

Facts:

Mr. Aron Salomon was a leather boot and shoe manufacturer of his firm in Whitechapel High Street, with warehouses and a large establishment. He had it for 30 years and 'he might fairly have counted upon retiring with at least £10,000 in his pocket.' He had a wife, a daughter and five sons, four of whom worked with him. The sons wanted to be partners, so he turned into the business into a limited company. The wife and five eldest children became subscribers and two eldest sons also directors. Mr. Salomon took 20,001 of the company's 20,007 shares.

The price fixed by the contract was £39,000, which was 'extravagant' and not 'anything that can be called a business like or reasonable estimate of value.' Transfer of the business happened on June 1, 1892. Purchase money for the business was paid, totaling £20,000, to Mr. Salomon. £10,000 was paid in debentures to the Salomon (i.e., Salomon gives the company a loan, secured by a charge over the assets of the company). The balance paid went to extinguish the business' debts (£1000 of which was cash to Salomon).

There was economic trouble, and a series of strikes led the government, Salomon's main customer, to split its contracts between more firms. Bordered called in his security in September 1893. Salomon lost business. His warehouse was full of unsold stock. He and his wife lent the company money. He cancelled his debentures. The company gave them to (i.e. got a loan from) a Mr. Broderip, of £5,000. When the company was liquidated, Broderip was paid but other unsecured creditors were not.

The liquidator met Broderip's claim with a counter claim, joining Salomon as a defendant that the debentures were invalid for being issued as fraud. The liquidator claimed all the money back that was transferred when the company was started: rescission of the agreement for the business transfer itself, cancellation of the debentures and repayment of the balance of the purchase money.

Judgment

High Court

In the first case, *Broderip v Salomon* [1895] 2 Ch 323, Vaughan Williams J said Mr. Broderip's claim was valid. It was undisputed that the 20,000 were fully paid up. He said the company had a right of indemnity against Mr. Salomon. He said the signatories of the memorandum were mere dummies; the company was just Mr. Salomon in another form, an alias, his agent. Therefore it was entitled to indemnity from the principal. The liquidator amended the counter claim, and an award was made for indemnity.

Court of Appeal:

Lindley LJ in the Court of Appeal (an expert on partnership law) confirmed Vaughan Williams J's decision against Mr. Salomon, though on the grounds that Mr. Salomon had abused the privileges of incorporation and limited liability, which the Legislature had intended only to confer on "independent bona fide shareholders, who had a mind and will of their own and were not mere puppets". The Lords Justices of Appeal variously described the company as a myth and a fiction and said that the incorporation of the business by Mr. Salomon had been a mere scheme to enable him to carry on as before but with limited liability.

House of Lords

The House of Lords unanimously overturned this decision, rejecting the arguments from agency and fraud. They held that there was nothing in the Act about whether the subscribers (i.e. the shareholders) should be independent of the majority shareholder. The company was duly constituted in law and it was not the function of judges to read into the statute limitations they themselves considered expedient. Lord Halsbury stated that the statute "enacts nothing as to the extent or degree of interest which may be held by each of the seven [shareholders] or as to the proportion of interest or influence possessed by one or the majority over the others."

Lord Halsbury remarked that - even if he were to accept the proposition that judges were at liberty to insert words to manifest the intention they wished to impute to the Legislature - he was unable to discover what affirmative proposition the Court of Appeal's logic suggested. He considered that identifying such an affirmative proposition represented an "insuperable difficulty" for anyone putting forward the argument propounded by the Lords Justices of Appeal. Lord Herschell noted the potentially "far reaching" implications of the Court of Appeal's logic and that in recent years many companies had been set up in which one or more of the seven shareholders were "disinterested persons" who did not wield any influence over the management of the company. Anyone dealing with such a company was aware of its nature as such, and could by consulting the register of shareholders become aware of the breakdown of share ownership among the shareholders.

Lord Macnaghten asked what was wrong with Mr. Salomon taking advantage of the provisions set out in the statute, as he was perfectly legitimately entitled to do. It was not the function of judges to read limitations into a statute on the basis of their own personal view that, if the laws of the land allowed such a thing, they were "in a most lamentable state", as Malins V-C had stated in an earlier case in point, *In Re Baglan Hall Colliery Co.*, which had likewise been overturned by the House of Lords.

The House held:

"Either the limited company was a legal entity or it was not. If it were, the business belonged to it and not to Mr. Salomon. If it was not, there was no person and no thing to be an agent [of] at all; and it is impossible to say at the same time that there is a company and there is not."

The House further noted:

"The company is at law a different person altogether from the [shareholders] ...; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands received the profits, the company is not in law the agent of the [shareholders] or trustee for them. Nor are the [shareholders], as members, liable in any shape or form, except to the extent and in the manner provided for by the Act."

On the issue of floating charges, Lord Macnaghten also said this.

"For such a catastrophe as has occurred in this case some would blame the law that allows the creation of a floating charge. But a floating charge is too convenient a form of security to be lightly abolished. I have long thought, and I believe some of your Lordships also think, that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture holders generally step in and sweep off everything; and a great scandal it is."