Limited liability

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Introduction

- The limited liability of companies offers a more significant advantage as compared to a traditional partnership.
- The doctrine of limited liability is an essential part of the corporate form.
- Many scholars opine that this doctrine is the backbone of corporate form.
- Furthermore, it is responsible or is the real contributor to the increase in the so-called wealth of the world.
- But *whether the liability is absolutely limited*?
- Let us engage with questions such as; *what problem does limited liability potentially raise concerning tort claimants, and why?*
- *How to invoke limited liability to safeguard a company from liquidated and unliquidated damages accrued on the company's management or has potential exposure to any civil and criminal liability?*

Some questions to think about...

Do you think the term ‘limited liability’ is a misnomer?

What problem does limited liability potentially raise respecting tort claimants, and why? What legal rules might ameliorate this problem?

Do you think limited liability is invoked to cloak and safeguard liquidated and unliquidated damages accrued on the company’s management rather than for ease of business?

Is it right to conclude that One Person Company’s limited liability extends to personal liability? Pragmatically, is it possible to draw a line between individual, shareholder, or company director in an OPC?

History of Limited Liability

- The *first turning point* in the history of limited liability was the separation of this attribute from the legal personality attribute and the creation of a new dimension offering different liability regimes.
- The *second turning point*, more than a century later, was the completion of a process of convergence into a single, uniform and universal liability regime at the far end of the continuum that made full limitation of shareholder liability the standard. Limited liability in the modern sense, full owner shielding, I contend, is therefore less than a hundred years old.
- As per *Harris,*
  - Period I: before the conceptualization of limited liability, [1600–1800]
  - Period II -
    - the emergence of unlimited liability, 1780–1830 [transition phase]
    - a continuum of liability regimes, c. 1800–1900
  - Period III -
    - convergence to uniform limitation, 1880s–1930s [transition phase]
    - the era of limited liability from the 1930s

History (contd...)

1600–1800

Phase I (1600 to 1800) – Emergence of Unlimited Liability

- the establishment of first joint-stock business corporations there was no notion of the attribute of limited liability and no actual manifestation of it as such.
- Corporation was used for asset partitioning but not for owner shielding.

1780–1830

Transition to Phase II

- small but significant steps towards forming the attribute of liability and distinction from the legal personhood attribute.
- the separation of the liability attribute from the personality attribute gave rise to the unlimited liability corporation

History (contd...)

a continuum of unlimited and partly limited regimes had been created

diverse types and levels of limitation of liability had been experimented with

arious types of partial owner shielding or partial limited liability were offered and tried

Phase II (1800 to approx. 1930) – Moulding of the concept of limited liability

Transition **to Phase III (around 1900 until the mid-20th century)**

Gradual convergence into a single, universal model, that may be termed as 'limited liability in the modern sense' or strong owner shielding (Hansmann et al..)

Change in business environment where:-

- *business corporations have both equity investors and long-term financial creditors*
- *some corporations become balance-sheet insolvent*
- *a procedure for liquidating insolvent corporations is available*
- *creditors have legal priority over equity*

History (contd…)

- **<u>Phase III (1800 to approx. 1930)</u>**
  - legal-economic theoreticians laid out the theoretical arguments supporting the proclamation that without limited liability, the entire corporate economy could not have developed
  - the second transition phase that public intellectuals celebrated the ‘invention of limited liability’
  - emergence of economic analysts of corporate law in the 1960s and beyond
  - Nicholas Murray Butler, President of Columbia famously in 1911 in his speech before the Chamber of Commerce of the State of New York said:

    "I weigh my words, when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times … Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it"

Rationale for Limited Liability

- Public Investment – If shareholders holding small stakes were subjected to unlimited liability to corporate debts, then investors with personal wealth would be reluctant to invest in public corporations because every single share would place all their personal assets at risk
- Public Share markets – essential for stock markets to operate efficiently: without it, shares would not be priced uniformly and efficiently
- Partitioning of Assets

Advantages of Limited Liability

- Monitoring on a regular level
- Incentives for managers
- Wealth of shareholders
- Efficient diversification
- Optimal investment
- Protection from corporate risks
- Easy transferability

Major disadvantage(s) of Limited Liability

- Tax implications are too high
- Transferring Ownership is very tough
- More expensive to form than sole proprietorships and general partnership or other forms of business entities

Limited Liability and Tortious claims

Interplay of *tort law* and company law

- Principles of liability different under Tort Law
- Generally, *tort law* does not 'use' the principle of limited liability unlike companies and highlight two major forms of liability:-
  - Strict Liability
  - Absolute or *No-Fault Liability*

Personal liability vis-a-vis Group Liability for tortious claims

Human Rights Issues and nature of liability of corporations

Conclusion

- Full unlimited liability is a non-starter in the 21st century. One should not use it as a *straw person*.
- The prevailing theory fails to assess sufficiently the viability of other liability regimes that provided partial owner shielding.
- Analysis of various liability regimes that were widely used in Period II – those that disappeared in the transition to Period III – can inspire the theoretical and policy discussion of alternatives to our present-day limited liability regime.
- They reinforce the case made by some economists and lawyers who have proposed alternatives to full limited liability for investment banks and the financial sector more generally in the wake of the crisis


THANK YOU