The Trouble with Stockjobbers: the South Sea Bubble, the Press and the Legislative Regulation of the Markets

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Abstract: The South Sea Bubble Act of 1721 is often taken as the first securities legislation. Further it is understood to be a response to a stock market scandal. In fact, the Act was enacted prior to the scandal and indeed the likely cause of the collapse of the stock bubble itself. This article reviews the historical context, including the finance of government of the era, the development of the South Sea Company and its bubble, the legislation, burst and subsequent effects. It places securities legislation in its historical context as part of a broader movement in corporate law, shifting liabilities and priorities among the members of the corporation and society at large.

Keywords: South Sea Bubble, Securities Legislation, Legal History, Stock Bubbles,
1. Introduction

For the northern peoples, the southern seas and southern locales have a long held mystique. It is something similar to a western view of the orient—an unknown place in which the possibilities are restrained only by the limits of one’s imagination. Such differences, real or imagined, continue to this day in which much more information is at hand, in forms including photos, video, and travel, unimaginable three hundred years ago.

Eighteenth century England was an era of great innovation and great expectation. Having changed the form of its government radically in the previous century’s Glorious Revolution of 1688, won various wars, and begun what was to become its global empire, England had at least a basis for great hopes. It was an era too of discovering lands previously beyond the bounds of western knowledge. From an economic point of view, as well, the era was one of growth and innovation. While certainly considerable expenditures had been incurred in the various wars and conquests, there too had grown considerable wealth among the aristocracy and the merchant class. It was in this atmosphere that the first frenzied speculative stock bubble occurred—the South Sea Bubble.

Company law in the eighteenth century was practically non-existent. Nothing more than a few general doctrines applied, and nothing more than what would be understood today as partnership law. Companies of this era were what would be understood in common parlance of today as ‘company’—i.e. a group of people together keeping company. The notion of corporation was of a corporation sole—i.e. an office. There was no notion of separate personhood, nor limited liability, nor notions of directors duties. As will be noted further on in this paper, the government response to company scandal was retrospective. Accordingly, notions of stock in any modern sense are out of the question although the notions of dividend and residue would occasion as would be expected in
partnership law. Finally, while there was an established market for securities, it was not well organized and no securities laws existed.

2. High Finance in Eighteenth Century England

England’s war with Spain left it with considerable debt. But England had undergone a financial revolution in the previous century for a variety of reasons. First, as a result of the Glorious Revolution control over the country’s finances was given to Parliament. Prior to such transfer, public debt was coerced lending, with uncertain prospects of repayment. This transfer of power from monarch to parliament, however, allowed England’s status as a borrower to rise considerably. Parliament’s control over national debt permitted it to seek new types of funding not previously available. Whereas previously the doctrines of Crown immunity which precluded creditors from suing the crown for the repayment of loans, and such powers as used by the Exchequer to stop all payments to creditors commencing in 1672, the reformed powers of parliament increased creditors’ confidence in repayment by the government. The Corporation of London, various Merchants Associations and the East India Company were used as sources of finance. Further, innovation in finance from The Netherlands and France was introduced, particularly with the introduction of short and long bills. Finally, the founding of the Bank of England and more companies generally created a new source of credit previously unavailable. Such companies either loaned money directly to the government or purchased government debt at the behest of government. These

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2 Clay, ibid, 11.
4 Clay above n 1, 277.
5 Clay above n 1, 269 and 272
7 Schubert ibid. See also Clay above n 1, 276 n 27 in which it is noted that from 15 joint stock companies in 1688 until 1695, the number had increased to 150 such companies.
transactions have been described as blackmail essentially extorted on the basis of having to maintain a monopoly concession.  

In the early eighteenth century, England’s government finance essentially consisted of three financial instruments and sources: bonds, annuities, and corporate held debt. In 1720, the debt of £50 million was composed of £18.3 million held by corporations, privately held redeemable bonds in the amount of £16.5 million, and £15 million in irredeemable long (72 and 87 year) and short (22 year) annuities.

3. The South Sea Company

England’s economy, although fluctuating with various rises and falls in the decades leading up to the start of the eighteenth century, generally had a strong growth trend. Part of this growth was generated by overseas trade which not only increased wealth but also diffused that wealth more widely than before. Certainly, recession and depression did occur in the 1690’s, however, the overall trend continued upward.

The Spanish War of Succession (1702-1713) came at a great cost to England estimated at £29 million, in an era when £5-6 million was annual expenditure of the government. This expense in addition to the costs of its war with France created a huge and on-going burden of debt on the country. The government of England sought and found sources of finance both in international money markets and its domestic arrangements with joint stock companies. As to the latter, its arrangement was usually a grant of charters and monopolies in exchange for certain requested financial favours.

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8 Clay above n 1, 278.
10 Clay above n 1, 280.
11 Clay above n 1, 275.
12 Dickson, above n. 3, 10.
13 Figure for 1690’s from Clay above n 2, 267.
As previously mentioned, Merchants Associations often purchased government debt. In 1711, by an arrangement of the Earl of Oxford, Harley, such an association purchased a considerable sum of debt requiring an interest payment of £600,000 per annum. The group of merchants then sought and received an incorporation by an Act of Parliament. It also received its monopoly in the South Seas in that same act The Company of Merchants of Great Britain Trading to the South Seas.

Great fortunes had been made from trade with the New World in the previous century and stories circulated about wealth from Mexico and Peru firing the imagination. Further, as mentioned in the introduction, the imagination was the only limit on the possibilities understood to exist in worlds unknown. Finally, there had grown a considerable pool of capital available for investment of all types including speculative investment. The extent of speculative investment capital may be inferred from the number of bubble companies offering investment opportunities in all types of project including a successful fund raising by a joint stock company offering as its purpose ‘a company for carrying on an undertaking of great advantage, but nobody to know what it is.’ The extent of this speculation was described by the nineteenth century commentator Charles MacKay as ‘madness’ perhaps equivalent to current commentary of economic ‘irrationality’. In such atmosphere, it is hardly surprising that one finds investors eager for a turn at anything promising a return.

As previously mentioned, in addition to using the Corporation of London, various financiers, goldsmiths and others, one of the main means for the English government to raise funds was through debt for equity swaps. Such transactions, permitted government

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14 Clay above n 1, p. 281.
16 Wernick ‘When the Bubble burst, all of England would up broke,’ 155 discusses Paterson’s successful fund raising for an investment in Panama.
17 Ribstein, ‘Bubble Laws,’ 95.
18 MacKay, above n. 15, 54-56.
20 Clay above n 1, p. 274.
debt holders to exchange the government debt they were holding for shares in joint stock companies which held monopoly rights over valuable trade. This method had been used successfully in Paris under the tutelage of John Law, and in England with the East India Company and the Bank of England.

Garber explains Law’s financial scheme as follows:

To finance the company, Law took subscriptions on shares to be paid partly in cash but mostly in government debt. He then converted the government's debt into long term *rentes*, offering the government an interest-rate reduction.

The idea was to establish a solid ‘fund of credit,’ a certain cash inflow that, when capitalized, could be leveraged to undertake the grand commercial schemes that lay at the heart of Law's economic theory. The nature of Law's scheme was that finance of the operation came first; expanded commercial activity would result naturally once the financial structure was in place.

The South Sea Company issued par value shares—shares with a set face value presumably backed up by a cash investment—and swapped these for government debt. In reality, the shares were not backed up by cash and such would have been well known among most investors, as trades for annuities were occurring such that for a debt valued at £146, a combination of shares, bonds and cash equivalent to £3375.

The actual business of the company, the supposed value of the monopoly of trade in the South Seas was specious. England’s concession from the Spanish in the area was limited to a few ships of limited tonnage and restricted loads, and the most profitable aspect of the trade was slaves not precious metals. As a result, the main asset of the company was financial instruments and obligations of unpaid up shares.

4. Bubble Companies, Bubble Development and Bubble Burst

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21 Schubert, above n 6, p. 302.
24 Ibid, chap 17.
25 Ibid, chap 16.
26 Smant, Famous First Bubbles? South Sea Bubble, Erasmus University of Rotterdam, http://www.few.eur.nl/few/people/smant/m-economics/southsea.htm#
27 Garber, above n 9, chap 16.
The South Sea Company was one of a number of ‘bubble’ companies. Such companies were established and grew exponentially in the overheated investment climate marking the era of the early eighteenth century England. MacKay lists eighty-six such companies’ objectives including the following more outlandish ones:

36. For a wheel for perpetual motion. Capital, one million….
38. For insuring and increasing children's fortunes….  
58. For a grand American fishery….  
63. For carrying on a trade in the river Oronooko….  
76. For extracting silver from lead….  
79. For making iron with pit coal.  

All of these companies were bubble companies that successfully raised funds in the hot investment market of the early eighteenth century. The South Sea Company was among of these companies, albeit the most important of the group. The South Seas Co.’s stocks were initially issued at £100 per share on a par value share; however, these initial stocks were not actually paid for. In a practice common in the era, the stocks were taken up by Parliamentarians and other influential people as bribes for ensuring that the concession of the monopoly and the granting of the corporate charter.  

The speculation in the South Sea Co.’s stock quickly gained momentum after discussion began in Parliament about refunding a larger portion of the national debt. In January of 1720 Parliament created a committee to consider a refunding of the national debt by the sale of about £30 million of debt to the South Sea Co. In January 1720, prior to the refunding, the stock was trading at about £120 per share. Upon first reading of the legislation pursuant to the committee’s recommendation of a refunding act submitted March 21, 1720, shares were being traded at £300 per share although curiously.

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28 MacKay, above n. 15.
29 Garber, above n 9 chap 16 ‘The Purchase of Parliament’.
30 Ibid Chap 17.
seventeen days later upon passage of the refunding act on April 7, 1720, shares dipped momentarily to £290 per share.\textsuperscript{31} (See Figure 1)

Figure 1

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure1.png}
\caption{Source: Garber}
\end{figure}

Essentially, the stock continued its meteoric rise until July at which time they reached £950 per share\textsuperscript{32} and then collapsed back to close to their face value. The rise was not without its bumps along the way; however, the company’s directors and promoters were never short of a story which would not only prop up the price, but drive it to new heights. Indeed as MacKay observes:

so many sellers, and so few buyers, appeared in the Alley on the 3\textsuperscript{rd} of June, that the stock fell at once…the directors were alarmed and ordered their agents to buy…. It would be needless and uninteresting to detail the various arts employed by the directors to keep up the price of stuck. It will be sufficient to state that it finally rose one thousand percent.\textsuperscript{33}

The collapse was just as spectacular as the great price explosion. From its peak of £950 in July, it fell to about £200 in October, settling in around £120 in mid-December of that

\textsuperscript{31} MacKay writes ‘contrary to all expectation, South Sea stock fell when the bill received the Royal assent.’
\textsuperscript{32} See discussion of peak price as 1050 versus 950 in Garber above n 9, Chap 17, n. 1
\textsuperscript{33} MacKay, above n. 15
same year. In other words, over the course of its bubble history, the company went from about £120 through the bubble of £950 down into its ultimate level below the £100 mark in 1722. (See Figure 2)

Figure 2  Source: Elliot Wave International
What caused the collapse? The answer to this question is intriguing and caught the attention of many commentators. Recently, the discussion has focused on liquidity crises\(^3^4\) and on the passage of the Bubble Act.\(^3^5\) It has been argued that the South Sea Co viewed the rapidly expanding number of bubble companies to be a threat to its cash flow for new subscriptions and so sought to limit the development of new companies and restrict or eliminate the activities of its competitors through the Bubble Act.\(^3^6\) Regardless of the collapse, the passage of the Bubble Act led to a significant restriction of the

\(^{3^4}\) Garber Chap 17, ‘Price Collapse’.
\(^{3^5}\) Ibid Chap 17.
corporate form in England\textsuperscript{37} for the next one hundred and twenty odd years until the Company Act of the 1844.

5. Response of the Regulators and the Public

There was considerable alarm upon the collapse of the South Sea Company. Given the perilous state of the kingdom’s finances prior to the development of the bubble and the relief which the bubble provided, it can be imagined that there was considerable consternation among the financiers as well as the government upon the collapse. In one sense, the government prospered considerably. The value of its debt collapsed along with the company; however, it still left a number of formerly well to do gentry, aristocracy and others in straightened circumstances. As Wernick observes:

> The collapse of the South Sea stock led to a collapse of all credit. By October it was clear that a financial crisis had engulfed England. No one wanted paper any more. The real estate market collapsed. Unemployment, especially in the luxury trades, spread. So did bankruptcies. The government fell….Everyone who had had any dealings with the South Sea Company, and that meant almost everyone of consequence in Great Britain, was in a rage and a financial fix.\textsuperscript{38}

The public outcry was predictable. Both in the House of Commons and in the House of Lords, calls for extreme punishments grabbed attention. Lord Molesworth ‘looked upon the contrivers and executors of the villainous South Sea scheme as the parricides of their country, and should be satisfied to see them tied in like manner [to Rome’s parricides] in sacks, and thrown into the Thames.’\textsuperscript{39} Essentially, the problem was viewed as a matter of corrupt individuals who were company directors assisted to a large degree in their malfeasance by stock jobbers who distributed shares and facilitated the perpetration of a fraud on the investing public. A bill was brought in which sought to restrain the South Sea directors from leaving England until the end of an inquiry, called for a twelve month imprisonment, disclosure of their estates and restrictions on alienation of the estates.\textsuperscript{40}

\textsuperscript{37} Arner ‘Development of the American Law of Corporations to 1832,’ 33.
\textsuperscript{38} Wernick, above p. 4.
\textsuperscript{39} Quoted in MacKay, above n. 15.
\textsuperscript{40} MacKay above n. 15.
That the blame was put on the avarice of individual directors can be seen from the governmental response. Parliament established a Secret Committee which was charged with investigating the causes and involvements of the individuals associated with the South Sea Company. Ultimately, a number of former directors were implicated, their fortunes largely appropriated, and at least one was imprisoned. Interestingly, there was no law allowing for this particular outcome. In 1703 Lord Chief Justice Holt had asked of a jury: ‘Shall we indict a man for making a fool of another?’ Still in the circumstances of the South Sea Company’s collapse, such a pronouncement was an insufficient answer to the clamour. Accordingly, the punishments were administered on a post-hoc basis, including the imprisonment just mentioned, and fines and restitution orders based on the disclosure of estates.

As to the other group of individuals deemed responsible, the stock jobbers, MacKay observes: ‘Resolutions were passed to the effect that the calamity was mainly owing to the vile arts of stockjobbers, and that nothing could tend more to the re-establishment of public credit than a law to prevent this infamous practice.’ The occupations of stockjobbers who trade on their own account and stockbrokers who traded on behalf of others, which had existed at least since the late seventeenth century in England, had been effectively banned by the Bubble Act of 1720.

Interestingly, there were no legislative changes ensuing. The Bubble Act of 1720 was the result of the South Sea Company’s efforts to sequester the benefits of bubble speculation to itself. The Bubble Act essentially prohibited the creation of new companies and banned some already in existence. It prohibited ‘the acting or presuming to act as a corporate body …[and] the raising or pretending to raise transferable stocks…. Without legal authority, either by Act of Parliament or by any charter from the Crown.’ The Act was not to apply to companies incorporated prior to June 24, 1718 and in no way

41 Ibid.
42 Ibid.
43 Clay above n 1, p. 276.
44 6 Geo 1, c. 18, s. 20.
prohibited the establishment of partnerships. Money could be raised by companies, however, only by those companies themselves without intermediaries.\(^{45}\) The net effect of these changes was to limit the growth in the number of companies and ban the occupations of stockjobber and stockbroker.

Companies, however, did continue to exist and new companies created as a result of the ingenuity of lawyers, but such ingenuity was essentially in breach of the spirit or intention of the law. Such companies were known as Deed of Settlement Companies, in which the investors acting as the settlors of a deed of settlement known as articles of association, settled on the directors as managers, funds to be used for the enterprise under consideration, with the investors as the beneficiaries of the commercial activity.\(^{46}\)

How does one explain this peculiar response of government? The problem to be solved by the South Sea was a government problem. It needed funding for its extended warfare with other nations. Hoppit argues convincingly that the whole matter was a governmental failure to act in the public good.\(^{47}\) It was well known that the finance scheme was at least suspect and indeed, this method of finance was openly attacked in Parliament prior to the grant of the South Sea Company’s charter.\(^{48}\) In addition, the refunding of public debt by various schemes including share subscriptions was well satirized in street ballads well before the creation of the 1720 bubble.\(^{49}\) Still, at least in part because of the practice of bribery, the scheme was ultimately approved by Parliament. Further, it is important to recall the lack of investment opportunities as well as the recent changes in financing options and markets discussed earlier.

Yet, despite the great outcry and generally accepted deep impact on the economy, it is contested on good grounds that the effect was not as widely spread or caused the deep

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\(^{46}\) Redmond, above n 1 pp. 37-39.

\(^{47}\) Hoppit, ‘The Myths of The South Sea Bubble’ 159.

\(^{48}\) MacKay, notes Walpole warning that: ‘If it [the South Sea scheme] failed, which he was convinced it would, the result would bring general discontent and ruin upon the country.’ above n. 15

\(^{49}\) Duga, 46-50.
harm to the English economy often cited. Hoppit argues that ‘the Bubble itself has been bubbled.’ Hoppit explains this exaggeration as a result of a moral panic among other things. He notes that the cause for the inquiry and great public noise about the collapse may well be because 75 per cent of the subscribers were parliamentarians. Further, in his examination of the economic evidence, he finds little to suggest serious or long term consequences.

There was a response from the clergy and the media each for their own purposes. The clergy had benefited from the subscriptions to various companies, some of which were established for the improvement of the Church of England’s real estate and activities. For example, one such bubble company had as its objects ‘for encouraging the breed of horses in England, and improving of glebe and church lands, and repairing and rebuilding parsonage and vicarage houses.’ Undoubtedly, some were also investors themselves. Generally, it appears that the clergy took the opportunity of the collapse to condemn such activity.

The media itself is always pleased to have a scandal to report and it is well served by stoking the fires of discontent and publicizing problems. The media response can be seen through a number of satires from the era and subsequent. Jonathan Swift who himself lost funds in the bubble wrote a satire ‘the run upon the bankers’ as did Thomas d’Urfye, and Alexander Pope. Indeed, a whole range of ballads were created variously mocking, lamenting and excoriating the participants. These ballads were effectively a combination of news and commentary. D’Urfey’s ballad provides a fine example:

50 Hoppit, 141
51 Ibid, abstract.
52 Ibid, 150.
53 Ibid, 155.
54 MacKay, above n. 15
55 Hoppit, above n 47, p. 160.
56 ‘Hubble Bubble’
57 ‘Epistle to Lord Bathurst’
58 See Dugaw, ‘High Change in ‘Change Alley’: Popular Ballads and Emergent Capitalism in the Eighteenth Century,’ 43.
59 Ibid, p. 46.
A bubble is blown up with air,
In which fine prospects do appear
The bubble breaks the prospects lost,
Yet some bubble pay the cost
Hubble bubble bubble hubble all is smoke
Bubble hubble hubble bubble all is broke
Farewell your woods your houses lands your pastures
And your flocks
For now you have nought but your selves in ye stocks.\(^\text{60}\)

Another plain explanation of the phenomenon of the South Sea bubble is in Ned Ward’s 1720 piece ‘A South Sea Ballad, or, Merry remarks upon Exchange-Alley Bubbles’. It includes the following stanza:

Five hundred millions, notes and bonds
Our stocks are worth in value
But neither lie in goods or lands
Or money let me tell ye
Yet tho’ our foreign trade is lost
Of mighty wealth we vapour
When all the riches that we boast
Consist in scraps of paper\(^\text{61}\)

Over time the outcry died down as it does in all such instances as new events overtake public attention and life moves forward. The South Sea became an object lesson, a topic of historical interest and investigation, and a model of speculation gone bad.\(^\text{62}\)

The net result was nothing. There was no regulation introduced subsequent to deal with matter and laissez faire capitalism continued. The minds of the lawyers working with the

\(^{60}\) Quoted in ibid, p. 52.
\(^{61}\) Quoted in ibid, p. 53.
\(^{62}\) Hoppit describes these as ‘phases’ in Hoppit above, n. 47, 159, 163-5.
hands of the scriveners succeeded in carrying forward commercial actors intentions and, other than a few prosecutions in early nineteenth century, nothing more of the Bubble Act prior to its repeal in 1825 was heard.\textsuperscript{63}

6. Conclusion

What happened in the early eighteenth century was unremarkable, at least from the point of view of legislative historians. Certainly, new financial instruments were created, an economy boomed both preceded and followed by other booms and busts,\textsuperscript{64} and companies were established, bloomed, took in great sums of investor cash, and went bust. The predictable public outcry ensued, including clergy, media and government, but ultimately all continued as before.

No securities regulation occurred until the early twentieth century with the creation of the Security and Exchange Commission after the 1929 Wall Street collapse. Directors did well, investors got what they could and capitalism developed permitting the development of the great robber barons of the late nineteenth century in the USA.

Corporate law continued to develop slowly, shifting liability away from shareholders, pursuant to government policy,\textsuperscript{65} and transferring power to directors while at the same time shielding them. The notions of independent personality and corporate veil were developed and reified by the courts over the interim.\textsuperscript{66} And government response to corporate scandal appears to be much the same now as it was then—a response to certain well prepared lobby groups catching the opportunity presented by the scandal.\textsuperscript{67} Individual blame continues to be popular and regulators continue to make proposals

\textsuperscript{63} Redmond, above n. 1, 38.
\textsuperscript{64} Cooke, Corporation, Trust and Company,. 81.
\textsuperscript{65} Grantham, ‘The Doctrinal Basis of the Rights of Company Shareholders’. For a broader analysis of shareholders’ rights see Sheehy, ‘Shareholders, Unicorns and Stilts: An Analysis of Shareholder Property Rights,’.
\textsuperscript{67} Romano ‘The Sarbanes-Oxley Act and the Making of Quack Corporate Governance,’ 152.
further tying individual directors both in USA through Sarbanes-Oxley and in Australia through CLERP 9.

Market regulation is a highly charged politico-philosophical debate, with little to do with respect to economics, public good and outcry, or moral sentiment. To the extent that one can predict the future from the past (a highly dubious endeavour) the bubbles and busts of the past which were blamed on individuals suggest that in future blame can predictably be visited on individuals rather than systems, and that significant changes to company law, while loudly called for in the times closest to a crisis, will most likely be ignored and both corporate law and business practice will continue as they are. 68