RETHINKING LIMITED LIABILITY

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Both contractual and tortious claims made against a company do not affect company members when a limitation is placed on their liability for the debts of their company. Members enjoying the protection of limited liability may desire the business to perform operations in a manner they would not have wished it to operate had their liability not been limited. The legal developments in the 1980s preventing directors, including de facto and shadow directors, from defrauding creditors and wrongful trading, and disqualification procedures that were put in place as a check on directors’ propriety have removed the need to introduce unlimited liability for “one-man companies”, but have essentially failed to resolve the deficiency in the law of business organisations in respect of company groups. Double insulation of limited liability prevents creditors of an insolvent company from bringing claims against other solvent companies in a company group. Tort victims, in particular, are at the most disadvantageous position, as they cannot negotiate around liability for the debts of an insolvent company and cannot mitigate their losses by taking security. Despite the shift of the focus from sorting out the consequences of a business failure to rescuing companies, it is time to rethink the doctrine before another industrial accident takes place, leading to transnational mass tort litigation.

I. Introduction

The majority of advanced legal systems of the world has laws designed in certain prescribed circumstances to limit a person's liability that he or she would have otherwise incurred.1 Company law, as it currently stands in the UK, allows organisations at the time of incorporation to opt for limited liability,2 which would obligate company members, upon corporate insolvency, to pay the value of unpaid shares, or money they have agreed (guaranteed) to pay, and no more.3 Historically, in the very formative phase of organisational law, limited liability was a synonym for treating a company as an artificial person, but gradually it started to acquire its own force and identity.4

The proponents of limited liability have extolled it to such a degree, describing it as “the corporation’s most precious characteristic” and heralding it as the instrument that has substantially contributed to enterprise progress, above all other legal innovations in company law.5 In fact, most

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1 It is important to note that the concept of limited liability is not unique to corporations, for other legal devices such as exclusion and limitation clauses in contract law have a similar effect. Another important caveat that one should bear in mind is that limited liability is different from liability of company managers, who are deemed to be the company’s agents. Even the term ‘limited liability’ itself is misleading because it is based on the assumption that it is common for company members not to pay the full value of the acquired shares or the guaranteed sum at the moment of incorporation. Without such a presumption, the concept would go contrary to what the term actually entails, for the company members will not have any liability for the debts incurred by the company.

2 This is provided in section 3 of the Companies Act 2006.

3 See section 74 of the Insolvency Act 1986.

4 F. Lawson, A Common Lawyer Looks at the Civil Law (Michigan 1953), at p. 200. The legal instrument of “piercing the corporate veil”, which is reluctantly deployed by the English judiciary, operates in both shielding effects, showing a very close inter-relatedness of the two doctrines.

companies do opt for limited liability, and it is in this light that the proclamation by a group of company law scholars that it is a key element of corporate form, along with separate corporate personality, transferable shares, delegated management and shareholder primacy, becomes understandable. Not only did it, mirabile dictu, overcome distrust that was initially expressed by the wealthy class, but also, having found support within business and political circles, it led other jurisdictions, realising its economic advantages, to follow suit. In spite of the commercial role that limited liability plays in corporate affairs, it has always been a subject of heated academic debates. The famous judgment of the House of Lords in Salomon v. Salomon Ltd. had been criticised for many decades for permitting the existence of ‘one man companies’. Further, the venerated regime has been subject to immense criticism for producing suboptimal consequences for involuntary creditors, such as victims of tort. The unfairness of the position in which the victims of tort find themselves is further magnified in company groups.

More recently, there has been a shift in the discussion from analysing the consequences of a business failure to preventing the failure and promoting corporate rescue and restructuring. Company law is deficient in that it does not address the aforementioned unfair position of tort victims. The Salomon principle in company groups should not have provided for double insulation of liability, as this goes against the spirit of the doctrine of limited liability itself. Not only is it economically undesirable to have a limitation of liability of company members with regard to tortious claims, but it is also morally wrong not to compensate the most deserving victims of tort who suffered death or personal injury as a result of the wrongdoings of an insolvent subsidiary.

This paper will seek to determine whether it is justifiable to ascribe a high status to limited liability. In so doing, I will examine whether economic efficiency arguments are plausible to justify the limitation. Having determined through a case study that it brings economic efficiency to a business, in section II of the paper, an assessment will be made as to whether historical doubts were not fallacious, and limited liability fosters opportunistic behaviour and excessive risk-taking. Section III(A) will address the decision in the Salomon case questioning whether the criticism is plausible in the light of the new legal developments. Creditors’ position will be illuminated and given a particular emphasis in section III(B) assessing whether limited liability is a core element of corporate form and whether its application should be reformulated to address the disadvantageous position of tort victims. After briefly considering various ideas on reforming the regime, in section IV, the present writer will propose adoption of an imperative rule of law, which will allow some tort victims to sue the parent company of an insolvent subsidiary. Section V will conclude the article.

II. Justifications Grounded in Economic Efficiency

From the outset of this section it shall be acknowledged that unlimited liability can be a viable option for many businesses to conduct their commercial affairs in an economically efficient way. Indeed, members of some forms of business organisations (e.g. general partnerships) cannot put a limitation on their liability for the debts of their businesses.

9 Scholars who adopt a Marxist perspective suggest that the tendency to see limited liability as an economically rational way of organising corporation is prone to naturalisation and de-politicisation of the key corporate characteristics and corporate form itself. The present paper does not aim at analysing the doctrine of limited liability from this perspective.
10 Note that under the Limited Liability Partnerships Act 2000, partners may enjoy limited liability in respect of the debts of the limited liability partnership. This form of business organisation is popular in legal and accounting professions.
As mentioned in the introductory part of this paper, the doctrine of separate corporate personality is very closely intertwined with limited liability as a consequence of which the two concepts initially appeared as one and the same thing. Both doctrines possess the shielding effect, which is economically efficient. Thus, as a contracting and financing tool, limited liability brings an abundance of advantages to a legal entity and its legal owners, forming the most compelling justification for retaining the regime. The classical analysis of the economic structure of corporation, including that of limited liability, can be found in the famous work of F. Easterbrook and D. Fischel. Economic analysis sees a corporation as a standardised contract designed to reduce a plethora of contractual costs that would have otherwise been incurred by various parties involved in company incorporation. The parties need not negotiate each time for limited liability as it was prior to the Limited Liability Act 1855, and the law facilitating low transacting costs minimises the associated social costs.

A case study of Lloyd’s nicely illuminates how an unincorporated entity could benefit from putting a limitation on liability of its members. For many years Lloyd’s has been a market for insurance policies. It required from its trading members to guarantee payment of losses arising from insurance policies down “to the last cufflink.” At some point the business faced massive claims in relation to asbestos pollution in the US. Almost reaching corporate insolvency, it agreed to accept limited liability companies under its umbrella. Within several months there was a massive capital flow into Lloyd’s, which, having re-considered its long-standing principles, finally allowed individual subscribers to insurance policies to trade with limited liability in November 1993.

From the Lloyd’s example it may be discerned what proponents of limited liability have advocated for: that ‘no prudent man would risk more than he would afford to lose’ and therefore, the regime would encourage the upper, middle and working classes to invest capital into productive business. In a similar vein, an investor should be able to pool his resources without worrying about being subsequently held financially responsible for the company debts.

III. Corporate Recklessness

It has been feared that a company merely transfers the burden of liability from shareholders to creditors, facilitating corporate recklessness. This would not have arisen but for limited liability. It is for this reason that the idea of limiting the members’ liability introduced by the 1855 Act was not welcomed by the wealthy class and treated with particular distrust in the second half of the 19th century. With such a regime in place, shareholders want company directors to take greater risks in running the company’s affairs. More risk means more return. It is not difficult therefore, to see a problem of moral hazard: the residual owner of a company loses nothing when the company collapses due to bad business, but becomes richer if the risk of failure does not materialise. Opponents who claim that limited liability has always been a political construct also agree that it

11 H. Hansmann and R. Kraakman, “The Essential Role of Organizational Law” (2000) 110 Yale Law Journal 387, at p. 393. Whereas the doctrine of separate corporate personality forms the basis of the corporate structure through shielding the entity’s assets from claims advanced by personal creditors of the company’s members, limited liability’s role is to strengthen that basic form, by shielding members’ assets from claims advanced by the company’s creditors.


15 Ibid., at p. 137.

16 Ibid., at p. 139.

17 L.E. Talbot, Critical Company Law (Oxford 2008), at pp. 54-57. The class has feared that the regime of limited liability decelerates economy, since hardly any creditor would want to advance money to a company that places a limit on liability of its members. Only rogue companies, so this argument went, would advocate for such a regime, as a person who does not want to account personally for the performance of the venture might take greater risks and ruin the business.
fosters corporate irresponsibility. The debate in this area is concerned with the so-called ‘one-man companies’ and corporate groups.

A. “One-man companies”

The unanimous decision of the House of Lords in upholding the appellant’s arguments in the Salomon case established that once all the formalities were observed, relatively small in size and capital, the so-called “one man companies” are permitted by law to incorporate as limited liability entities. The court reasoned that by refusing incorporation to such businesses, the judiciary would have departed from the intentions of Parliament, and it is for the Parliament to legislate. Lord Macnaghten stated:

If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading; if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of creditors.

The major problem with this judgment is the issue of moral hazard inviting corporate irresponsibility to the detriment of corporate creditors, as in small closely held companies the owner manages the company. The owner can therefore limit his or her liability to the money he has invested and effectively secure his position by subscribers for debentures. This would make him a secured creditor taking priority over unsecured creditors in insolvency. Halpern et al. argue that unlimited liability is the most efficient regime for small companies, because members would be able to negotiate around limited liability provisions in their contracts with creditors. Only then, so their argument goes, would creditors possess a complete picture of the allocation of risks. Lord Hershall however pointed out that: “The creditor has notice that he is dealing with a company liability of the members of which is limited, and the register of shareholders informs him how the shares are held, and that are in the hands of one person, if that be that fact.” The underlying idea is that a creditor knows in whom he invests and therefore may organise his or her commercial affairs accordingly, being fully compensated for all the risks he or she undertakes in the course of investment. Today, common law and statutory checks create sufficient protection against the

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18 The Marxian school of thought highlights that limited liability was created to advance mercenary interests of the investor class, which tries to popularise the use of the Anglo-American shareholder-value model around the world to further its interests. Limited liability thus appears to be a political construct designed to assist the class in realising its objectives.
20 Contrast the judgment with reasoning of Lindley L.J. in Broderip v. Salomon [1895] 2 Ch. 323.
22 See note 11 above at pp. 474-475.
23 P. Davies, Gover and Davies’ Principles of Modern Company Law, 8th ed. (London 2008), at p. 35.
25 See Salomon v. Salomon (per Lord Hershall), at p. 45.
26 It should be noted that in the context of small companies creditors before entering into transactions with a company usually ask for personal guarantees or security, which is usually a matrimonial house. Business failure of the company could potentially lead to litigation with the spouse arguing that she/he was misled, unduly influenced, defrauded, improperly advised in signing the necessary documentation.
problem of moral hazard, disallowing a company director to act opportunistically to the detriment of corporate creditors.\textsuperscript{27}

\textbf{B. Company Groups}

Much more complicated issues arise in relation to liability of corporate groups. The present law does not draw the demarcation line between human and corporate shareholders. Each and every company in a group is a separate and distinct entity with its own assets and liabilities and its directors owe fiduciary duties to promote the success of the particular company on the board of which they serve.\textsuperscript{28} Similarly, if there is a risk of liquidation, directors owe duties to the creditors of the particular company in the group, rather than the group as a whole. In corporate groups a subsidiary company could deliberately engage in risky activities, so that if it subsequently goes bust, other members of the group would have no obligation whatsoever to put their hands in their pockets to meet claims of the insolvent company’s creditors. Companies in a group may enter into contractual arrangements with each other.\textsuperscript{29} Unlike some jurisdictions where the courts are able to compound resources of various companies constituting a corporate group,\textsuperscript{30} English company law does not provide for a deviation from the principle that each company in a company group is a separate and distinct entity.

\textit{1. Contractual limited liability}

The crucial question is whether the current liability regime is adequate in allowing a parent company in a company group to escape liability for the debts of its insolvent subsidiary. On the one hand, a parent controls its subsidiary, or is in the best position to do so. It could therefore be argued that the relationship between the companies in a company group is an integrated one where they constitute, in combination, a single economic enterprise.\textsuperscript{31} Furthermore, not all economic efficiency justifications could be applied to corporate groups.\textsuperscript{32} Companies may theoretically have different interests, but in practice it is possible to discern a single group interest. Breaches of duty cannot be objected to by creditors of a subsidiary company if ratified by its parent or other companies that invested equity into the subsidiary company, whose directors acted for the benefit of the group as a whole to the detriment of the subsidiary company creditors.\textsuperscript{33} The veil that separates the companies amounts to a double insulation of limited liability.\textsuperscript{34} Each corporate tier represents an additional layer of infusion by limitation. Since this outcome was not envisaged at the time the doctrine was first articulated, it has been extensively argued that corporate groups should not enjoy the privilege of limited liability. Removing the veil between a parent and its subsidiary will not completely remove limited liability, for the shareholders of the parent company will still be protected against the claims of company creditors.\textsuperscript{35}

On the other hand, as was noted by some legal commentators, keeping limited liability in cor-

\begin{itemize}
\item \textsuperscript{27} See \textit{West Mercia Saferywater Ltd. v. Dodd} \textsuperscript{[1988]} B.C.L.C. 250, the Insolvency Act 1986 and Company Directors Disqualification Act 1986.
\item \textsuperscript{28} E. Ferran, \textit{Principles of Corporate Finance Law} (Oxford 2008), at pp. 31-32.
\item \textsuperscript{29} See \textit{Re Polly Peck International plc} \textsuperscript{[1996]} 2 All ER 433.
\item \textsuperscript{30} See for example section 271 of the New Zealand Companies Act 1993.
\item \textsuperscript{31} The most powerful judicial proclamation of the single economic unit doctrine was made by Lord Denning MR in \textit{DHN Food Distributors Ltd v. Tower Hamlets London Borough Council} \textsuperscript{[1976]} 1 W.L.R. 852.
\item \textsuperscript{32} See note 28 above at p. 34.
\item \textsuperscript{33} \textit{Ibid}.
\item \textsuperscript{34} P. Muchlinksi, \textit{Multinational Enterprises & the Law}, 2nd ed. (Oxford 2007), at pp. 309-313.
\item \textsuperscript{35} See note 28 above at p. 34.
\end{itemize}
porate groups enhances managerial risk-taking, which is key to facilitating the business growth. The success of a company also depends on attracting investors. Should the veil separating companies in a corporate group be removed, company creditors will have to investigate financial positions of each and every company in the group. With limited liability in place, company creditors understand that each entity is responsible for its own assets and liabilities and strike the bargain accordingly. It is also contended that there is a legitimate interest of shareholders to risk a small fraction of assets in a particular business sector. The company “may have even incorporated for the purpose of escaping liability.”

In general, the judiciary is very reluctant to pierce the corporate veil in company groups holding a parent and its subsidiary as a single entity. Nevertheless, there are other methods to make a parent company liable for the debts of its insolvent subsidiary. Firstly, it could be argued that a subsidiary was a mere agent of its parent. Secondly, the creditors could obtain contractual guarantees from a parent promising to pay any debts unpaid by its subsidiary. Thirdly, the statutory developments in the 1980s have allowed company creditors to sue directors in breach of sections 213 and 214 of the Insolvency Act 1986. A parent company could itself be found by the court to be in breach of these sections if the court is satisfied that it acted as a de facto or shadow director. Fourthly, sections 238 and 239 of the 1986 Act disallows any transactions at undervalue.

The present regime is defective, and both the English judiciary and the Cork Committee have acknowledged this fact. Having reviewed the law, the committee produced a report setting out recommendations to modernise insolvency law in the UK. In it, the committee pointed out difficulties with adopting the enterprise liability approach and refused to make any particular recommendations in that respect. In contrast, the Company Law Review Steering Group concluded that the new law would be less flexible and difficult to implement in practice and therefore, suggested keeping the current regime.

36 Ibid.
37 See note 11 above at p. 423.
39 In Berkey v. Third Avenue Railway Company 244 N.Y. 602 (1927) Cardozo J. stated that “The logical consistency of a juridical conception will indeed be sacrificed at times when the sacrifice is essential to the end that some accepted public policy may be defended or upheld”. In Littlewoods Mail Order Stores v. Inland Revenue Commission [1969] 1 W.L.R. 1214 Lord Denning MR stated that judges are prepared to “pierce the corporate veil” when equity and consciousness so dictate. In the light of subsequent jurisprudence, his analysis shall be treated with caution.
40 The problem with this approach is in the absence of the presumption of agency.
41 The guarantee would depend on the solvency of the guarantor and there is a possibility that it could be tainted with a breach of duty. See also Kleinwort Benson Ltd. v. Malaysia Mining Corp. [1989] 1 W.L.R. 379. Another issue with guarantees within the corporate group is that upstream guarantees i.e. a subsidiary company guaranteeing to pay debts of its parent company are deemed to be unacceptable.
43 It is agreed that in practice, it is extremely difficult to prove de facto or shadow directorship of the parent company, especially when the relationship between the companies is so structured to minimise the risk of being caught by the sections.
44 These sections aim at preventing any movements of assets within corporate group that are not based on healthy commerce.
46 Insolvency Law and Practice (Cmd 8558, 1982), Ch. 51.
47 Company Law Review Steering Group, “Modern Company Law For a Competitive Economy: Completing the Structure”, URN 00/1335. It shall be noted that the final report of the Group did not cover company groups.
2. Tortious limited liability

There is no doubt that not all creditors are able to negotiate around limited liability. In fact, it is virtually impossible for involuntary creditors, such as victims of torts, to sue company members of an insolvent company.\footnote{48 Some authors argue that certain contractual creditors such as junior employees and certain unsecured creditors have no real opportunity to bargain. This class is sometimes termed as “quasi-involuntary creditors”. See for example D. Prentice, “Some Comments on the Law Relating to Corporate Groups” in J. McCahery, S. Piccoitto and C. Scott, Corporate Control and Accountability (Oxford 1993), p. 371.} In the context of corporate groups, a parent company may be held jointly liable for the torts of its subsidiary if the claimant can establish his or her case on the ordinary principles of the law of tort, and solely liable if a parent company has deceived another party to transact with its subsidiary by disseminating false information, or was a de facto controller of its subsidiary owing a duty of care to persons affected by its controlling actions or omissions.\footnote{49 Lubbe v. Cape plc. [2000] 4 All. E.R. 268, HL.} Even if the subsidiary is a wholly owned subsidiary controlled by its parent, the courts are reluctant to find that the parent controlled its subsidiary to such an extent that it can be said to owe a duty of care to third parties.\footnote{50 Stocznia Gdanska SA v. Latvian Shipping Co Latreerfer Inc. [2002] 2 Lloyd’s Rep. 436, CA.} The principles of vicarious liability are not applicable to establish liability in tort for claims against other companies in the group.\footnote{51 Kuwait Asia Bank EC v. National Mutual Life Nominees Ltd [1991] 1 A.C. 187, PC.} Thus, the current alternatives to lifting the veil are very narrow in scope, reducing the chances to bring a legal claim.

The fundamental reason for disallowing involuntary creditors to sue a parent company lies in the principle that company assets shall not be used to pay any third party because that would adversely affect the position of company creditors. It is not surprising, therefore, that limited liability is abhorred for its harshness vis-à-vis victims of tort who are at the most disadvantageous position when a company is in distress.\footnote{52 See note 11 above at pp. 431-432.} In practice, it is not uncommon that when a company goes bust there is nothing left for unsecured creditors. It is therefore inequitable to use the doctrine of limited liability to deny fair compensation for harm caused to innocent people. As mentioned above, companies may engage in extremely hazardous activities and such subsidiaries are usually incorporated in developing states, further complicating the matter.\footnote{53 P. Muchlinksi, “Holding Multinationals to Account: Recent Developments in English Litigation and the Company Law Review (2002) 23 Company Lawyer 168, at pp. 168-169. The misuse of highly risky technologies in multinational company operations may injure people in the overseas territories, leading to transnational tort class actions. The Bhopal incident that happened in 1984 is just one example of transnational tort litigation where hazardous technology injured millions of innocent people.} To minimise its liability for breaches of tort law generally, a parent company might undercapitalise its high-risk operating companies.\footnote{54 Ibid.}

The Court of Appeal case Adams v. Cape Industries plc,\footnote{55 Adams v. Cape Industries plc. [1990] Ch. 433.} distinguishing the DHN Food Distributors case,\footnote{56 See note 31 above.} which is now confined to its own facts, unequivocally established that the group enterprise approach is not the principle of English company law. The case concerned a class action initiated by victims of tort, who suffered personal injury as a result of exposure to asbestos, against an English company which engaged in mining asbestos in South Africa and marketing it in other jurisdictions. The claimants tried to enforce the US judgment delivered against the English company, but the Court of Appeal did not support the claimants’ position. As Lord Slade explained:

[We] do not accept as a matter of law that the court is entitled to lift the corporate

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52 See note 11 above at pp. 431-432.
53 P. Muchlinksi, “Holding Multinationals to Account: Recent Developments in English Litigation and the Company Law Review (2002) 23 Company Lawyer 168, at pp. 168-169. The misuse of highly risky technologies in multinational company operations may injure people in the overseas territories, leading to transnational tort class actions. The Bhopal incident that happened in 1984 is just one example of transnational tort litigation where hazardous technology injured millions of innocent people.
54 Ibid.
56 See note 31 above.
veil as against a defendant company which is a member of a corporate group merely because the corporate structure has been used to ensure that the legal liability (if any) in respect of future activities of the group … will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law. [Counsel] urged us that the purpose of the operation was in substance that [Cape Industries plc] would have the practical benefit of the group’s asbestos trade in the US, without the risks of tortious liability. This may be so. However, in our judgment [Cape Industries plc] was entitled to organise the group’s affairs in that manner and … to expect that the court would apply the principle of Salomon v Salomon in the ordinary way.  

Since the case was subsequently settled, the fundamental question in the case, namely whether or not a company group is liable as a whole for the wrongdoing of its overseas subsidiaries to claimants in the overseas location, is yet to be answered. Thus, even the most deserving claimants such as victims of tort in the Adams case, 58 who suffered from asbestosis as a consequence of tortious actions (or inactions) of an insolvent subsidiary, may not successfully petition the court to pierce the veil to establish group liability.

The Company Law Review Steering Group concluded that it had not received much opposition for refusing to propose recommendations on reforming the group liability in respect of torts committed by the (overseas) subsidiary company.59 In fact the discussion has shifted from “promoting rescue, rather than sorting out the consequences of financial failure.”60 This shift does not solve the problem, for it merely avoids tackling the core issue. As long as the law is deficient, innocent people are left at the mercy of negotiations and settlements with solvent companies in a company group.

The current position does not address the vicissitudes of corporate activity and has fuelled calls for a radical change of policy, including the abolishment of the doctrine, disregarding the fact that it is “the distinguishing characteristic of corporate form.”61 The protection of tort victims could be achieved both at domestic and international levels if judges felt more comfortable with piercing the corporate veil. Such preparedness could be achieved if the judiciary starts to apply the requirements of the Human Rights Act 1998 to prevent the abuse of the corporate form, which at present shields a parent company from paying for harm caused by its subsidiary.62 Basing on the premise that limited liability is a device designed to lower transaction costs that would have been otherwise incurred by the parties at company formation, limited liability presupposes a bargaining process. It goes against the instrument’s spirit to shield members from claims of involuntary creditors of an insolvent company. Further, there is no mention of extension of limited liability to torts in the Salomon judgment. The present writer is of the view, therefore, that limited should not have been extended to tortious debts. As it has been so extended, there is now a necessity to eliminate the shortfall in company law.

IV. Addressing The Legal Deficiency

Many eminent company law scholars have suggested a number of methods to overcome the

58 See also Sithole and others v. Thor Chemicals Holdings Ltd and another [1999] All. E.R. (D) 102.
59 See note 47 above at paras. 10.58-10.59.
60 See note 28 above at pp. 42-48.
61 See note 7 above at p. 121.
62 See note 53 above at p. 174.
problem.\textsuperscript{63} Scholars supporting the economic efficiency of limited liability agree that it can lead to a situation where tort victims subsidise a company to engage in highly risky activities, and propose that there should be unlimited liability for torts.\textsuperscript{64} This proposal is supported because the shareholder is in the best position to cover the risk, since unlike a tort victim, a shareholder of a large public company is more likely to diversify his or her assets, and thus he or she loses less if his wealth covers the loss occasioned by the tortious action or inaction.\textsuperscript{65} Many scholars also contend that it is morally wrong to recognise the ability of a business organisation to structure itself in such a way so as to remove the possibility of a tort claim against the assets of other companies in the corporate group.\textsuperscript{66} The major downside of this approach is that it will certainly inflict serious damage to the operation of capital markets. Alternatively, tort victims may be given a higher position in the so-called ‘entitlement ladder’ upon insolvency, sharing statutorily dedicated funds with preferential creditors.\textsuperscript{67} The shortfall of this approach is that it can only offer a partial solution to the problem.\textsuperscript{68} Another school of thought argues that instances of corporate irresponsibility might be resolved by enforcing the notion of corporate social responsibility.\textsuperscript{69} The major weakness of this premise is that corporate social responsibility,\textsuperscript{70} even in its strengthened form, would remain voluntary and non-binding.\textsuperscript{71} The vagueness of corporate social responsibility should not, however, stop anyone from sending a positive message to corporations inviting them to conduct their affairs in a socially optimal way.

\textit{A. Imperative Rule}

It is the present writer's view that in the context of company groups the new imperative rule, preventing a parent company from denying liability for tortious debts of its insolvent subsidiary is desirable when the inflicted damage is death or personal injury. Death and personal injury have long been regarded as special harm due to their harsh impact on the victim, his or her relatives, and society in general. Many jurisdictions disallow exclusion and/or limitation of liability for

\textsuperscript{63} Some scholars argue that insurance may provide an adequate solution to the problem. This paper omits the detailed discussion of insurance, as it is not a remedy developed under the tenets of company law, i.e. it does not eliminate the legal deficiency through a company law reform mechanism.


\textsuperscript{66} See note 14 above at p. 154.

\textsuperscript{67} \textit{Ibid.}, at pp. 120-121.

\textsuperscript{68} \textit{Ibid.}, at p. 157.

\textsuperscript{69} P. Ireland, “Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility” (2010) 34 Cambridge Journal of Economics 837, at p. 853. In its present condition the CSR, so this argument goes, is a weak instrument and some may further argue that it is subject to manipulation by shareholders. The company's business should not be just about profitmaking, for companies are granted existence by society through law, and thus legal requirements are a floor for behaviour. Companies shall be concerned with emerging and constantly evolving global norms. Following these aspirational ideas, there have been a number of guidelines adopted at international level to remind transnational corporations of their duty to conduct affairs in a socially responsible way. The OECD Guidelines for Multinational Enterprises 2008 and the UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights adopted in 2003 represent an attempt within international circles to send a message that corporations shall conduct their businesses in a rational way.

\textsuperscript{70} The term 'corporate social responsibility' is defined by the International Chamber of Commerce as "the voluntary commitment by businesses to manage their roles in society in a responsible way". See the ICC web-based guide on corporate responsibility (2004). Available at <http://www.iccwbo.org/corporate-responsibility/id14454/index.html> (last accessed on 30 June 2011).

\textsuperscript{71} A lack of legal force would still fail to meet the society's ethical expectations and contributing to the social good. Being held accountable to society does not mean being accountable for torts of failed subsidiaries. Furthermore, it is difficult to find comparable 'responsible' and 'irresponsible' companies.
negligence resulting in death or personal injury through a contractual term. The law of business organisations should also address the significance of these damages, at least in the context of company group liability. The most deserving victims should be allowed to sue a parent company, even if it contradicts the fundamental principle that the company’s assets shall be solely used to pay the company creditors. Shareholders of a parent company would still be under protection by limited liability no matter whether or not the parent company goes into insolvency after the claim against its assets is made. The imperative rule of law will not inhibit enterprise progress, because the business maxim ‘the riskier the activity, the more profit it generates’ will continue to exist. Investor companies will still be interested in investing in hazardous sectors, but will oversee their subsidiaries with enhanced care and skill. Creditors should be able to absorb the cost of extended monitoring and investigation associated with the parent company’s investments. A transitional period could be arranged for the existing creditors to accommodate the changes. However, although of less complexity, issues will remain concerning the allocation and apportioning of liability, as well as its extent.

The rule is not too expansive, yet it provides the most deserving claimant with a legal ground to initiate proceedings against a parent company in a corporate group. Avoiding insolvency and fostering corporate social responsibility within a corporate group are effective methods, but they do not address the core deficiency in the law of business organisations. The new approach will attempt to correct the occasioned injustice that victims of tort encounter. Limited liability, the doctrine that is constructed on the tenets of economic analysis, cannot be abused to insulate a company shareholder from tortious liability. It is unacceptable for the law to leave an innocent person without compensation, and justifying this outcome by the benefit that limited liability brings to the community at large. In corporate groups at least, death and personal injury should be regarded as actionable losses that would equip the victim of tort with a legal ground in bringing a case against other companies in a company group.

V. Conclusion

Today’s commercial reality is that a parent company that is genuinely concerned about its reputation and the group’s goodwill would do its best to prevent insolvency of its subsidiary or, at a minimum, pay the debts incurred by the failed company. There is no doubt that limited liability is the most economically efficient way of organising a business for the benefit of all the constituencies who have an interest in the company’s expansion. It reduces many costs, enhances managerial risk-taking, facilitates transferability of shares, enforces the separate corporate personality and has potential to save a business from unfortunate failure. Once the liability of shareholders is limited however, they might be more inclined to put pressure on managers to behave opportunistically by engaging in riskier activities to generate greater profits for the company, which will in turn maximise their wealth. If the owner is also the director, as is usually the case in small companies, he does not have any corporate checks and balances to prevent him from realising his desires. The developments in insolvency law and directors’ disqualification rules in the 1980s filled in regulatory gaps in the system, and ‘one-man companies’ no longer represent a significant problem. Much more complicated is the problem concerning corporate groups where each company enjoys separate corporate personality and limited liability is insulated at each corporate tier. The law does not allow for a single enterprise approach even when justice so demands. The rule is particularly harsh in relation to involuntary creditors such as victims of tort. The recent shift in the discussion concerning limited liability seems to detract from the core problem – inadequate redress by the law of business organisations of the position that tort victims find themselves in upon company

72 See for example section 2(1) of the Unfair Contract Terms Act 1977.
insolvency. In fact, if limited liability presupposes bargaining, the doctrine should not have been extended so as to cover tortious debts. Therefore, it seems logical and fair to limit the scope of the doctrine at least in the context of company groups, where the law should allow the victims who suffered death or personal injury from the hands of an insolvent subsidiary to sue the parent company. This approach would not eliminate all problems associated with removing the veil, but it would grant adequate compensation to the most deserving claimants.