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New Forms and New Balances: Organizing the External Relations of the Unincorporated Firm

Robert W Hillman*

The sudden emergence of limited liability companies (LLCs) and limited liability partnerships (LLPs) and the near universal legislative acceptance of these new vehicles for conducting business activities offer valuable insights into legislative process and the extent to which state legislatures bear even a remote resemblance to deliberative bodies. Like Diogenes wandering the streets of Athens, lantern in hand, searching for the honest man, anyone seeking evidence of a debate among lawmakers over the wisdom of limited liability or the cost-shifting consequences of LLCs and LLPs is destined for disappointment.

Although debate over limited liability will not be found in the annals of state legislatures, it will be found in the literature of law and economics. The extent to which the literature truly informs us, however, is another question. In *An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition*,¹ William W Bratton and Joseph A. McCahery offer an insightful analysis of both the literature of limited liability and the reasons why the LLC has achieved such universal and sudden legislative acceptance. As to the efficiency of limited liability, Professors Bratton and McCahery conclude, with some disappointment, that existing economic theory supports neither a presumption for nor a presumption against limited liability. Having found the literature inconclusive on the issue of efficiency, they then consider whether the widespread legislative acceptance of LLCs is itself an indication of the efficiency of this new form of business association. Rejecting the idea that

* Professor of Law, University of California, Davis. Professor Hillman presented this Introduction at the Washington and Lee University School of Law on November 15, 1996, in connection with *The Future of the Unincorporated Firm* Symposium.

1. William W Bratton & Joseph A. McCahery, *An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition*, 54 WASH. & LEE L. REV. 629 (1997).

the legislative action in this area is a "race to the top" explainable by the regulatory competition theory of efficiency, Bratton and McCahery conclude that the proliferation of LLC statutes is an indication of the legislatures' responsiveness to a domestic interest group — the Bar.²

In *Limited Liability and the Real World*,³ Robert W Hamilton and Larry E. Ribstein offer perspectives from cyberspace on the desirability of limited liability. In an interesting exchange of e-mail, Professors Hamilton and Ribstein present sharply divergent views on the desirability of limited liability. Professor Ribstein argues, as he has in his earlier articles on the subject,⁴ for the efficiency advantages of limited liability. Professor Hamilton questions whether creditors generally prefer limited liability to unlimited liability.⁵ At the core of their debate is disagreement over the "real world" and, in particular, whether credit generally is priced to reflect limited versus unlimited liability.

My own contribution to the Symposium is *Limited Liability in Historical Perspective*. Ignoring the historical perspective leads many commentators to excesses of excitement over what they regard as new and pathbreaking developments. My Article shows that the quest for limited liability and the development of trading and investment vehicles to achieve this objective are ancient activities. To state the point more bluntly, the "movement" of the last decade embracing limited liability offers little that is truly new. The wheel may have been restylized by placing a few new spokes here and there, but the invention occurred some time ago.

Although virtually every jurisdiction has enacted LLC and LLP statutes, the contributions to this Symposium illustrate the continuing interest of academics in issues raised by the principle of limited liability. This is as it should be, for the suddenness with which the LLCs and LLPs appeared should not obscure the very real, important policy issues raised by laws that limited the liability of those engaged in business activities.

2. This represents an important extension and development of the authors' ideas on interest rate capture expressed in William W Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV 1861 (1995).

3. Robert W Hamilton & Larry E. Ribstein, *Limited Liability and the Real World*, 54 WASH. & LEE L. REV 687 (1997).

4. See, e.g., Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership*, 70 WASH. U. L.Q. 417 (1992). My own difficulties with Professor Ribstein's position are outlined in Robert W Hillman, *Limited Liability and Externalization of Risk: A Comment on the Death of Partnership*, 70 WASH. U. L.Q. 477 (1992).

5. In his discussion, Professor Hamilton builds on some of the themes he introduced in Robert W Hamilton, *Registered Limited Liability Partnership: Present at the Birth (Nearly)*, 66 U. COLO. L. REV 1065 (1995).

Limited Liability in Historical Perspective

Robert W Hillman*

The sudden emergence of new limited liability vehicles — notably limited liability companies (LLCs) and limited liability partnerships (LLPs) — suggests a revolution in the law of limited liability. When placed in historical perspective, however, the developments of the last decade can be seen as more evolutionary than revolutionary. Indeed, for as long as commerce has existed, merchants, financiers, and others associated in business activity have sought to eliminate, minimize, and shift their losses and liabilities. Often, those efforts have been reflected in the development of associational relationships, grounded in contract or law, that bear a striking resemblance to modern forms of business association, most notably the limited partnership and its cousins, the LLP and the LLC.

This Article offers some historical perspective on both the quest for limited liability and the responsiveness of the law to that quest.¹ Its aims are modest, as is its length. No attempt is made to offer a comprehensive history of limited liability, or even to identify the earliest point at which limitations on liability were sought. To establish the point of the Article — that the development of limited liability vehicles is an ancient activity in the law — it should be sufficient to sample the diverse periods in the development of law and commerce when creative efforts to limit liability have been revealed.

* Professor of Law, University of California, Davis. Maxwell Taylor provided valuable research assistance on this Article. This Article is based on an address presented at the Washington and Lee University School of Law on November 15, 1996, in connection with *The Future of the Unincorporated Firm* Symposium. © 1997 by Robert W Hillman.

1. This Article focuses on attempts to achieve limited liability through means other than the creation of corporations and related entities that shield their owners from liability. Contrary to popular perception, limited liability of shareholders did not flow automatically from the entity status of their corporations. For a discussion of this point and the development of limited liability for shareholders, see Phillip J. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573 (1986). For a discussion of foreign antecedents and counterparts to the LLC, see William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855 (1995).

This brief survey begins with Roman law ²

I. Roman Law

Through the concept of *noxal liability*, Roman law recognized a form of vicarious liability for torts (delicts).³ Interestingly, Roman law also recognized a means of limiting such extended liability

Under Roman law, the *paterfamilias* — the head of the family — was personally answerable for the torts of his child or his slave,⁴ but in either case "possessed the singular privilege of tendering the delinquent's person in full satisfaction of the damage."⁵ The option of turning over the offending family member or slave operated as an effective ceiling on damages and at least in theory, if not in practice, was the functional equivalent of limited liability ⁶

Extended liability in contract developed along somewhat different lines. Under Roman law, the essence of the contractual obligation was personal,⁷ which meant third parties could not be bound through contract, even if they controlled one of the contracting parties. Such a norm acted as an impediment to commerce, however, because it made conducting business through other parties (agents) difficult, if not impossible. Eventually, Roman law responded to meet the needs of the commercial environment in which it was applied. One sign of that change was the development of the *actio institoria*, which allowed a claim against the "principal" for acts done by the "agent" in the "course of the business."⁸ Although the application of the concepts

2. The choice of Roman law as a beginning point is convenient but arbitrary. Agency and partnership relationships, and liability problems arising from them, date to antiquity. See, e.g., Henry F Lutz, *Babylonian Partnerships*, 4 J. ECON. HIST. & BUS. 552, 563 (1932) (discussing joint liability in Babylonian partnerships).

3. See JOSEPH A.C. THOMAS, *TEXTBOOK OF ROMAN LAW* 381-83 (1976).

4. At least from a contemporary perspective, this is appropriately described as "vicarious" liability. Under the Roman view of the family, the liability may seem in some ways more direct. Cf. HENRY SUMNER MAINE, *ANCIENT LAW* 129 (5th ed. 1888) ("At the outset, the peculiarities of law in its most ancient state lead us irresistibly to the conclusion that it took precisely the same view of the family group which is taken of individual men by the system of rights and duties now prevalent throughout Europe.").

5. MAINE, *supra* note 4, at 140. On *noxal liability* in general, see ALAN WATSON, *THE LAW OF OBLIGATIONS IN THE LATER ROMAN REPUBLIC* 274-80 (1965).

6. Finding expression in the Twelve Tables, *noxal liability* was grounded in early Roman law. By the time of Justinian, the practice of surrendering children had been abandoned, leaving the delivery of the slave who caused an injury as the lingering remnant of this early mode of limiting liability. WATSON, *supra* note 5, at 381.

7. For an overview, see David Johnston, *Limiting Liability: Roman Law and the Civil Law Tradition*, 70 CHI.-KENT L. REV. 1515 (1995).

8. See WATSON, *supra* note 5, at 191-92.

may have differed, the core ideas are quite recognizable to contemporary business lawyers and merchants.

Over time, relatively advanced methods were developed to limit liability in contract or for wrongful acts.⁹ The most important of the techniques employed the *peculium*, which achieved wide usage by the middle of Republican times. The *peculium* consisted of assets entrusted to a slave by his master or to a son by his father.¹⁰ As the following description reveals, it provided a way of achieving limited liability in the conduct of business affairs.

A slave or child in *potestas* could not own property themselves. However, where the slave, or son, traded with his *peculium*, as commercially minded slaves were encouraged to do by their masters, debts and liabilities incurred in such trading could only be enforced by third parties against the master or *pater familias* to the extent of the *peculium*, and not against *all* of the latter's property. Thus, any Roman seeking to invest in a business would trade through his slave or son and limit his liability by fixing the size of the *peculium*.¹¹

It appears that much commerce may have been conducted through slaves:

[I]n commerce a slave can do much more for his master than an extraneous free person could. A Roman with mercantile interests in Alexandria

9. See generally Johnston, *supra* note 7, at 1521-23.

10. The *paterfamilias* remained the owner of the property placed in the *peculium*. See ALAN WATSON, *THE LAW OF PERSONS IN THE LATER ROMAN REPUBLIC* 98-100 (1967); see also WATSON, *supra* note 5, at 188-89. He could not, however, withdraw property from the *peculium* if the effect of such an action would be to defeat the claim of a creditor. See Alan Watson, *Thinking Property at Rome*, 68 CHI.-KENT L. REV. 1355, 1365 (1993).

11. David L. Perott, *Changes in Attitude to Limited Liability — The European Experience*, in *LIMITED LIABILITY AND THE CORPORATION* 81, 86 (Tony Ornhol ed., 1982). The following comments offer some insights into the *peculium* as a legal fiction:

Nothing, at first glance, is more diverse than the positions of a slave and the heir to an estate. The one has to look forward only to a lifetime of service; the other, at the death of his father, steps into his father's place in society. To the classical jurist, however, both men were not only in the power of another but also specifically under his *patria potestas*. Thus it was that, in classical times, the *peculium* or property a Roman father would assign his grown son to administer and dispose of on his own became an institution by which slaves could be assigned money, tools, and even other slaves to manage independently for the slaveholder's profit. Because the situation is foreign to us the fiction is patent and striking. In reality it is no more striking than the modern rules that have created a variety of intellectual properties — copyrights, patents, medical degrees, even personal likenesses — all protected by the same remedies originally intended to protect cattle.

CHARLES M. RADDING, *THE ORIGINS OF MEDIEVAL JURISPRUDENCE* 18 (1988).

would, from a legal point of view, be well advised to have a slave agent there rather than employ a free agent. The advantages of using the slave were particularly great for acquiring rights under contracts. The use that could be made of slaves, though it cannot be a full explanation, may help to explain why there was apparently little pressure to create direct agency¹²

Because the master could withdraw property from the *peculium* at will, the degree to which the slave shared the master's interest in the success of the trading activities may not be apparent at first glance. For a variety of reasons, however, the interests of the slave conducting business through the *peculium* were aligned with those of the master so that the slave and master shared the success of the venture. In particular, as Alan Watson points out: "It was in the interest of masters and slaves alike that a master acquire the reputation for allowing his slaves to buy their freedom with the *peculium*."¹³

The *peculium* proved an excellent limited liability vehicle for conducting business activities.¹⁴ Over time, Roman law adapted to the inevitable development of claims arising from activities associated with the *peculium*. By the late Republic, for example, there developed a special form of action — the *actio de peculio et in rem verso* — for the purpose of rendering the *paterfamilias* liable for actions of the family subordinate to the extent of the latter's *peculium* at the time of judgment and to the extent that the father's estate had achieved a benefit under the transaction.¹⁵ Such an action was particularly useful if the child or slave had secured an item using credit and presented the item to the *paterfamilias*, and if at the time the debt was due the *peculium* was insolvent.¹⁶

12. ALAN WATSON, ROMAN SLAVE LAW 107-08 (1987).

13. *Id.* at 95. Watson asserts that "[i]f much in Roman law and life can be said to dehumanize the slave, the *peculium* did much to humanize him." *Id.* (footnote omitted). Specifically, he points to the *peculium* as a means for the slave to gain a stake in society, education, and a measure of self-respect, not to mention freedom. *Id.*

14. See David V Snyder, *The Case of Natural Obligations*, 56 LA. L. REV 423, 429 (1995) ("The existence of the *peculium* in this circumstance made slaves particularly useful for engaging in commerce because limited liability trading (liability being limited to the *peculium*) was thus possible centuries before creation of the corporation."). Conducting business through a *peculium* should be distinguished from a direct authorization of the son or slave to conduct business on behalf of the father/master. With direct authorization, liability ran to the "principal" by virtue of the grant of authority, but even here notice through public advertisement of any limit on the authority of the "agent" served to limit the liability of the principal in the event authority was exceeded. See THOMAS, *supra* note 3, at 240-41.

15. See THOMAS, *supra* note 3, at 241.

16. *Id.*

II. Byzantine *Chreokoinonia*

The Rhodian Sea Law (*Nomos Nautikos*) was a collection of statutes regulating, among other matters, the relative rights and duties of parties involved in maritime trade.¹⁷ Although the exact date is unknown, the Sea Law likely was compiled between 600 and 800 A.D. Within this same general period, the *Ecloga* was developed as an effort to bring the Justinian Code up to date to reflect practices of the time. Both the Sea Law and the *Ecloga* reference the *chreokoinonia*, described by one scholar as the "the most popular mediaeval contract to pool capitals in sea ventures."¹⁸ The Sea Law outlined the contract's use as follows:

A gives gold or silver for the service of partnership. The partnership is for voyage, and he writes down as it pleases him till when the partnership is to last. *B*, who takes the gold or the silver, does not return it to *A* when the time is fulfilled, and it comes to grief through fire or robbers or shipwreck. *A* is to be kept harmless and receive his own again. But, if before the time fixed by contract is completed, a loss arises from the dangers of the sea, it seemed good that they should bear the loss according to their shares and to the contract as they would have shared in the gain.¹⁹

The *chreokoinonia* proved an important means of pooling capital in sea ventures,²⁰ which had become risky affairs since the seventh century because of raids by Arabian and Slavic pirates.²¹ Like a loan, it offered the passive investor, *A* in the above model, the benefit of a limitation of liability to the amount invested, but unlike a loan, it provided significant participation in the profits from the venture.²² In the words of Robert Lopez, a leading scholar on commerce of this era, the *chreokoinonia* "is justly regarded as having been a sinew of mediaeval sea trade."²³

17 See generally WALTER ASHBURNER, *THE RHODIAN SEA-LAW* (1909); Abraham L. Udovitch, *At the Origins of the Western Commenda: Islam, Israel, Byzantium?*, 37 *SPECTRUM* 198, 201-02 (1962).

18. Robert S. Lopez, *The Role of Trade in the Economic Readjustment of Byzantium in the Seventh Century*, *DUMBARTON OAKS PAPERS* XIII 80 (1959), reprinted in ROBERT S. LOPEZ, *BYZANTIUM AND THE WORLD AROUND IT: ECONOMIC AND INSTITUTIONAL RELATIONS*, ch. X (1978).

19. RHODIAN SEA LAW, Part III, ch. 17, quoted in ASHBURNER, *supra* note 17, at 97

20. See generally Lopez, *supra* note 18, at 79-80.

21. See A.A. VASILIEV, *HISTORY OF THE BYZANTINE EMPIRE* 248 (1952) (describing piracy during period as "habitual phenomenon").

22. See Lopez, *supra* note 18, at 81.

23. *Id.*

III. *Early Islamic Law and Limited Liability*

Particularly in its early development, Islamic law was merely an extension of the Muslim religion, a factor that viewed alone might suggest the development of legal norms not grounded in commercial necessity. But Arabs were perhaps the most sophisticated business people of the time, and Mecca, the cradle of Islam, was also a thriving merchant community with considerable commerce conducted among individuals residing in distant locations.²⁴ Importantly, Islamic law was reformatory rather than preemptory and did not displace custom and prevailing practices not inconsistent with the precepts of the religion.

Turning to those essential precepts, the most authoritative source of law — divine revelations to the Prophet Mohammed as set forth in the *Qurān* — dictates that "[p]rofit goes with liability," meaning that only a person willing to bear a risk of loss is entitled to claim a profit.²⁵ This would hardly seem conducive to the development of partnerships in which profits were to be shared disproportionate to liabilities. Yet that is exactly what happened through a variety of techniques developed to limit liability.²⁶

The first technique — the "licensed slave" — resembles the Roman *peculium* discussed above.²⁷ A business was launched upon a proclamation of the master authorizing a slave to engage in business. The merchant/slave was able to engage in a wide variety of commercial activities, including purchasing and selling goods on cash or credit, employing workers, and incurring debt. Only the slave was responsible for claims arising from the business. If the slave was unable to satisfy the claims from his earnings, he could be sold, with the proceeds used to settle claims. Significantly, the master was not responsible for claims and could even reclaim any identifiable goods that he had put in the business. At least one scholar has noted

24. See generally Alfred E. Lieber, *Eastern Business Practices and Medieval European Commerce*, 21 *ECON. HIST. REV.* 230 (1968).

25. See generally S.W. Hasanuzzaman, *Limited Liability of Shareholders: An Islamic Perspective*, 28 *ISLAMIC STUD.* 353 (1989).

26. The flexibility allowed in merchants in this regard was attributable to the lack of guidance on commercial matters provided in the *Qurān*:

It might have been expected that the *Qur'an*, given the alleged importance of trade during the Prophet's lifetime and in the growing Muslim community should, at least, have formed a skeletal code of obligations concerning commercial transactions. This was not the case, for those regulations governing commerce that are to be found in the *Qur'an* are more like paradigmatic "occasional hints" than clear instructions, and must be sifted out from among the usually lengthy passages of general exhortations.

S.E. RAYNER, *THE THEORY OF CONTRACTS IN ISLAMIC LAW* 80 (1991).

27. See Hasanuzzaman, *supra* note 25, at 358-59.

the "remarkable affinity" between the Islamic institution of the licensed slave and more modern European limited liability vehicles.²⁸

A second and more important means of achieving limited liability was the *qirād*,²⁹ which is not mentioned in the *Qurān* or the traditions of the prophet. Our knowledge of this associational form is drawn from a chapter on the *qirād* found in Mālik's *Muwatta*,³⁰ which reflects practices of Arabia in the eighth century, if not earlier.³¹ As described by Mālik, the *qirād* was created from a profit-sharing arrangement in which a "man [the merchant] takes money from his colleague [the investor] in order to work with it without any liability to himself." The investor could not stipulate that liability would be borne by the merchant. The merchant had complete discretion on trading policy, but the investor could assert control over broader matters such as the nature of goods that the merchant could buy and sell and the locations where the agent could travel. Profits were evenly divided between the merchant and the investor, although the parties could agree on different proportions that each would share. As so described, the *qirād* presents an interesting twist on the modern limited partnership, in which it is the passive investor rather than the active manager that enjoys the benefits of limited liability

IV Medieval Trading and Investment Vehicles

A. The Commenda

The appearance of the *commenda* in eleventh century Italy is a milestone in the history of limited liability. All serious attempts to trace the

28. *Id.* at 359. Hasanuzzaman adds:

In the former case a master authorizes the slave, who is his personal asset, to do business; in the later case the shareholders subscribe a part of the personal assets to form a company and authorize it to conduct trade. In the same manner as the master of the licensed slave is not held responsible for the liabilities incurred by the slave, so too is the shareholder not responsible for the liability incurred by the company.

Id.

29. This discussion of the Islamic *qirād* is drawn largely from Udovitch, *supra* note 17, at 202-06.

30. The *Muwatta*, which dates to the late eighth century, is an early compilation of Islamic law that includes a digest of opinions of scholars as well as commentary by Mālik.

31. Indeed, it appears that the *qirād* was a popular and important form for conducting commercial activities in pre-Islamic Arabia. See RAYNER, *supra* note 26, at 72-73. The *qirād* is also known as the *Mudāraba*. An alternative to the *qirād* was the partnership grounded in contract, or *Mushāraka*, also prevalent in pre-Islamic Arabia. A variety of more specialized relationships having some partnership characteristics were also recognized in both pre- and post-Islamic Arabia. See generally *id.* at 74-75; S.M. Hasanuzzaman, *The Liability of Partners in an Islamic Shirkah*, J. ISLAMIC RES. INST., Dec. 1971, at 319.

origins of modern limited liability vehicles trace the line of development back at least to the *commenda*. But the *commenda* had its own roots, and in this form of business association can be seen the influence of earlier legal and commercial cultures, some of which are discussed above.³² The link between the Islamic *qirād* and the *commenda* seems particularly strong:

The *qirād*, it can unequivocally be stated, is the earliest example of a commercial arrangement identical with the later *commenda*, and containing all its essential features. Whether the *qirād* was taken over wholesale by Italian sea merchants and transformed into the *commenda* or evolved independently to meet a need created by commercial expansion is something which cannot be stated with certainty. However, even in the darkest period of the Dark Ages trade between the Catholic West and the Muslim World did not come to a complete standstill. The political and economic contacts between Islam and the West during the eighth, ninth, and tenth centuries offered Western merchants numerous and convenient opportunities to learn and adopt commercial techniques and practices from their more advanced Eastern colleagues.³³

Used largely for sea trade,³⁴ the *commenda* had many of the characteristics of the modern limited partnership.³⁵ One party (the passive, or

32. See, e.g., ROBERT S. LOPEZ & IRVING W. RAYMOND, *MEDIEVAL TRADE IN THE MEDITERRANEAN WORLD* 174 (1955) ("Precedents to the *commenda* have been found in the Babylonian *tapputum* contract, in the Muslim [*qirād*], in the Byzantine *chreokoinonia*, and, less convincingly or less directly, in the Greek and Roman sea loan and other contracts of the Hellenistic-Roman world, or even in certain Germanic agrarian contracts."). The origins of the *commenda* is the subject of intense debate among scholars.

33. Udovitch, *supra* note 17, at 207. Robert Lopez suggested that the *commenda* evolved from the Byzantine *chreokoinonia*. See Lopez, *supra* note 18, at 80. The *qirād* developed at roughly the same time as the *chreokoinonia*, and both saw their primary uses in the pooling of capital for sea trade. This Article accomplishes conciseness at the expense of completeness by omitting discussion of a third means of pooling capital, the Jewish *'isqa*, which strongly resembled the *chreokoinonia*. On the *'isqa*, see Udovitch, *supra* note 17, at 199-201.

34. Until the mid-thirteenth century, the sea loan was an important alternative to the *commenda*. Both the sea loan and the *commenda* utilized the capital of the passive investor, but in the sea loan the risk of loss from misfortune at sea (principally piracy or shipwreck) was borne by the investor/lender. The investor/lender and the merchant were not in partnership, and there was no sharing of business risks. If the ship arrived safely in port, the debt under the sea loan was due in its entirety. Not surprisingly, the sea loan carried a high return, with payments due on voyage completion often 40% to 50% greater than the amount loaned. Sea loans were dealt a serious blow in 1236, when Pope Gregory IX condemned them as usurious. On sea loans, see generally 3 *THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE* 53-55 (M. Postan et al. eds., 1963).

35. This description of the *commenda* is drawn from LOPEZ & RAYMOND, *supra* note 32, at 174-76.

sleeping, partner) would provide capital to another party (the traveling, or managing, partner) to finance an overseas commercial venture. The managing partner, who did not necessarily provide capital but did assume the risk of a dangerous voyage, would have responsibility for all aspects of management of the venture.³⁶ The *commenda* would terminate upon completion of the venture, at which time the parties would divide profits under a pre-determined formula.³⁷ Typically, three-fourths of the profits went to the passive partner with the traveling partner receiving only one-fourth. It has been observed that "[t]his arrangement may seem unfair, but in the twelfth and thirteenth centuries life was cheap and capital scarce."³⁸

One of the great advantages of the *commenda* was that the passive investor enjoyed limited liability. Indeed, it appears that third parties doing business with the managing partner were generally unaware of the existence of the passive partner.³⁹ The establishment of the *commenda* as an accepted form of investment enabled passive investors to diversify their investments by placing money in several *commendae* rather than placing large bets on single voyages.⁴⁰ Over time, diversification against the risks of sea voyages joined literary appeal with economic advantage. Shakespeare opens *The Merchant of Venice* with the merchant Antonio wondering aloud why he is

36. This meant that "the major direction of a voyage was in the hands of the merchants, not of the shipowners, one of the characteristic differences between medieval and modern shipping." E.H. BYRNE, *GENOESE SHIPPING IN THE TWELFTH AND THIRTEENTH CENTURIES* 36 (1930), *quoted in* 3 *CAMBRIDGE ECONOMIC HISTORY OF EUROPE*, *supra* note 34, at 59.

37. See ARMANDO SAPORI, *THE ITALIAN MERCHANT IN THE MIDDLE AGES* 43 (P Kennem trans., 1970) (noting that upon completion of voyage new venture would be formed, "sometimes with the same members, but usually with different ones").

38. 3 *CAMBRIDGE ECONOMIC HISTORY OF EUROPE*, *supra* note 34, at 50.

39. A marked development in contemporary limited partnership law has been the relaxation of restrictions on the extent the limited partner can be active in the business and still enjoy the benefits of limited liability. It seems quite the opposite trend prevailed as use of the *commenda* grew:

Early *commenda* agreements usually left to the investor the right of deciding the destination, choice of ship, and other essentials of the commercial venture undertaken by the traveling party. They also insisted on meticulous accounting and often specified that the goods should go and return in the custody of the traveling party. In time, however, greater and greater latitude was left to the traveling merchant. Evidently, it was impossible for the sedentary investor to control adequately the management of the venture without hampering the initiative of the traveling party; nor were all merchants willing to accept limitations from investors.

LOPEZ & RAYMOND, *supra* note 32, at 176.

40. See 3 *CAMBRIDGE ECONOMIC HISTORY OF EUROPE*, *supra* note 34, at 53.

so sad.⁴¹ Perhaps, his friends suggest, his mind is tossing on the ocean in anxiety over the fate of his investments. Surely, they suggest, Antonio "is sad to think upon his merchandise."⁴² Anticipating modern portfolio theory, Antonio responds:

Believe me, no. I thank my fortune for it,
My ventures are not in one bottom trusted,
Nor to one place; nor is my whole estate
Upon the fortune of this present year,
Therefore my merchandise makes me not sad.⁴³

Interestingly, contemporary scholars who argue in favor of limited liability cite the same diversification benefits.⁴⁴

B. *The Compagnia*

For overland rather than sea trade, the *compagnia* was used in place of the *commenda*.⁴⁵ For the most part, the differences between the two modes of association are explained by the special perils associated with trade by sea, where the *commenda* was used. In contrast to the *commenda*, the *compagnia* did not limit the liability of the passive investor.⁴⁶ The background of the distinction provides an interesting lesson in the development of forms for doing business:

This collective responsibility may have been originally a legacy of the time when the *compagnia* really was, as the name indicates, a non-commercial association of members of the same family eating the same bread and working for the same increase of the common patrimony. But liability remained unlimited when the "table companions" because merchants often unrelated by blood, no doubt because third parties were averse to dealing with a member of a company unless all partners shared full responsibility with the latter. Consequently any partner could run

41. WILLIAM SHAKESPEARE, *THE MERCHANT OF VENICE*, act 1, sc. 1 (Jay L. Halio ed., Clarendon Press 1993) (1596-97).

42. *Id.* at l. 40.

43. *Id.* at ll. 41-45. The play, of course, was post-medieval, but at least as to views on diversification presumably reflects attitudes held in earlier times.

44. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 96-97 (1985).

45. Only rarely was the *commenda* used for overland trade. See 3 CAMBRIDGE ECONOMIC HISTORY OF EUROPE, *supra* note 34, at 49.

46. SAPORI, *supra* note 37, at 42-43 ("In these companies the members' personal fortunes were also at stake since they were held responsible for all and jointly with their fellow members in the case of bankruptcy").

completely the others by a poor speculation, and the risks increased with the number of new partners admitted to the company⁴⁷

Although some commentators regard the unlimited liability associated with the *compagnia* as an advantage of this form of organization,⁴⁸ it is noteworthy that the limited liability option was not made available, or at least was not exercised, for trade other than by sea. This is not for lack of commercial sophistication. Banking and industry were well developed in inland cities, and the essential characteristics of the *commenda* were certainly known to inland merchants and financiers. A partial answer for why limited liability was not a feature of partnerships engaged in overland trade may be found in the use of insurance as a means of limiting certain risks. Indeed, from at least the mid-fourteenth century there is evidence of premium-based insurance activity,⁴⁹ and there are examples of *compagnia* contracts mandating insurance coverage.⁵⁰ It is doubtful, however, that a *compagnia* arrangement combined with insurance limited risks to the same extent as a *commenda*, and the limited liability associated with the *commenda* should be regarded as the exception rather than the rule for the time.

C. A Case Study: The Failed Attempt of the Bonsignore Compagnia to Achieve Limited Liability

The Bonsignore partnership of Siena was one of the great merchant-banking concerns of the thirteenth century. Originally operated as a family firm, the partnership grew to include twenty-three partners, eighteen of whom were not members of the Bonsignore family. Over time, internal

47. 2 CAMBRIDGE ECONOMIC HISTORY OF EUROPE 324 (M. Postan & E.E. Rich eds., 1952) [hereinafter 2 CAMBRIDGE ECONOMIC HISTORY OF EUROPE].

48. See, e.g., SAPORI, *supra* note 37, at 43. Saporì adds:

The mutual trust and long-calculated efforts which could reduce risks to a minimum and lead to happy results favored unlimited liability. In addition, a prolonged activity in common directed toward the same ends demanded of the members a reciprocal confidence and esteem and frequent consultation. It implied the other basic principle of the company; that of shared responsibility. This total solidarity in bearing responsibility conferred on the administration a particular prestige in its dealings with outsiders.

Id.

49. See 3 CAMBRIDGE ECONOMIC HISTORY OF EUROPE, *supra* note 34, at 99.

50. See, e.g., LOPEZ & RAYMOND, *supra* note 32, at 206-11 (discussing contract providing that merchant partner "insure or cause to be insured fully all wool, cloth, or other merchandise that may be shipped anywhere on behalf of said *compagnia*, no matter in what ship it shall be loaded, with the exception that if he should ship by Florentine or Venetian galleys he may take a risk up to £60 groat in each galley and no more").

dissension crippled the business operations of the firm.⁵¹ Attempting to secure relief from creditor demands, the partnership sought the intervention of municipal authorities, requesting (in part) the following assistance:

That it may please you to see to it that two ambassadors of the Commune of Siena go to the lord pope and speak in behalf of said societas, and that he [the pope] use the influence of his holy office with the creditors of said societas to the end that, in presenting their demands, these creditors may not burden the partners of the societas *except in the proportion that falls to each one*⁵²

The petition was denied, and the firm failed. Perhaps as a result of the Bonsignore experience, Siena adopted the concept of proportional liability in later statutes. In the view of some scholars, the statutes, which were subsequently repealed, contributed to the decline of Siena as an important business center.⁵³

V To the Present

Had its troubles occurred a century or more later, the Bonsignore partnership may have fared better. In 1408, Florence enacted a statute that allowed the creation of *società in accomandite*, or limited partnerships, the essential characteristic of which was that passive partners were liable only to the extent of their investments.⁵⁴ From this point, one can easily trace the development of limited partnerships to the French *société en commandite*, incorporated in French law first at the time of Louis XIV in 1671 and then in the Code de Commerce of 1806.⁵⁵ Widely used in

51. This description of the Bonsignore partnership is drawn from 3 CAMBRIDGE ECONOMIC HISTORY OF EUROPE, *supra* note 34, at 67, 75.

52. The translated text of the petition, which was dated August 9, 1298, may be found in LOPEZ & RAYMOND, *supra* note 32, at 298, 301 (emphasis added).

53. See Robert S. Lopez, *Italian Leadership in the Medieval Business World*, 8 J. ECON. HIST. 63, 66 (1948) (expressing agreement with Armando Sapori on this point and adding, "this clause, conservative as it may seem to us, was partly responsible for the rapid decline of Siena as a leading center of business. The public wanted to nail solidly each and all of the partners to each and all of the partnership's debts.").

54. There is evidence that this form of business association was actually used earlier. See 2 CAMBRIDGE ECONOMIC HISTORY OF EUROPE, *supra* note 48, at 347 ("A scholar has found in a Barcelonese contract of 1332 closer resemblance to the modern *société en accomandite* than can be noticed in the *commenda* or the *compagnia* contracts most commonly used in Italy in the same period."). But cf. FERNAND BRAUDEL, 2 CIVILIZATION AND CAPITALISM 15TH-18TH CENTURY: THE WHEELS OF COMMERCE 438 (S. Reynolds trans., 1982) (noting that first recorded *accomandita* contract dates from 1532).

55. The *société en commandite* was well established long before the development of the Code de Commerce. See, e.g., REPORT FROM THE SELECT COMMITTEE ON THE LAW OF

France,⁵⁶ the *société en commandite* was the model for the Irish Anonymous Partnership Act of the late eighteenth century⁵⁷ and early American limited partnership statutes, the first of which was enacted by New York in 1822.⁵⁸

And so ends this brief survey of the history of limited liability, which should at least be sufficient to show that the development of vehicles for achieving limited liability in business ventures is an ancient activity. Of course, there is much more to the story of limited liability. For example, this discussion has ignored England, where limited liability developed along a different line and at a slower pace than occurred on the Continent.⁵⁹ The nineteenth century presents a particularly interesting chapter in the English story because of the level of the debate that occurred over the desirability of limited liability. Specifically, in the 1837 *Report on the Law of Partnership*, prepared by H. Bellenden Ker at the direction of the Board of Trade, and in the 1851 *Report from the Select Committee on the Law of Partnership*, prepared at the direction of the House of Commons, we can more than a century later find a level of inquiry, a quality of debate, and an awareness of history that is largely absent from contemporary discussions of limited liability.

PARTNERSHIP 32 (1851) (statement of M. Labouchere).

56. One reason the commandite associational form proved so popular was that members of the nobility could invest as silent partners. See BRAUDEL, *supra* note 55, at 439 ("This undoubtedly explains the success of the *commandite* system in France, where those who were 'in trade' were still not readily admitted to high society, even during the business explosion of the eighteenth century. Paris was not London or Amsterdam.").

57. 21 & 22 Geo. 3, ch. 46 (Irish). Apparently, the limited partnerships allowed by the Irish Act were not very popular. As to why, consider the following comments:

[In contrast to the French New York experiences, the effect in Ireland has been that] after 50 years experience, it appears that few persons have availed themselves of the provisions of the Act allowing limited partnerships, the provisions of which are somewhat similar to the French law, except that the duration of these partnerships is limited to 14 years, and the minimum capital is 1,000 l. and the maximum 50,000 l.

It has been suggested that the risk attending any accidental noncompliance with the strict and minute provisions of the Act has been the cause of deterring the Irish capitalists from availing themselves of this law.

H. BELLENDEN KER, REPORT ON THE LAW OF PARTNERSHIP 21 (1837).

58. See 1822 N.Y. LAWS., 45th Sess., ch. CCXLIV.

59. See generally LIMITED LIABILITY AND THE CORPORATION, *supra* note 11, at 96-102.

