



Aaron Salomon was a successful leather merchant who specialized in manufacturing leather boots. For many years he ran his **business** as a **sole trader**. By 1892, his sons had become interested in taking part in the business. Salomon decided **to incorporate** his business as a **Limited company**, Salomon & Co. Ltd.

At the time the legal requirement for incorporation was that at least seven persons **subscribe as members of a company i.e. as shareholders**. Mr. Salomon himself was managing director. Mr. Salomon owned 20,001 of the company's 20,007 shares - the remaining six were shared individually between the other six shareholders (wife, daughter and four sons). Mr. Salomon sold his business to the new corporation for almost £39,000, of which £10,000 was a debt to him. He was thus simultaneously the company's principal shareholder and its principal creditor.

When the company went into liquidation, the liquidator argued that the debentures used by Mr. Salomon as security for the debt were invalid, on the grounds of fraud. The judge, Vaughan Williams J. accepted this argument, ruling that since Mr. Salomon had created the company solely to transfer his business to it, the company was in reality his **agent** and he as **principal** was liable for debts to unsecured creditors.

#### **High Court:**

The judge, Vaughan Williams J. accepted this argument, ruling that since Mr. Salomon had created the company solely to transfer his business to it, then the company and Salomon were one unit; the company was in reality his agent and he as principal was liable for debts to unsecured creditors.

#### **The appeal:**

The Court of Appeal also ruled against Mr. Salomon, 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 lord 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.

### **The Lords:**

The House of Lords unanimously overturned this decision, rejecting the arguments from agency and fraud.

Salomon followed the required procedures to set the company; shares and debentures were issued. The House of Lords held that the company has been validly formed since the Act merely required 7 members holding at least one share each.

There was no fraud as the company was a genuine creature of the Companies Act as there was compliance and it was in line with the requirements of the Registrar of Companies.

**The Company is at law a separate person.** The 1862 Act created limited liability companies as legal persons separate and distinct from the shareholders. They held that there was nothing in the Act about whether the subscribers (i.e. the shareholders) should be independent of the majority shareholder. It was held that: "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 nothing 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." Hence the business belonged to the company and not to Salomon, and Salomon was its agent.

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."