include limited partnerships. Their proportion of multi-owner forms has grown in recent years from about 4 percent in 1993 to about 6 percent in 2002, so the table understates the drop in ordinary partnerships.

Appendix table: summary of terminology and abbreviations

Short Name or Abbreviation	Country	Form	Full name
AG	Germany	Corporation	Aktiengesellschaft
Commandite simple	France	Limited partnership	Société en commandite simple
Commandite par action	France	Limited partnership with tradable shares	Société en commandite par action
GmbH	Germany	Private limited company	Gesellschaft mit beschränkter Haftung
KG	Germany	Limited partnership	Kommanditgesellschaft
KGaA	Germany	Limited partnership with tradable shares	Kommanditgesellschaft auf Aktien
OHG	Germany	Ordinary partnership	Offene Handelsgesellschaft
PA	US (some states)	Private limited company	Partnership association
Private limited company	Britain	Private limited company	Private limited company
SA	France	Corporation	Société anonyme
SARL	France	Private limited company	Société á responsibilité limitée