Legal Regime and Contractual Flexibility: A Comparison of Business’s Organizational Choices in France and the United States during the Era of Industrialization

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We compare the law governing business organizational forms in France and the United States during the nineteenth century and find that, contrary to the conventional wisdom, the contracting environment in the U.S. was neither freer nor more flexible than in France. U.S. businesses had a more limited menu of organizational choices and also much less ability to adapt the basic forms to meet their needs. Moreover, American law did not evolve any more readily in response to economic...
change than French law. In both nations, major changes in the rules governing organizational forms required the passage of new statutes.

1. Introduction

Although there has long been widespread agreement that the effectiveness with which property rights are specified and enforced matters a great deal for economic growth, this idea has recently been pushed in a provocative direction by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny (hereafter LLSV). According to these scholars, two alternative legal regimes—a common-law system based on judicial precedent and a civil-law system based on formal codes—emerged in Europe during the early modern period and were transplanted to the rest of the world through European expansionism. Reporting cross-country regressions for the mid-1990s, LLSV show that the type of legal regime a country adopted at that time continues to affect its economic performance in dramatic ways. They find that countries whose legal systems are based on civil codes (especially of French origin) have systematically weaker environments for business than those whose legal systems are based on Anglo-American common law. Common-law countries appear to offer external suppliers of finance, whether shareholders or creditors, better protection than countries with legal systems based on French civil law. Moreover, firms’ ability to finance their activities, whether measured by the ratio of stock market capitalization or debt to GNP, seems to be superior in common-law countries than in French civil-law countries, even controlling for the existence of protections to debt and equity holders and the quality of law enforcement in each country (LLSV, 1997, 1998, and 1999).

Even as LLSV’s findings about the superiority of the Anglo-American over the French legal regime were touching off heated debate, scholars were rushing to resuscitate traditional ideas about the greater flexibility of the common law to explain the cross-country results (Beck and Levine, 2003; Beck, Demirgüç-Kunt, and Levine, 2002, 2004). According to these ideas, comprehensive code-based systems like that of France have two important drawbacks. First, they are the products of academics—“of philosophers”—rather than practitioners (Stone, 1936). As a result, they impose the views of the code’s drafters on economic actors rather than
emerge out of the actual experience of those actors. Second, even if the drafters were good at their jobs—that is, even if they created rules that fit economic circumstances reasonably well—of necessity, codes are revised only infrequently. As a result, their provisions are likely to become increasingly outmoded as the economy develops and changes. By contrast, because the Anglo-American system of common law consists of precedents forged out of actual litigation, legal rules evolve as businesses confront new problems. The direction of this evolution, moreover, is likely to be toward greater efficiency over time, because inefficient rules are more likely to lead to litigation (Posner, 1973; Priest, 1977; Rubin, 1977).

Whether the different processes by which law is created under the French and Anglo-American systems can account for the observed differences in business environment around the world is a question that cross-sectional analysis is poorly suited to investigate. If the nature of the legal regime, as opposed to the specific policies adopted by governments, really matters for economic performance, then the effects should be observable over long periods of time. In this article, therefore, we pursue a historical approach. In particular, we focus on France and the U.S during the nineteenth century, when both countries were undergoing industrialization, and compare the extent to which the legal systems of these two countries imposed constraints on business people’s ability to resolve the contracting problems they faced in organizing their enterprises. We also compare the

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1. This literature elides the distinction between the civil code and the commercial code. The latter was not designed by philosophers but by a combination of jurists and public servants with considerable knowledge of and connections to the business world. It is certainly the case, however, that France was uncommonly slow in revising its commercial code. The first major revision of the 1807 code did not come until the 1960s (Lemercier, 2003, pp. 114–15, 151–52).

2. This idea of the superior flexibility of the common law has deep roots in the literature on comparative legal systems. See Stone (1936) for early citations. It has not, however, gone uncontested. Some scholars have argued for the superiority of code-based regimes (Weber, 1954; Horn, Kötz, and Leser, 1982); others have insisted that the differences between the two types of systems have been exaggerated or that they have diminished over time through a process of transplantation (Watson, 1974); and still others claim that law in the French colonies was very different from that in France itself (Merryman, 1996). For more comprehensive treatments of Anglo-American versus French law, see Zwiegart and Kötz (1998) and Glendon, Gordon, and Carozza (1999).
facility with which French and American legal rules evolved as these economies industrialized and businesses’ organizational problems changed.

France is an obvious case to study, as it was the main producer of the codes singled out by LLSV for their detrimental effect on business. We study the U.S. rather than Great Britain because, like France, it was a “follower” nation in the timing of its industrialization. In addition, the U.S. is a particularly appropriate case for our purposes because its decentralized federal structure of government should, if anything, have increased the flexibility of the common-law system relative to the civil-law codes that governed highly centralized France. A further motive for focusing on the U.S. is that the most industrial of the American states pioneered in making corporate charters available to business enterprises, and it has generally been assumed that this leadership role extended to other organizational forms as well.

If the Anglo-American system of common law is intrinsically superior to French civil law, then one might expect U.S. businesses to have faced a freer, more flexible contracting environment than French businesses in the nineteenth century—as well as at the present time. As we show in the next three sections, however, this expectation did not hold true for the period of industrialization. Not only did U.S. law offer business people a more limited menu of organizational forms, but the possibilities for adapting the basic forms to specialized needs were much greater in France than in the U.S. Nor, as we demonstrate in the fourth section, did American law evolve more readily in response to economic change than French law. On the one hand, our research suggests that the static nature of the French legal system has been overstated in the literature. On the other, we find the common law to be more inherently conservative than many scholars have been willing to admit. Indeed, in both nations, major changes in the menu of available organizational forms, as well as in the rules governing these contracts, required the passage of new statutes.

Although our finding that French law offered businesspeople greater contractual freedom than U.S. law would seem to reverse the traditional stereotypes of code versus common-law legal regimes, it does not necessarily follow that the French legal system was superior to the Anglo-American one. Even if this flexibility enabled French businesspeople to solve their contracting problems better, it may also have entailed costs. For example, it is possible that standardized contracts would have afforded
better protection to outside investors or reduced the information costs of
deciding whether or not to participate in an enterprise. It is beyond the
scope of this article to resolve such issues, but we can say that any
problems that resulted from this greater flexibility are unlikely to be
attributable to the intrinsic nature of the French legal regime. A brief
consideration of the case of Great Britain, the canonical common-law
country, shows that its law of organizations was in important respects
more like that of France than the U.S. Moreover, in the second half of the
twentieth century, new statutes in the U.S. would provide American busi-
nesspeople with much the same degree of contractual freedom that their
French counterparts had long taken for granted.

2. The Corporation and Alternative Organizational Forms

On the surface, it might appear that mid-nineteenth-century U.S. firms
had a more favorable set of organizational choices than French firms
because they had reader access to the corporate form. In France, busi-
nesses could not organize as corporations without the (difficult-to-obtain)
approval of the government until 1867; and, in fact, only 642 corporations
were chartered between 1807 and 1867 (Freedeman, 1979, 1993, pp. 1–9).
Although initially U.S. firms also needed special permission (in the form of
a legislative act) to organize as corporations, by the second quarter of the
century, a number of states had made it easier for firms to obtain charters;
and by the 1860s, most of the leading industrial states had passed general
incorporation laws that routinized the entire process (Evans, 1948; Hurst,
1970; Maier, 1993; Blair, 2003). Not surprisingly, the number of corpor-
ations formed in the U.S. during the first two-thirds of the nineteenth
century was much greater than in France. In New England, for example,
more than 3,200 corporations were organized between 1800 and 1843, and
in excess of 3,500 between 1844 and 1862 (Kessler, 1948, p. 46)—that is, in
this region alone, more than ten times as many corporations were organ-
ized as in the whole of France over approximately the same period.

Whether the more restricted access to corporate charters before 1867
was seriously detrimental to French businesses, however, depends on what
the advantages of incorporation were relative to alternative organizational
forms. It has generally been thought that the main advantage of the
corporate form was that it provided a means to raise funds on the capital
markets and that the lack of a general incorporation law in France until 1867 prevented industrial enterprises from raising capital in the requisite amounts. As a matter of fact, however, even in the U.S., few of the manufacturing corporations chartered during the nineteenth century raised funds by selling shares on the market. Although New England legislatures chartered more than 3,000 manufacturing corporations during the first three-quarters of the nineteenth century, as late as 1875, stock prices for only about 50 were quoted on the local Boston market. According to a contemporary survey of trading activity in that city, manufacturing stocks generally were held by people who did not intend to sell them. As a result, “it was exceedingly difficult to obtain reliable quotations,” even for the region’s largest enterprises, because the securities rarely appeared on the market “except in stray shares or in the case of executors’ sales” (Martin, 1898, pp. 126–32). Even fewer manufacturing stocks were traded in New York, let alone listed on the New York Stock Exchange (Navin and Sears, 1955; Baskin and Miranti, 1997). As late as 1890, for example, the *Commercial and Financial Chronicle* reported financial information for only about 15 industrial enterprises and quoted stock prices for less than half of those.

The consequences for French firms of not being able to form corporations, moreover, were not as significant as they are often made out to be, because the Code de Commerce offered businesses an important alternative: the *société en commandite*, or limited partnership. (In both France and the U.S., of course, businesses could also organize as ordinary partnerships.) A descendant of the medieval Italian *commenda*, the limited-partnership form was sanctioned by Colbert’s Ordinance of 1673 and explicitly defined and regulated by Napoleon’s Code of 1807. *Sociétés en commandite (simples)* consisted of one or more general partners, who managed the firm and were unlimitedly liable for its debts, and one or more special partners, whose liabilities were limited to their investments and who played no role in management (see Table 1). An important advantage of the form was that it enabled the general partners to raise funds from wealthy individuals who were not interested in participating actively in the business (Rivière, 1882, pp. 80–81; Lyon-Cahen and Renault, 1924, pp. 112–14; Howard, 1932; Houpin and Bosvieux, 1935, Vol. 1, p. 368; Ripert, 1967, Vol. 1, pp. 456–58; Kessler, 2003).

These limited partnerships could take a variety of forms; and, by the third decade of the nineteenth century, some had even begun to issue
bearer shares. In 1830, a group of disgruntled shareholders challenged the legality of this practice on the grounds that it was not explicitly permitted by the Code de Commerce. Loosely constructing the code’s provisions, both the Commercial Tribunal of Paris and, on appeal, the Royal Court upheld the practice. Over the next couple of decades, the number of commandites par action, as these enterprises were called, grew rapidly until the passage of legislation in 1856 that more strictly regulated the issuance of shares and strengthened stockholders’ rights with respect to the managing partners (Freedeman, 1979). 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. When the 1867 general incorporation law removed the limit on capitalization, the number of corporations (sociétés anonymes) grew rapidly until, by the period 1880 to 1913, they accounted for about 20% of new multiowner firms (see

**Table 1. Availability of the Basic Forms of Organization in the United States and France**

<table>
<thead>
<tr>
<th>Type of Form</th>
<th>Definition of Form</th>
<th>Available in U.S.?</th>
<th>Available in France?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary partnership (société en nom collectif)</td>
<td>Two or more partners, all unlimitedly liable</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Limited partnership (commandite simple)</td>
<td>One or more general partners with unlimited liability, and one or more special partners who cannot participate in management but who have limited liability</td>
<td>Yes, but provisions less attractive</td>
<td>Yes</td>
</tr>
<tr>
<td>Limited partnership with shares (commandite par action)</td>
<td>Same as above, except special partners’ shares can be bought and sold</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Limited liability company (société à responsabilité limitée)</td>
<td>All members have limited liability, but their shares are not tradable</td>
<td>Not until the late 1980s</td>
<td>After 1925</td>
</tr>
<tr>
<td>Corporation (société anonyme)</td>
<td>All members have unlimited liability, and their shares are tradable</td>
<td>Yes, after circa 1850; increasingly before then</td>
<td>Yes, after 1867; limited before then</td>
</tr>
</tbody>
</table>
As might be expected, the greater availability of the corporate form made the share *commandite* less attractive. Initially, corporations seem also to have reduced the popularity of *commandites simples*, but this form quickly regained its earlier position.

As in the case of the U.S., relatively few of the new corporations chartered under the general law (indeed, only 19 of the nearly 800 formed between 1867 and 1875) were listed on the official exchange. Nonetheless, French firms seem to have had readier access to national capital markets than their American counterparts. Because government approval was needed to list a security on the Paris Bourse, the shares of many enterprises traded instead on the *coulisse* (curb market). By 1875, there were frequent quotations for more than 300 enterprises (not including banks, insurance companies, and railroads). At a time when quotations were available for no more than a handful

**Figure 1.** Distribution of New Multiowner Firms in France, 1840–1913

*Source:* Annual issues of the *Compte général de l'administration de la justice civile et commerciale.*
of industrial firms in New York and for only about 50 in Boston, at least 208 of the firms whose securities were actively traded in Paris can be identified as manufacturing enterprises. Many, moreover, were commandites par actions rather than corporations (Plache, 1999; Hautcoeur, 1994, ch. 2).

Although there were attempts to introduce the commandite form into the U.S. during the early nineteenth century, the idea never took off. New York passed an enabling statute in 1822, and most other states followed its example over the next decade or so (Kessler, 2003). The statutes, however, were much more restrictive than the provisions of the French Code de Commerce. For example, all members of a limited partnership had to sign a certificate (to be filed with a government authority) declaring, among other things, the amount of their individual investments, so there was no possibility of issuing tradable shares. Moreover, because the innovation did not fit well with the body of common-law precedent, the courts interpreted the statutes conservatively in ways that potentially exposed limited partners to unlimited liability. For example, they tended to view any deviation from the declarations contained in the partnership certificate as sufficient cause to hold all of the partners unlimitedly liable for the firm’s debts—even partners who were innocent of error, and even if the substance of the deviation was inconsequential (Howard, 1934; Lewis, 1917; Warren, 1929, ch. 6). Not surprisingly, the form was comparatively rarely used. A sample of over 160 partnerships for which the R. G. Dun Company collected credit information in Boston during the 1840s and early 1850s included only two with limited partners. Similarly, a search by Stanley Howard of the records of five New Jersey counties (representing about one-third of the population of the state) from the 1830s until the 1930s yielded only about 140 limited partnerships (Howard, 1934).

Comprehensive data on business forms are not available for the U.S. for the nineteenth century, but Jeremy Atack and Fred Bateman used the names of firms enumerated in the Census of Manufactures to estimate that

3. By the end of the century, a few states (mainly in the western parts of the country) had passed legislation protecting special partners who were not involved in the misstatement. See Gilmore (1911, pp. 618–19).

4. The sample consisted of every firm on the right-hand page of Massachusetts, Vol. 67, that had an entry that began before 1853. The records of the R. G. Dun Co. are located at the Baker Library, Harvard University Graduate School of Business Administration.
partnerships of all kinds accounted for nearly 90% of multiowner firms during the period 1850–70 (Atack and Bateman, 1995). In 1900, the first year the U.S. Census recorded information on organizational form, 67% of all manufacturing establishments owned by more than one person were partnerships (including limited partnerships) and 29% were corporations, with the remaining 4% consisting mainly of cooperatives (U.S. Census Office, 1902, p. 503). Economy-wide counts are not available until after 1916, when the Internal Revenue Service began to collect the income tax. In 1920, there were approximately 314,000 corporations in the U.S. compared to about 241,000 partnerships, again including limited ones. These figures likely understate the use of partnerships because all corporations were required to file tax returns, whereas partnerships only had to file if their income exceeded the threshold for the tax (U.S. Internal Revenue Service, 1922, pp. 8–10). The number of limited partnerships, however, was clearly very small—so small that the IRS did not bother to count them separately until 1976, at which point they constituted only 7% of all partnerships and 2.7% of partnerships in the manufacturing sector (U.S. Internal Revenue Service, 1979, p. 408). The bottom line is that multiowner firms in the U.S., unlike those in France, effectively had only two organizational choices during the era of industrialization: ordinary partnerships or corporations.

3. Flexibility within Organizational Forms in France

Not only did French firms have a broader range of organizational choices, they also had considerable freedom to modify the basic forms to suit their needs. As a result, for them liability was essentially a continuous variable rather than a dichotomous choice. The French legal system even allowed members of ordinary partnerships (sociétés en nom collectif) to limit the extent of the risks they assumed. Businesspeople who organized partnerships under the terms of the Code de Commerce were required to draft formal written agreements, the main details of which had to be registered with the government and published in a newspaper of record. Because the provisions of these agreements were public knowledge, partners had a great deal of freedom to specify the terms of their relationships. Although many firms organized under the code gave all partners equal rights and responsibilities, others added to their agreements clauses that limited the capacity of one or more of their members to act on behalf of the
firm. So long as these clauses were published in the requisite journal, they were enforced by the courts. If a partner who was not authorized to do so borrowed money on behalf of the firm, the firm was not obligated to repay the debt (Lyon-Cahen and Renault, 1924; Houpin and Bosvieux, 1935, Vol. 1; Merle, 1998).5

There is abundant evidence that businesspeople took advantage of this flexibility to control their liabilities. During the years 1832–43, for example, 27% of the new partnerships that published notices of their formation in the Paris newspaper of record, *Gazette des tribunaux*, delegated managerial authority to a subset of their members (see Table 2). About the same proportion (25%) required that debt instruments be signed by more than one member of the firm, and 7.7% prohibited partners from incurring any debts whatsoever. As Table 2 indicates, moreover, the value of this

Table 2. Restrictions on the Activities of Members of Ordinary Partnerships

<table>
<thead>
<tr>
<th>Number of Partners</th>
<th>Firm Cannot Borrow</th>
<th>Joint Signature Required to Encumber the Firm</th>
<th>Delegated Management</th>
<th>Partnerships without Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>238</td>
<td>905</td>
<td>755</td>
<td>1847</td>
<td>3617</td>
</tr>
<tr>
<td>3</td>
<td>61</td>
<td>180</td>
<td>305</td>
<td>228</td>
<td>685</td>
</tr>
<tr>
<td>4</td>
<td>31</td>
<td>31</td>
<td>104</td>
<td>42</td>
<td>168</td>
</tr>
<tr>
<td>&gt;4</td>
<td>18</td>
<td>20</td>
<td>65</td>
<td>6</td>
<td>79</td>
</tr>
<tr>
<td>Total</td>
<td>348</td>
<td>1136</td>
<td>1229</td>
<td>2123</td>
<td>4549</td>
</tr>
</tbody>
</table>

Percentage of Row Total

<table>
<thead>
<tr>
<th>Number of Partners</th>
<th>Firm Cannot Borrow</th>
<th>Joint Signature Required to Encumber the Firm</th>
<th>Delegated Management</th>
<th>Partnerships without Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>6.6</td>
<td>25.0</td>
<td>20.9</td>
<td>51.1</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>8.9</td>
<td>26.3</td>
<td>44.5</td>
<td>33.3</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>18.5</td>
<td>18.5</td>
<td>61.9</td>
<td>25.0</td>
<td></td>
</tr>
<tr>
<td>&gt;4</td>
<td>22.8</td>
<td>25.3</td>
<td>82.3</td>
<td>7.6</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>7.7</td>
<td>25.0</td>
<td>27.0</td>
<td>46.7</td>
<td></td>
</tr>
</tbody>
</table>

Source: Notices of new firms published in *Gazette des tribunaux*, January 1, 1832–December 31, 1843. Note: “Cannot borrow” refers to partnership contracts that required all business to be on a cash basis. “Joint signature” contracts required more than one partner (though not necessarily all) to sign any debt instrument. “Delegated management” contracts gave a subset of partners the right to manage the firm on a day-to-day basis and could occur with either (or none) of the previous clauses. “Without restrictions” means that each partner had full ownership rights.

5. Contract clauses that required partners to fulfill obligations to the firm (e.g., make promised infusions of capital) were enforceable even if they were not published.
flexibility appears to have increased with the number of partners. Whereas over half of the firms (51.1%) with only two partners did not in any way restrict the ownership rights of members, only 7.6% of the firms with more than four partners had similarly permissive governance rules.

The *commandite* form was equally flexible, both with respect to relationships among the firms’ general partners and to relationships between the general and silent partners. Of the 412 *commandites simples* with multiple general partners in our dataset, 41.7% imposed some kind of restriction on one or more of the partners’ managerial authority—for example, controlling the liabilities that each could impose on the others by requiring joint signatures to encumber the firm (see Table 3). In slightly more than 10% of the cases, moreover, the managing partners were completely prohibited from borrowing, a provision that in effect made the approval of the silent partners requisite for the firm to take on debt. Contracts might also require the managing partners to render accounts to the silent partners on a regular basis. In addition, they could require that the managing partners pay out a minimum dividend each year (generally between 4–6%) to guarantee the silent partners at least a fixed return on their investment. As in the case of ordinary partnerships, the value of all this flexibility appears to have increased with the size of the firm.

Table 3. Restrictions on the Activities of General Partners in *Commandites Simples*

<table>
<thead>
<tr>
<th>Number of General Partners</th>
<th>Firm Cannot Borrow</th>
<th>Joint Signature Required to Encumber the Firm</th>
<th>Delegated Management</th>
<th>Partnerships without Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>113</td>
<td>--</td>
<td>--</td>
<td>642</td>
<td>755</td>
</tr>
<tr>
<td>2</td>
<td>37</td>
<td>38</td>
<td>72</td>
<td>213</td>
<td>347</td>
</tr>
<tr>
<td>3</td>
<td>5</td>
<td>9</td>
<td>16</td>
<td>25</td>
<td>50</td>
</tr>
<tr>
<td>&gt;3</td>
<td>3</td>
<td>2</td>
<td>10</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>158</td>
<td>49</td>
<td>98</td>
<td>883</td>
<td>1167</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of Firms</th>
<th>Percentage of Row Total—All Firms</th>
<th>Percentage of Row Total—Firms with More Than One General Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>13.5</td>
<td>4.2</td>
</tr>
</tbody>
</table>

*Source and Note:* See Table 2.
There were, of course, limits to what organizers of *commandites simples* could do: there had to be at least one general partner; shares were not tradable; and the only way to replace a general partner was to dissolve the firm and form a new one. The last two of these limitations could be overcome (without giving up any of the flexibility of the *société en nom collectif* or the *commandite simple*) by organizing the firm as a *commandite par actions* (see Table 4). Not only were the shares of these ventures tradable, but shareholders might also hold regular annual or biannual meetings at which they could fire the manager or change other aspects of the organization. Between 1832 and 1843, 227 such shareholder meetings resulted in modifications to firms. In 108 of these cases, new managers were appointed. Organizers of *commandites par actions* could also specify which types of shareholders could attend these assemblies and what voting rules would be employed—that is, whether there would be one vote per share, one vote per shareholder, or some intermediate scheme. In addition, shareholders could appoint a *conseil de surveillance*, or supervisory committee. In some cases, the *conseil* was simply a communication device between managers and shareholders; but in others, it acted as a board of directors whose approval was required for important decisions, such as whether to encumber the firm. (The latter role became more common over

<table>
<thead>
<tr>
<th>Number of General Partners</th>
<th>Firm Cannot Borrow</th>
<th>Joint Signature Required to Encumber the Firm</th>
<th>Delegated Management</th>
<th>Partnerships without Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of Firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>262</td>
<td>9</td>
<td>–</td>
<td>869</td>
<td>1142</td>
</tr>
<tr>
<td>2</td>
<td>87</td>
<td>48</td>
<td>117</td>
<td>204</td>
<td>429</td>
</tr>
<tr>
<td>&gt;2</td>
<td>42</td>
<td>41</td>
<td>85</td>
<td>48</td>
<td>170</td>
</tr>
<tr>
<td>Total</td>
<td>391</td>
<td>98</td>
<td>202</td>
<td>1121</td>
<td>1741</td>
</tr>
</tbody>
</table>

**Table 4.** Restrictions on the Activities of General Partners in *Commandites par Action*

<table>
<thead>
<tr>
<th>Number of General Partners</th>
<th>Firm Cannot Borrow</th>
<th>Joint Signature Required to Encumber the Firm</th>
<th>Delegated Management</th>
<th>Partnerships without Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percentage of Row Total—all Firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>22.5</td>
<td>5.6</td>
<td>11.6</td>
<td>64.4</td>
<td></td>
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<tr>
<td>2</td>
<td>21.5</td>
<td>14.9</td>
<td>33.7</td>
<td>42.1</td>
<td></td>
</tr>
</tbody>
</table>

Source and Note: See Table 2.
time, especially after an 1856 law made the creation of a conseil mandatory.  

Abuses during the boom of the 1850s moved legislators to attempt to regulate the use of share commandites. In so doing, they sought to balance two contradictory goals. On the one hand, they aimed to keep limited partners out of the day-to-day affairs of the firm. On the other, they did not wish to give insiders (the managing partners and members of the conseil) unrestricted power to do as they pleased. The 1856 law tried to resolve this dilemma by imposing personal liability on members of the (now mandatory) conseils if they did not perform their duties properly (Rivièrè, 1882, p. 90). This solution proved unsatisfactory, however, because shareholders were not willing to serve on such boards if they bore personal liability (Lefebvre-Teillard, 1985). As a consequence, the general incorporation law of 1867 took a different tack. It required shareholders to elect audit committees and allowed them to assume a more active role in the affairs of the enterprise. At the same time, it absolved those who served on these committees of personal liability for the firm’s obligations (Hautcoeur, 1994, pp. 247–48).

Under the 1867 act, firms still had considerable freedom to determine their governance structures and how they would meet the requirements of the law. Indeed, incorporators had all of the choices that had been available to organizers of commandites par action, including the ability to distinguish different types of shares, set voting rules for stockholders, determine the timing of regular shareholders’ meetings (as well as the circumstances under which extraordinary meetings could be called), and fix a minimum level for dividends. French businesspeople thus could obtain the advantages of incorporation without any significant loss of contractual flexibility.

6. Unfortunately, the Code de Commerce did not require firms to publish the articles of their contracts relating to internal policing. Nonetheless, information about conseils de surveillance can be gleaned from notices of amendments to contracts for existing commandites par action. The conseils could range in size from three to seven members; their meetings could occur quarterly or be as frequent as once a week; their powers could be limited to auditing the books; their approval could be required to sell assets and/or incur debts.
4. Lack of Flexibility in the U.S.

Businesspeople in the U.S. had much less ability than their French counterparts to modify the basic organizational forms to meet their needs. Under Anglo-American common law, for instance, partnerships were not legal entities. They were defined by the relationship of the parties to each other rather than by the existence of a contract. If two or more businesspeople agreed to share the profits from a venture, then they were partners. There was no requirement that they enter into a formal contract and no requirement that they notify the public of their relationship. This simple principle had two profound consequences. First, businesspeople could be held by a court to be partners even if they had not entered into a partnership agreement and did not consider themselves to have formed a firm. Second, a firm had no existence or identity that was independent of the people who comprised it. Each partner exercised full ownership rights and could enter into debt contracts that were binding on the firm without consulting the other members. Although businesspeople could draw up copartnership agreements that restricted the ability of individual partners to contract debts on behalf of the firm, these agreements were private arrangements and not matters of public record. As a consequence, they were not legally binding with respect to third parties who had not been given formal notice of their terms. Partners often did negotiate such agreements, but if a member obligated the firm in violation of the partnership contract, the other partners were likely nonetheless to be held liable for the debt (Story, 1859; Warren, 1929, ch. 1). As John Marshall, Chief Justice of the U.S. Supreme Court, explained in Winship v. The Bank of the United States (30 US 529, 561–62 [1831]), “The articles of copartnership are . . . rarely if ever seen, except by the partners themselves. . . . The trading world, with whom the company is in perpetual intercourse, cannot

7. This ambiguity in the law generated large amounts of litigation during the early nineteenth century, especially during downturns, as creditors desperately sought to collect on the obligations of failed debtors. Over time, new legal tests evolved that reduced the risk of being held liable as a partner for contracts that were not intended to be partnerships but involved some sharing of profits (Lamoreaux, 1995).
individually examine these articles, but must trust to the general powers contained in all partnerships.\textsuperscript{8}

Although, in theory, a partner might seek an injunction in equity against a member of the firm who violated a partnership agreement, such a remedy could do little more than force the dissolution of the partnership and a settlement of accounts (Story, 1859, p. 352). This is not to say that such contracts were useless. At the very least, they provided written evidence of the rules to which partners expected each other to adhere. Perhaps more important, the threat of dissolution gave partners some ability to discipline each others' behavior—particularly if the threat was made by the wealthiest member or if there was a chance that dissolution would require the liquidation of assets whose value outside the firm was much lower than within. Nonetheless, not only was this method of discipline inferior to the power that French businesses had to enforce the terms of their contracts directly, but it entailed considerable risk that otherwise profitable enterprises would be forced into untimely dissolution (Lamoreaux and Rosenthal, 2004).

Businesspeople in the United States could, of course, turn to the corporate form as a remedy for the deficiencies of partnerships. Because all members of a corporation had limited liability, stockholders did not have to negotiate special side contracts to protect assets held outside the firm.\textsuperscript{9} In addition, because the corporate form concentrated managerial

\textsuperscript{8} Many state courts allowed two alternative means of concentrating management (and, therefore, the right to encumber the firm) in a partnership: the joint-stock company and the trust. Neither of these options was extensively used in the U.S., however, because they had drawbacks that made them less attractive than other available forms. Members of joint-stock companies were fully liable for the enterprises' debts in the absence of explicit contracts with creditors to the contrary. Trusts could offer the benefits of limited liability, but only if the members completely relinquished control for the duration of the agreement. In both cases, moreover, there was considerable uncertainty about whether the courts would enforce all of the terms of the agreements (Warren, 1929, pp. 327–404; Blair, 2003).

\textsuperscript{9} The earliest corporate charters in the U.S. were often silent on the issue of stockholders' liability, creating considerable uncertainty that, by the second decade of the nineteenth century, was resolved by the courts in favor of the presumption of limited liability. Where early charters were not silent, they sometimes explicitly denied stockholders this privilege. Over time, however, limited liability came to be treated as a standard aspect of the corporate form, though charters for railroads and banks might still make shareholders liable up to double the par value of their stock, and some states (for example, California) did not grant limited liability until
authority in an elected board of directors, only those persons explicitly authorized by the board could encumber or otherwise act on behalf of the firm. Contracts negotiated by any other stockholder were unenforceable (Freund, 1896; Blair, 2003).

At the same time as incorporation solved some of the agency problems associated with partnerships, however, it also created new problems—problems that were potentially exacerbated by the increasingly standardized nature of the form in the U.S. During the early period when corporate charters could be granted only by special legislative act, their terms varied significantly from one enterprise to the next. For example, some charters allowed stockholders one vote for each share owned, but others specified one vote per share up to some ceiling, and some even gave each stockholder the same vote regardless of his or her holdings. As the number of corporate charters increased, legislatures developed standard templates that made the provisions much more uniform. The passage of general incorporation laws further reduced the extent of variation, with some states mandating one-vote-per-share, majority-rule governance from the very beginning and most others adding this requirement over the course of the century (Dunlavy, 2004).

This standard governance rule was a potential source of agency problems because it weakened the position of minority shareholders and potentially subjected them to exploitation by shareholders controlling a majority of the stock. If the majority followed policies that members of the minority thought were wrongheaded or detrimental to their interests, in the absence of outright fraud there was little the latter could do but grin and bear it. Minority shareholders could not force a dissolution. Nor could they easily exit by selling their shares. Indeed, in the case of closely held

the twentieth century (Livermore, 1935; Handlin and Handlin, 1945, pp. 8–17; Dodd, 1954, pp. 365–437; Horwitz, 1992, p. 94; Perkins, 1994, pp. 373–76). Of course, even with limited liability, stockholders of small corporations often found that they had to assume personal responsibility for their enterprises’ debts to secure loans at affordable rates (Woodward, 1985; Forbes, 1986). Nonetheless, this attribute of incorporation did resolve to an important degree the principal-agent problems that partners faced vis-à-vis each other by removing the possibility that one member of a firm could unilaterally encumber the enterprise with debts that the others might have to repay out of their own assets. In a firm with limited liability, members were personally responsible only for obligations that they deliberately chose to assume.
corporations, often the only buyers for their shares were the same majority shareholders with whom they were in conflict—a situation conducive more to extortion than to an equitable resolution of the problem (Hetherington and Dooley, 1977; Hillman, 1982; Dickinson, 1984; Mitchell, 1990; Moll, 2000; Lamoreaux, 2004; Lamoreaux and Rosenthal, 2004).

Of course, voting rules that limited the power of the majority could also cause problems by giving minority shareholders the ability to hold up the majority (Rock and Wachter, 2000; Blair, 2003), but it is not obvious that one-vote-per-share, majority-rule governance schemes are always superior. Presumably, the desirability of alternative rules would vary from one firm to the next depending, for example, on the role played by minority shareholders in the ongoing success of the enterprise. Where members of the minority contributed critical human capital, it might be important to give them a voice disproportionate to their shareholdings. The competitive position of the Edison Electric Light Company was undermined, for example, by Thomas Edison’s dissatisfaction with the business strategy embraced by J. P. Morgan and other major stockholders. At one point, Edison waged a costly proxy battle to wrest control of the company from Morgan, only to lose it again. Ultimately, the company’s successor, Edison General Electric, merged with the more profitable Thomson-Houston Company to form General Electric (McGuire, Granovetter, and Schwartz, 1993; Carlson, 1995).10

Minority shareholders in corporations sometimes attempted to protect themselves by means of side contracts. As in the case of partnerships, however, these contracts were often unenforceable. Indeed, as late as the 1950s, there was still a high probability that agreements that required shareholders’ unanimity (or even a supermajority vote) for corporate decisions would be overturned by the courts (Hornstein, 1950, 1953; Cary, 1953; O’Neal, 1953, 1958, 1965; Gower, 1956). Even worse, shareholders who ignored or altered the standard governance rules in such ways risked being held partners and thus unlimitedly liable for their firms’ debts.

10. Another similar episode involved the Edison United Phonograph Company. Edison had assigned his phonographic patents to the firm in exchange for half of its stock. Later, he found himself in disagreement with the policies pursued by the majority of the firm’s directors and was unable to persuade them to change course. Frustrated, he sued in equity to force the dissolution of the firm, but the court refused to intervene (Edison v. Edison United Phonograph Co., 52 NJ Eq. 620 [1894]).
As the New Jersey chancellor had warned in 1852, if firms operating for all practical purposes as partnerships were allowed to exercise corporate privileges like limited liability, the result would be to perpetrate “a fraud upon the community.” In the case at issue, two shareholders held all of the stock of the New England Manufacturing Company, excepting four shares, “which were put in the names of four other persons, merely for the purpose of having a sufficient number of stockholders to organize the company in the manner directed by the act of incorporation.” After incorporation, the two major owners continued to run their business “as before . . . , by and between themselves as individuals, the company not acting by its board.” In the chancellor’s view, the business was “in reality but an ordinary partnership.” Therefore, either the members of the firm “should be held, and that strictly, to conduct their business as a corporation, and in the manner required by the act of incorporation,” or they “should be liable to debts to the whole amount of their property” (Vandyke v. Brown, 8 NJ Eq. 657, 670 [1852]).

Although the courts would not permit stockholders to opt out of the standard corporate governance rules, they did usually allow stockholders to contract among themselves to exercise their votes in particular ways.11 For example, the courts were willing to enforce agreements among stockholders to vote for particular persons as directors or to place their stock in voting trusts whose officers in turn would choose the directors of the firm. Thus, a federal court declared in 1867 that it was “unable to perceive anything. . . contrary to public policy, or anywise open to objection” in an agreement by a group of stockholders to place their shares in an irrevocable voting trust for a specified period of time (Brown v. Pacific Mail Steamship Co., 4 F. Cas. 420 [1867]). Similarly, an Illinois court saw nothing wrong in an agreement among a majority of the shareholders of the Chicago Carbon and Coal Company to “determine among themselves as to the officers and management of the company, and that if they could not agree, they would ballot

11. There were, however, also contrary decisions. See, for example, Seitz v. Michel, 148 MN 80, 85 (1921): “There is much authority tending to sustain plaintiff’s contention that the owners of a majority of the stock of a corporation may combine, either through the agency of a voting trust or by private agreement, to secure and retain control and ensure permanency in the management of corporate affairs. There is nearly as much authority condemning all such combinations and private arrangements as contrary to public policy.”
among themselves for the directors and officers, and that the majority should rule, and their vote be cast as a unit, so as to control the election” (Faulds v. Yates, 57 IL 416, 419–20 [1870]). As this last example suggests, such agreements could actually worsen the situation of minority shareholders by making it easier for a controlling group to solidify its power. Moreover, even when such contracts were employed by the minority to protect their interests, there were limits to their reach. Most importantly, they could not be used to bind the directors to pursue a particular set of policies or elect specific people as officers. The courts regarded such provisions as “contrary to public policy” and would refuse to enforce them if the directors violated their terms (Guernsey v. Cook, 120 MA 501 [1876]; Cone v. Russell, NJ Eq. 208 [1891]; Manson v. Curtis, 223 NY 313 [1918]).

In sum, businesspeople in the U.S. not only had fewer organizational choices than their French counterparts; they also had less freedom to modify the basic forms to suit their needs. Although they sometimes attempted to compensate for this rigidity by writing side contracts, the case law indicates that many such agreements were often either unenforceable or of uncertain effect. Because these kinds of contracts were private matters, we have no way of estimating their incidence, but there is little question that they were generally an inferior means of obtaining the flexibility that French businesspeople obtained under the Code de Commerce.

5. Change over Time in Response to Industrialization

Despite dramatic changes in industrial technology, there was little change in the organizational choices available to businesspeople in the U.S. over the century following the passage of the first general incorporation laws. Not only did the common law fail to evolve in ways that increased the flexibility of the legal rules governing the basic forms; at times, it even functioned as a barrier to statutory innovation. For example, the weight of precedent derailed an effort to draft legislation that would have given members of partnerships more freedom to modify their governing contracts. During the first decade of the twentieth century, as part of the movement to standardize legal practice across states, the Conference on Uniform State Laws directed its Committee on Commercial Law to prepare a Uniform Partnership Act. The committee commissioned two drafts: one based on common-law precedent; the other on the idea, central to the French Code de Commerce, that
partnerships were legal entities. Because the latter statute would have required partnerships to publish notice of their formation, it had the potential to grant American businesspeople the same ability that their French colleagues enjoyed to write contracts controlling the extent of their liability. At the start of the drafting process, there was overwhelming sentiment for the French approach; but in the end, the draft based on common-law precedent prevailed. One of the primary reasons was the growing realization that such a statute would “abolish much of our existing partnership law and substitute in its place radically different legal principles” (Lewis, 1915, p. 172). Although eventually a Revised Uniform Partnership Act would declare partnerships to be legal entities, this change would not occur until 1992, and even then most states would balk at accepting it (Hurst, 1996).

In the case of corporations, there was similarly little evolution in the courts’ attitude toward stockholders’ agreements that altered the standard governance rules. Thus the New Jersey Appeals Court decided a key case in 1910 on much the same principles that the state’s chancellor had articulated over a half century earlier in *Vandyke v. Brown*. At issue was a corporation organized by Walter M. Jackson and Horace E. Hooper to publish and distribute the *Encyclopedia Britannica*. As in the earlier case, the two men had agreed between themselves to run the business as a partnership in which all decisions were to be made by mutual assent. When they had a falling out, Jackson sued in equity to enforce the agreement. The court turned him down, adamantly declaring that partnerships and corporations were different legal forms and that businesspeople could not “Proteus-like” become “at will a copartnership or a corporation, as the exigencies or purposes of their joint enterprise may from time to time require”:

If the parties have the rights of partners, they have the duties and liabilities imposed by law and are responsible in solido to all creditors. If they adopt the corporate form, with the corporate shield extended over them to protect them against personal liability, they cease to be partners, and have only the rights, duties, and obligations of stockholders (*Jackson v. Hooper*, 76 NJ Eq. 592, 599 [1910]).

This rigid view of the rules of corporate governance persisted at least until the mid-twentieth century. As late as 1945, for example, the New York State Court of Appeals struck down a corporate bylaw requiring stockholders’ unanimous consent for the election of directors on the grounds that “the State, granting to individuals the privilege of limiting their individual
liabilities for business debts by forming themselves into an entity separate and distinct from the persons who own it, demands in turn that the entity take a prescribed form and conduct itself, procedurally, according to fixed rules” (*Benintendi v. Kenton Hotel*, 294 NY 112, 118 [1945]).

Although state legislatures passed a number of revisions to their general incorporation laws during the late nineteenth and early twentieth centuries, the collective effect of these changes at least through the first half of the twentieth century was to increase the power of majority shareholders over the minority. For example, a wave of statutes enacted in the wake of New Jersey’s permissive 1888 law typically included provisions that reduced the ability of individual stockholders to block managerial decisions that fundamentally altered the business of the enterprise. As one writer put it, the result was increasingly to place the individual stockholder “in the position of holding a ‘pig-in-a-poke’”—to make him or her “more dependent with each new statute upon the desires of the management and the majority which often is only another name for the management” (Rutledge, 1937, p. 337; Berle and Means, 1933; Dodd, 1936; Dickinson, 1984).

Stockholders also found it increasingly difficult to monitor their investments. Although some early general incorporation laws (most notably New York’s widely copied 1848 statute) had required corporations to issue annual financial statements, reporting requirements tended to become more lax over time. Indeed, by the turn of the century, except for special types of corporations like banks, the statutes rarely included mandates to provide information on performance to stockholders—let alone publish balance sheets or profit and loss statements. Stockholders generally retained a common-law right to examine their enterprise’s books, but this right was difficult and expensive to exercise. Moreover, it did not

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12. Although some earlier decisions (see, for example, *Ripin v. U.S. Woven Label Co.*, 205 NY 442 [1912]) pointed toward a more flexible view of the statutory requirement, *Clark v. Dodge*, 269 NY 410 (1935) was the first case to articulate the view that a contract among stockholders that deviated from statutory norms might be upheld so long as it “damaged nobody—not even, in any perceptible degree, the public.” See Dickinson (1984).

13. Earlier the courts typically had held that important changes to a corporation’s charter required stockholders’ unanimous consent. By the late nineteenth century, however, even in the absence of such statutes, they increasingly permitted firms to liquidate and reorganize in order to bypass recalcitrant shareholders (Carney, 1980).
extend to those trying to decide whether or not to buy a firm’s stock. Not until the creation of the Securities and Exchange Commission in the 1930s was there much in the way of government protection for external investors; but even then, the only shareholders who benefited were those putting their money into corporations whose securities were traded publicly (Kuhn, 1912; Dodd, 1936; Cadman, 1949; Gower, 1956; Hawkins, 1986; Baskin and Miranti, 1997).

The plight of minority investors in small- or medium-sized firms received scant attention until the New York legislature responded in the late 1940s to the *Benintendi* decision by passing a law allowing stockholders in close corporations to set high voting and quorum requirements for corporate decisions (O’Neal, 1978, p. 874). Other states, however, were much slower to take action. North Carolina imbedded several provisions in its 1955 Business Corporation Act that were 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 parties partners among themselves” (O’Neal, 1965, p. 647). A few other states passed similar statutes over the next decade or so, after which the trickle finally became a torrent. Around the same time, states also began to pass new laws that defined and established legal remedies for “corporate oppression” and other similar torts (Hillman, 1982; Dickinson, 1984; Mitchell, 1990).

Because French businesses had a broader range of organizational choices and could more readily modify the basic forms to suit their needs, one might not expect industrialization to have generated much pressure for additional flexibility once a general incorporation law was passed in the late 1860s. Changing economic conditions and periodic bouts of speculative excess did, however, result in repeated calls for new legislation, particularly reforms that would protect small investors in *sociétés anonymes*. Some of these calls ultimately led to the passage of statutes. For example, a reform effort that began in the mid-1880s finally yielded an 1893 law specifying (among other provisions) that the original subscribers of a corporation were liable for calls on capital for two years, even if they sold off their stock, and that shares had to be fully paid in before they could be designated bearer shares. But subsequent proposals in 1903, 1906, and 1911 failed even to get to the floor of the Chamber of Deputies for a

French corporations were from the beginning required by law to deposit financial statements with their local commercial tribunals. In principle, shareholders could research these statements, but the lack of accounting standards meant that the information they contained could obscure as much as it revealed about a company’s actual condition. Although the state increased penalties during the 1930s for firms that did not file financial statements, it made no effort to standardize accounting practice or to force firms to publicize their balance sheets. Nor did the governing authority of the Bourse make any effort to increase transparency (Ripert, 1967, Vol. 1). Not until the wholesale redrafting of business law in 1966 were there substantial changes in the provision of information to investors in sociétés anonymes. These reforms ushered in a period of convergence towards U.S. reporting standards, for the laws that created the Commission des Operations de Bourse (and required that publicly traded corporations regularly publish financial statements) drew inspiration from the legislation that had set up the Securities and Exchange Commission in the mid-1930s (Merle, 1998, p. 553).

French businesspeople involved in small, privately held enterprises obtained a new organizational option in 1925, when the French government passed legislation authorizing the formation of limited-liability companies, or sociétés à responsabilité limitée (SARLs). Based on the model of the German Gesellschaft mit beschränkter Haftung (GmbH), this option mixed attributes of corporations and partnerships. For example, all members of an SARL had limited liability, but the capital was not divided into tradable shares. The new form apparently served an important economic need because businesses rapidly adopted it (see Figure 2). Despite the ready availability of the corporate form, as late as early 1920s, two-thirds of all the new multiowner firms formed in France were ordinary partnerships, and three-fourths had at least one liable partner.

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14. Sometimes, when problems developed that were not quickly resolved by new legislation, the French courts articulated their own rules, much like common-law courts in the U.S. For example, as their U.S. counterparts had done earlier, they determined that acts of corporations that involved fundamental departures from the terms of their original charters required the unanimous approval of stockholders rather than the simple majorities sufficient for minor alterations. The courts also decided what kinds of changes should be construed as fundamental, applying a broad definition that included most mergers until new legislation in 1913 provided a narrower standard (Freedeman, 1993).
Within a few years of the passage of the new statute, however, the numbers had completely reversed. By 1927 to 1932, fully 87% of all new multiowner firms were either corporations or SARLs—that is, forms that granted all members limited liability. Moreover, of these limited-liability firms, most (three-quarters) were organized as SARLs rather than sociétés anonymes.15

Intriguingly, although the limited-liability company was already in widespread use in Great Britain (as well as in Germany), the 1925 law was not a response to pressure from the French business community for access to this advantageous form. Nor was it an attempt by progressive

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15. These figures come from annual issues of Compte général de l’administration de la Justice Civile et Commerciale and include all new multiowner firms registered in France. The results for Paris alone are similar: ordinary partnerships accounted for 69% of new multiowner firms in 1920–25; addition of commandites would increase the figure to 83%. For 1927–32, 87% of firms in Paris were either corporations or SARLs; and of these, 65% were SARLs.
policy makers to copy models that had achieved desirable results elsewhere. Rather, the statute was a consequence of France’s recovery of Alsace-Lorraine after the First World War. These departments had been part of Germany and hence had been governed by German law since the Franco-Prussian War. Many businesses had organized during this period as GmbHs and did not want to give the form up when the area returned to French control. Instead, they campaigned for legislation that would make an equivalent form available throughout France. Despite the measure’s subsequent popularity, the bill faced staunch opposition, which delayed its passage until 1925 (Copper-Royer, 1925, Vol. 3, pp. 173–74; Houpin and Bosvieux, 1935, Vol. 2, pp. 752, 753n.1; Ripert, 1967, Vol. 1, pp. 476–77).

U.S. businesses did not obtain a similar option until the late 1980s. Then a wave of statutes made possible the formation of Limited Liability Companies (LLCs) along the lines of the French SARLs. A second wave of legislation that followed closely thereupon added the option of Limited Liability Partnerships (LLPs), making it possible for every member of an ordinary partnership to limit their liability for the firm’s future debts simply by filing appropriate notice (Bishop, 1995; Ribstein, 1996; Stover and Hamill, 1999; Banoff, 2002). These changes owed more than anything else to attempts by firms to reduce their increasingly burdensome income-tax liabilities, but the relatively slow take-up rate of these new forms suggests that the post–World War II modifications that the states made to their general incorporation laws (along with tax laws that enabled small corporations to be treated like partnerships) had already significantly added to U.S. businesses’ contractual freedom. Nonetheless, regardless

16. A few states had earlier passed legislation to enable businessmen to form limited-liability associations. In 1874, for example, Pennsylvania passed a law providing for the creation of a new form of enterprise called the limited-partnership association. Michigan followed suit in 1877, New Jersey in 1880, and Ohio in 1881; but the device did not spread beyond these four heavily industrial states. Moreover, even in these states, the form was rarely adopted, most likely because the governance structure dictated by the legislation was highly restrictive. The statutes vested the power to incur debts in a board that had to consist of at least three managers elected by the members of the firm. Debts in excess of $500 required the signature of at least two managers, and there were situations in which the prior approval of a majority of the members was required before the managers could take action. Approval of a majority was also necessary for the transfer of shares to new members (even from decedents to heirs) and for the acquisition of additional shares by an existing member (Schwartz, 1965; Gazur and Goff, 1991).
of which set of statutes one considers more significant, the change was long in coming. Not until the late twentieth century did U.S. firms obtain the ability that their French counterparts had long enjoyed both to secure limited liability for all their members and to choose among a broad range of governance structures.

6. Does Legal Regime Matter?

Except for its reluctance to charter corporations before 1867, there is no evidence that the centralized French state operated as more of a constraint on businesses’ organizational choices than the decentralized American state. To the contrary, French businesspeople had a broader menu of organizational forms from which to choose than their U.S. counterparts. They also had much more ability to modify the basic forms to suit their contracting needs. Although proportionally fewer businesses organized as corporations in France than in the U.S., even after 1867, this difference should not be taken as evidence that French regulation remained unduly restrictive. Not only was the corporate form more flexible in France than in the U.S.; but by the early twentieth century, a greater number of French manufacturing firms—both absolutely and relatively—issued securities that traded on the market (Rajan and Zingales, 2003). Although more U.S. than French firms organized as corporations, once the SARL form became available in France, relatively more U.S. firms also organized as ordinary partnerships—despite the obvious problems that the partnership form entailed. It makes sense, therefore, to recognize that French businesses chose to make relatively less use of the corporate form, and also of the partnership, because the alternatives that were available to them—but not to American businesses—had value.

Lest anyone succumb too quickly to the temptation to respond to our findings by trumpeting the advantages of the French legal regime over the Anglo-American system, it is important to consider the possibility that flexibility had drawbacks as well as advantages. Standardized organizational forms may lower information costs for outside investors because the choice of form itself conveys all that an investor needs to know about his or her rights and responsibilities. When there is substantial variation within forms in the terms of contracts, potential investors need to know not only what the specific provisions say but how they are likely to be
understood by the courts. Moreover, because there may be some slippage between the understanding of the contracting parties and that of the courts, standardized forms may offer outside investors better (or at least more predictable) protection than forms whose terms can vary significantly across firms.

Although it is beyond the scope of our article to resolve this issue, it is worth noting that such an emphasis on the detrimental consequences of flexibility would reverse much of the conventional wisdom about the superiority of the common law. Moreover, regardless of whether one views the greater contractual freedom that French businesses enjoyed as beneficial or harmful, it would be a mistake to conceive of this flexibility as an inherent feature of the French legal regime. Here it is instructive briefly to add the case of Great Britain to the comparison set. In some ways, the rules that British businesses faced in the nineteenth century were similar to those of the U.S. For example, in both countries, partnerships were governed by the common law; and in both countries, there was little evolution in the basic legal principles governing the form. Indeed, in Great Britain, the weight of precedent blocked the introduction of the limited partnership even more effectively than it did in the U.S. (Gower, 1953, 1956; Harris, 2000). In the case of corporations, however, the British rules were more similar to those of France than of the U.S. After Parliament passed a series of progressively more liberal general incorporation acts in 1844, 1855, and 1856, firms in Great Britain could organize freely as corporations—just as they could in the U.S. However, corporate law in Great Britain, like that in France, granted companies a great deal of freedom to structure their governance rules to meet the needs of their members. British company law included a model set of governance rules that offered small investors greater power than the American standard of one-vote-per-share majority rule. But the law also permitted businesses to deviate from this model by writing alternative provisions into their articles of association. Further, in 1907 (even earlier than in France), Parliament passed a statute permitting firms to organize as limited-liability companies similar to the German GmbH (Gower, 1953, 1956; Dunlavy, 2004).

This brief review of British organizational history adds support to the arguments that we have developed in this article: that the common law did not evolve flexibly in accordance with businesses' needs; and that such changes as occurred over time in the menu of organizational forms and in
the degree of contractual freedom available to businesses resulted mainly from the passage of new statutes. It also suggests that the pace and pattern of these statutory changes did not correlate in any readily apparent fashion with the type of legal regime in effect in the country. Britain, like the U.S., was a common-law country. Yet where organizational choices were governed by statute, British practice looked more like that of France than the U.S. Moreover, as we have seen, the U.S. ultimately looked more like France as well. Here again, change came primarily through the passage of new statutes that belatedly, during the second half of the twentieth century, moved U.S. practice toward the French model of organizational choice.

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