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EDITOR: HELEN ANDERSON

# DIRECTORS' PERSONAL LIABILITY FOR CORPORATE FAULT

A COMPARATIVE ANALYSIS



Wolters Kluwer

Law & Business

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# **Directors' Personal Liability for Corporate Fault**

**A Comparative Analysis**

**Helen Anderson**

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**Wolters Kluwer**

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## Chapter 1

# Looking for Responsibility in the Corporate World *or* The Corporation's Multiple Personality Disorder

*Harry Glasbeek\**

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## 1 The Corporation as a Political Problem – The Market

### 1.1 CORPORATIONS: WE NEED THEM; WE DISTRUST THEM

The centrality of corporations to market capitalism cannot be overestimated. They are everywhere. They are our preferred vehicles with which to generate and accumulate wealth. They talk with us, or better at us, all the time. They support think-tanks, political causes, parties and politicians. They fund football, boxing, athletics, cricket and tennis; they aid the arts, theatre, ballet and the opera; they underwrite recreational and community projects; they contribute to schools, universities and hospitals. They employ us; they sack us; they kill and maim us; they ravage and pollute our physical and cultural environments; they distort our political systems.

The tensions are palpable. The ends attained by means of the corporate vehicle are supposed to offset the means used by the corporate vehicle. Our societies are to view evils visited upon them by corporations as 'the inescapable price of civilized life and, hence, to be borne with resignation'.<sup>1</sup> But of course, the willingness to tolerate evils imposed by corporations depends on the level of satisfaction with the amount and kind of happiness yielded by their activities. This level of satisfaction

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1 Brandeis J in *Louis K. Liggett v. Lee* 288 US 517 (1933).



varies from person to person, from area to area, from time to time and from class to class. This is why the legitimacy of the modern corporation has been contentious since its advent.

The struggle for legitimacy arising out of this ceaseless *ends and means* debate is fuelled by the contradictory signals sent by the legal architecture of the corporation. Law holds out that in designing the corporation, it is merely facilitating market activities, the economic programme that is to be pursued in a liberal democracy. The essential features of a liberal market democracy are, therefore, not to be negated by liberal law's facilitating device: the corporation. This makes it logical to expect corporate behaviour to be compatible with the legally embedded values and standards of a liberal market democracy. At the centre of these values and standards is the autonomy of the individual. Free will and un-coerced choice are the lynchpins of a liberal polity and of a market economy.

## 1.2 FUNCTION

A corporation is the very opposite of the atomized self-seeking individual posited by Adam Smith as the fulcrum of his idealized economy. Corporations are associations – collectives bringing assets and people together under one legal umbrella. The synergy of capital and coordinated human activities is what makes them so efficient as organizations geared to the generation of wealth. Ireland has noted that it was the perceived need to facilitate the operations of *large* unincorporated joint stock companies that inspired modern English registration statutes. Initially, only unincorporated joint stock companies comprised of at least 25 members could take advantage of incorporation by registration.<sup>2</sup> It is the large scale pooling and coordination of people and resources that produce more wealth than could be generated by the discrete actions of the individuals and their property that form the corporate pool. To ward off the contention that a corporation is a collective, some of its supporters say that a corporation is just an individual, albeit a fictional one, or a useful device through which a bunch of individuals who have freely contracted with each other to exercise their individual free will and economic choice can attain their individual aims. Regardless of the legal plausibility of the arguments that apparent collectivization does not negate the underlying individualism, the public perception is that the way in which corporations operate and impact are attributes of collectivized actions. This popular perception presents serious legitimacy problems for a *market economy* and for a *liberal polity*. Continuous massaging and

2 P. Ireland, 'The Triumph of the Company Legal Form 1856–1914', in *Essays for Clive Schmitthoff*, J. Adams (ed.) (Abingdon, England, Professional Books, 1983), where the background to the English registration legislation is discussed and the assault on the requirement of a large number of incorporators is documented; see also L.S. Sealy's account of how the original numerical requirement was gradually reduced: 'Perception and Policy in Company Law Reform', in *Corporate and Commercial Law: Modern Developments*, Feldman and Meisel (eds) (London, Lloyds, 1996).

manipulation are required to avert the claim that the corporate vehicle is a threat to our proclaimed value system. We have quickly come to one of the tipping points in the ends *versus* means debate.

An idealized market scheme is opposed to collectives because of their capacity to coerce, that is, to distort the operation of the free market. That potential to coerce, to interfere with the free market model, increases with the size of the collectives. Some corporations are gargantuan and size matters.<sup>3</sup> The paradox, spawned by the acknowledged utility of granting large firms the privileges of incorporation and the accompanying anxiety that the existence of large collections of private property will lead to market imperfections, has been recognized for a long time. As Brandeis noted in the above cited judgment, incorporation was initially granted only for religious, educational and charitable purposes. Its potential to generate wealth was well understood, yet there was a reluctance to use it in industrial and commercial settings. This hesitancy was due to:

Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjugation of labor to capital. Fear of monopoly. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils similar to those which attended mortmain. There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations.<sup>4</sup>

These endemic fears are offset by the obvious economic utility of these firms and, politically, by the belief that it is all too late to change, given the economic dominance (and, therefore, political and cultural influence) of large corporations. In addition, there are many policy-makers and scholars who want to ensure that the

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3 Numbers are not needed to document this trite observation. A couple should do the trick. In 1999, the combined annual revenues of the world's largest six corporations were larger than the combined annual budgets of 64 nations which boasted over half the world's population: see *Multinational Monitor* June [1999]. Different corporations come to occupy these dominant positions, but the size of the giant corporations increases all the time. S. Blankenburg and D. Plesch, 'Corporate rights and responsibilities: restoring legal accountability' <[www.opendemocracy.net/globalization-institutions\\_government/corporate\\_responsibilities\\_4605.jsp](http://www.opendemocracy.net/globalization-institutions_government/corporate_responsibilities_4605.jsp)>, 10 May, 2007, report that 'Today, fifty-one of the world's largest economies are corporations, and 80 per cent of world industrial output is produced by only 1000 corporations.'

4 Above n. 1; see also A. Lincoln as cited in *Yes!*, Fall (2007) Issue 43, 1: 'I see in the near future a crisis approaching that unnerves me and causes me to tremble for the safety of my country...corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavour to prolong its reign by working upon the prejudices of the people until all the wealth is aggregated in a few hands and the Republic is destroyed'. Lincoln's sentiments were echoed by other US notables, none of whom were anti-market, anti-liberal democratic thinkers, folk like Maddison, Jefferson, Presidents Cleveland and Van Buren: see C. Chen and J. Hansen 'The Illusion of Law: The Legitimizing Schemes of Modern Policy and Corporate Law' (2004) 103 Mich LR, 1 135 *et seq.*

legitimacy of the goose that is capable of laying golden eggs is not questioned too seriously.

The resultant literature is sophisticated and well-known. It has many adherents and many trenchant critics. It need not detain us.<sup>5</sup> As already mentioned, a great deal of scholarly effort has gone into contending that the legal device of the corporate person is merely a convenient way for freely contracting investors to come together in their pursuit of wealth. If this is true, it becomes a calumny to characterize the corporation (large or small) as an inherently distorting institution in a market economy. However, refined as these arguments are, they do not overcome the intuitive and widely shared feeling that, *functionally*, the corporation, especially the larger corporation, is a poor fit with our preferred economic and political ideals.

Even those who believe that a corporation is just a nexus of freely entered-into individual contracts (dovetailing with the needs of the market model) have to confront the fact that, while large corporations may have some competitive market pressures on them, these may amount to no more than the waging of advertising wars fought over market share – for example, the market battles between Costco and Wal-Mart. In the meantime, their size may be such (as is true in the case of Wal-Mart and Costco) that they are likely to oppress the legions of small suppliers who must compete fiercely for their right to supply them – an absolute necessity to their survival. In the process, those who work for these suppliers are treated miserably. Cascading coercion is a frequent by-product of large incorporated firms' economic power. No matter how this kind of outcome is defended by pro-marketeers and corporate cheerleaders, there is no doubt about the ambivalence it imbues in the populace. We like the cheap goods and services produced by the pooling of people and resources in the Wal-Marts and Costcos of this world; we do not like either the exploitation in which these Wal-Marts and Costcos engage, or the coercive behaviour that they induce in far away others.<sup>6</sup> A positive outcome of this is that regardless

5 I have offered my take on this impressive literature elsewhere, e.g., in *Wealth by Stealth: Corporate Crime, Corporate Law and the Perversion of Democracy* (Toronto, Between the Lines, 2002); in 'Preliminary Observations on Strains of, and Strains in, Corporate Law Scholarship' in *Corporate Crime: Contemporary Debates*, F. Pearce and L. Snider (eds) (Toronto, Uni. of Toronto Press, 1995), 111. A partial list of the corporation as a bundle of contract theorists includes R. Posner, *Economic Analysis of Law* (6th edn, New York, Aspen Publishers, 2003); R. Posner and K. Scott (eds), *Economics of Corporate Law and Securities Regulation* (Boston, Little Brown, 1980); H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal*, 439; R. Clark, *Corporate Law* (Boston, Little Brown, 1986); F. Easterbrook and D. Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass., Harv. Uni. Press, 1991); L. Bebchuk (ed.), *Corporate Law and Economic Analysis* (Cambridge, UK, Camb. Uni. Press, 1990); B. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford, Clarendon Press, 1992).

6 From the *Financial Times* 19 October, 2007, 12: 'Cheering for Wal-Mart to boost its sales seems not unlike rooting for Bill Gates to win the lottery. But count US Federal Reserve chairman Ben Bernanke among those who should be wishing Wal-Mart all the best this holiday season. The top retailer is slashing prices on another 15,000 items to lure shoppers into its stores, after announcing sweeping price cuts on toys last month. Wal-Mart's latest

of the technical and logical theorizing that tries to negate the populist assertions that corporations are misfits in a market economy and liberal polity because they function as collectives, the suggestion that the gathering together of people and assets for private purposes, that is, of the formation of a corporation, is something of a threat to all that we have been taught to hold dear never recedes far from popular consciousness. The means do not always easily justify the ends. The manifestations of this built-in tension are brought out in a variety of ways and circumstances.

Investors are given incentives to foster the formation of corporations. Some of the risks of investment are removed to inveigle property owners to agree to submit their personal property for deployment by the corporation. Policy-makers believe that these privileges are warranted because there will be more wealth generated as a consequence of the synergies and efficiencies that inhere in coordinated, combined uses of people and resources. The understanding is that the accumulation of wealth so engendered will benefit the economy as a whole. The distribution of that wealth is seen to be a distinct problem – to be left to the external market and/or the political sphere, a sphere unoccupied by the corporation. The corporation is merely an economic instrument. Its job is done once it generates wealth.

All too often the spoils of corporate activity go to the few, not the many.<sup>7</sup> It will rarely be obvious that those who benefit the most deserve the most. This will lead to anxieties if it turns out that corporations use their bestowed economic clout

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move, part of its relentless campaign to sell products more cheaply than its competitors, *will tighten the noose on some suppliers and rivals*. But it may also help keep consumer prices in check, amid fears that the Fed's decision to cut its target rate by half a percentage point last month could spark higher inflation. Wal-Mart's expansion across the US dumped overall consumer prices by three per cent between 1985 and last year, or by an average of 0.15 per cent a year, according to a study in which the retailer opened its books to economic consulting firm Global Insight. The same study estimates Wal-Mart's laser focus on costs yield USD 957 in savings per capita last year. These rock bottom prices come at a significant cost to some. Wal-Mart's suppliers, facing their own inflationary pressures in the form of higher materials and shipping costs, are still pressed to absorb many of its price cuts. *The company has also been criticized sharply – and sued – over low worker pay and benefits. But even those who do not shop at Wal-Mart benefit from the effects of its notorious frugality, which forces suppliers to become more efficient and provokes competitive price cuts by other retailers. Five cents of every dollar spent at US retailers is spent at Wal-Mart.* The dollar's purchasing power may be depleted by other factors but the Fed can count on Wal-Mart to guard its cents closely.' (Emphases added); see also C. Fishman, 'The Wal-Mart You Don't Know' *Fast Company*, Issue 77, 2003, 68; D. Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Washington, DC, Brookings Institution, 2005), 90–96; Vogel records that Wal-Mart has as many as 100,000 suppliers and, while Wal-Mart is an exceptional giant, its ability to coerce is not unique; for instance, Disney has 30,000 suppliers vying for its business.

7 A recent report, on file with author, calculates that US families with incomes of USD 10 million or more, constituting 0.01 per cent of the population saw their income go up by USD 18,000 per year for every additional dollar earned by the bottom 90 per cent of the population.

to hinder governments that have held out that what is good for General Motors is good for all. There may be an expectation that the privileging of private corporate activity will lead to what is perceived to be a fair distribution of the spoils. Granted, fairness is a vague concept and there is a telling argument to the effect that only a properly working market economy can determine what a fair outcome is. This issue is beyond the scope of this introductory chapter (and my competence). It suffices to note that there is a great deal in our history that teaches the public that equity in material distribution, associated self-esteem and respectful treatment, should be central aims of any decent society. This vague set of ideas has a powerful hold on our unconscious. This is why the recurrent phenomena of reduced incomes and security of job tenure (so often coinciding with corporate sector prosperity) leads to continuous and troubling questioning of the currently preferred system of welfare creation.<sup>8</sup> It is equally obvious that there will be discontent if it becomes apparent that the corporate sector uses its economic clout to make it hard for the political system's functionaries to pursue policies that reflect the wishes of the majority of citizens of the non-corporate members of the polity.<sup>9</sup>

The economic clout used in these socially and politically controversial ways comes from the fact that the corporate form militates toward the concentration of wealth and resources to an unprecedented degree. This makes threats of disinvestment or non-investment far more menacing than if they are issued by discrete individuals. Moreover, it hides the human beneficiaries of the political manipulations engineered by the corporations' economic threats – they do not have to emerge and be exposed to the glare of political scrutiny.<sup>10</sup> Corporate bureaucrats and employees present the corporate view that concessions should be made to their corporations' activities.

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8 Clergy, philosophers and political economists have engaged in debates around the way in which ownership of assets affect desirable outcomes for eons; see T. More, *Utopia* (Cambridge, England, Camb. Uni. Press, 1989); G. Winstanley, *The Law of Freedom*, C. Hill (ed.), (Cambridge, England, Camb. Uni. Press, 1983); C.B. McPherson, *The Life and Times of Liberal Democracy* (Oxford, OUP, 1977), who discusses more ancient texts, as well as the contributions of the Levellers, Rousseau, Jefferson, the Knights of Labor, and so on. The point here is not to define fairness, but to aver that it is a far more contentious concept than those who believe that all it takes to attain fairness is to permit the invisible hand of the market to yield its *natural* outcomes. This is why apparent unfairness associated with the corporation is a factor in the tribulations encountered by the corporation as an institution. For a contemporary illustration, note the righteous public indignation when news is disseminated that there have been large corporate profits or excess executive remuneration at the same time as people have lost jobs.

9 Tax cuts that favour the rich or corporate sectors and their well-placed members and functionaries are a visible sign of measures taken regardless of the majority's wishes. A feeling that the electoral system does not offset the political power of the economic mighty may be resignedly accepted as part and parcel of a reliance on corporate economic welfare-creation while, simultaneously, it may well fuel the sense of unfairness that always threatens to erode the corporation's acceptability to the polity.

10 This is an example of risk-abandonment by otherwise responsible individuals to be discussed more generally below.

They tell the politicians that the favours they seek are not luxuries, but market driven necessities if governments want the corporate sector to deliver the economic welfare that governments promise their publics. The manipulation is given a technocratic cast, rather than appearing as a self-serving claim made on behalf of a few (largely unseen and unheard) rich people. This manipulative, but reasonable sounding, politicking is aided by corporate funding of a variety of objective-looking think-tanks, and by packaging political funding by corporations in such a way that they veil the sources of the monies and the intended beneficiaries of the lobbied-for outcomes.

From easier access to governments to undue influence, the corporate form as such plays a distorting role in liberal democratic politics.<sup>11</sup> Every now and again this is realized and there is an outburst of anger and demands for more transparency by donors and donees, for better monitoring and controlling of political financing and for more public funding of other sources of influence. Most of the time, the unevenness arising from disparate economic power that can be translated into political power is borne with resignation, occasionally engendering distaste.

So far the story told is that the facility created by law to accumulate huge pools of wealth by means of the corporate vehicle provides fertile ground for corporate nay-sayers, even if there are plausible arguments to the effect that, in principle, the corporate form is a mere technical device that does not threaten the value systems that under-gird our individualistic market economic and liberal democratic political spheres. The everyday experiences of citizens are that the large incorporated firm, (because it does generate so much wealth) sets the tone for their perception of the corporate world. It is the obverse of the butchers, bakers and brewers, whose single-minded quest to pursue their own goals as they see fit in competition with others, is likely to lead to the optimum use of all our resources and talents precisely because none of them can dictate prices to any others; none of them can force others to sell or purchase.<sup>12</sup>

The truth is that many, perhaps most corporations, in terms of size and power – although they too are collections of assets and people – do approximate the

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11 R. Reich, *Supercapitalism: The Transformation of Business, Democracy and Everyday Life* (New York, Knopf, 2007); K. Ewing, *Money, Politics and Law: A Study of Electoral Campaign Finance Reform in Canada* (Oxford, Clarendon Press, 1992); H.J. Glasbeek, *Wealth by Stealth*, above n. 5; K.Z. Paltiel, 'Public Financing Abroad: Contrasts and Effects', in *Money and Politics in the United States: Financing Elections in the 1980s*, M. Malbin (ed.) (Chatham, NJ, Chatham House, 1984); L. Snider, *Bad Business: Corporate Crime in Canada* (Scarborough, Ont., Nelson, 1993). Attempts at reform are never out of the news, speaking to the pervasive corporate influence on politics. C. Herbert, *Toronto Star*, 7 September, 2001, noted at A25: 'For all their ongoing talk about having the freedom to reinvent themselves, the fact is that rarely have so many parties been so beholden for survival to the generous hands that feed them.'

12 The famous maxim that summed-up Adam Smith's thesis, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Oxford, Clarendon Press, 1976), 84.

idealized market actors, do resemble the butcher, the baker and the brewer who cannot coerce anyone else. It is unsurprising, therefore, that a great deal of effort is expended on celebrating the worth of small business, incorporated or not.<sup>13</sup> In general, these proclamations boost the ideological underpinnings of a liberal market capital political economy. In the corporate setting, there is an implicit justification of the corporate form writ large because the corporate form, being the same for small and big business, is cleansed by its small business emanations. In the small business setting, incorporation does not bestow the power to distort either the market or the political model. The corporate vehicle becomes no more threatening to our value system than human actors are. This suits the political needs of the large corporation. However, another difficulty for the legitimacy of the corporate vehicle pushes itself forward: the laundering offered by small business incorporation is soiled by small business practices.

The grant of the privileges that go with the incorporation of a business is justified by the fact that, because of the synergies created by collectivizing and coordinating assets and people, they will be more productively deployed than would otherwise be the case. In addition, once assets and skills are brought under one umbrella, the resulting firms should be able to reduce transaction costs. But, the smaller the incorporated firm, the less realizable these advantages are. When a small partnership incorporates – let alone when a sole entrepreneur does so – it does not lead to a gathering of small capitals that would never have been aggregated; it will create little opportunity to reduce transaction costs. Why then permit incorporation? Why then do small firms incorporate?

Small business firms or sole entrepreneurs do so because of the privileges granted to incorporators, namely, limited liability and personal immunity. Whatever else the corporation is, it is a risk-shifting device.<sup>14</sup> Investors are not personally responsible

13 Again, there is no need to document this well-established attachment to individual entrepreneurs who pursue their own interests as they see fit. It is the ideology and logic of Adam Smith, the established perspective of the American original federalists, explaining the views of Lincoln *et al.*, referred-to above, and the mantra of the Friedmans and Hayeks of our contemporary world, a mantra often echoed by politicians on our stumps. The notion that, if business grew too powerful, especially if it was incorporated, it would undermine the freedom associated with non-coercive individual entrepreneurialism, has been a pervasive one ever since liberal capitalism emerged from its feudal and authoritarian past; see O. Gierke, *Community in Historical Perspective: A Translation of Selections from Das Deutsche Genossenschaftsrecht*, M. Fischer, transl., A. Black (ed) (Cambridge, England, Camb. Uni.Press, 1990) (expressing the fear that if firms became too large, some would rule and others be ruled, perhaps to the extent that they would become wage labourers, rather than enterprises, losing all claims to liberty – anticipating the fear inspired by Wal-Mart).

14 The fact that the *London Times* referred to limited liability provisions as a Rogues' Charter is cited often, either to indicate that limited liability was not *natural* or as a vignette about the quaintness of an idea that no longer has any salience. There is a tendency to marginalize the significance this vehement expression of the then-prevailing view attached to the worthiness of personal responsibility. See also T. Orhnial (ed.), *Limited Liability and the Corporation* (London, Croom Helm, 1982), which quotes J.K. McCollish as saying in 1859 that '[w]ere

for the conduct of the corporation, unless they make themselves responsible for it. This ability to avoid the costs of risks that materialize as a result of the corporation's chase for profits, at the same time as the investors' entitlement to any profits earned are not impaired, is a departure from the market model, from the obligations that go with being the un-coercing, freely-acting and choosing, butcher, baker and brewer.

It is a major departure. So much so, that many of those who perceive the corporate form as a legitimate means to pursue wealth-creation in a market economy argue that some of the risk-avoiding privileges should not be available when obligations to tort victims or to involuntary creditors are the issue or at least, not as readily available to those corporations most likely to be undercapitalized – often small businesses.<sup>15</sup> The fear is that the legitimacy of all corporations may be imperilled by the ease with which basic liberal and market principles can be undermined by incorporation.<sup>16</sup>

One partial way out would be not to allow small businesses to incorporate, given that incorporation does not make them more efficient wealth-generators. This does not happen because it is devilishly difficult to determine when it is appropriate to deny incorporation privileges on a costs-benefits basis without any real calibrating machinery. Line-drawing invites the kind of artifice that led Aron Salomon to

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Parliament to set about devising means for the encouragement of speculation, over-trading and swindling, what better could it do?' C. Cooke, *Corporation, Trust and Company: an Essay in Legal History* (Manchester, Manchester UP, 1950) noted that the grant of limited liability caused the Manchester Chamber of Commerce to declare that this 'was subversive of that high moral responsibility which has hitherto distinguished our Partnership Laws', 156.

- 15 P. Halpern, M. Trebilcock and S. Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 UTLJ, 117; H. Hansmann and R. Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale LJ, 1878; See J. Ziegel, 'Is Incorporation (with Limited Liability) Too Easily Available?' (1991) 31 *Cahiers de droit*, 1075.
- 16 For an empirical study that claims that there is widespread and conscious use of separate legal personality to avoid personal liability by both small and large enterprises, see A. Ringleb and S. Wiggins, 'Liability and Large Scale, Long-Term Hazards' (1990) 98 *Jrnl Pol Eco*, 574; a recent report by the Stand for Truth about Radiation (Star Foundation), *Riverkeepers*, August, 2002, records that large nuclear facility corporations have separated ownership and operation functions into different corporate entities within the enterprises, both to minimize the incidence of taxation imposts and to enable themselves to leave the corporate firm responsible for a cost-incurring failure with little funds, leaving the profitable part of the enterprise untouched; as cited in S. Blankenberg and D. Plesch, n. 3 above. This is a common ploy; see the Hardie saga referred to below; see V. Tong, 'Philip Morris unit to be spun off', *Toronto Star*, 30 Aug. 2007, reporting on a proposed spin-off of the corporation's international unit from the US parent: 'The spin-off would clear the international tobacco business from the legal and regulatory restraints facing Philip Morris USA'; see also M.J. Roe, 'Corporate Strategic Reaction to Mass Tort' (1986) 72 *Va L Rev* 1; see also H. Glasbeek, 'The Legal Pulverization of Social Issues: *Andar Transport Pty Ltd v. Brambles Ltd*' (2005) 13 *Torts LJ*, 217. Corporate cheerleaders do not want these potential and actual (ab) uses of the separate legal person/limited liability to be brought into the light by the non-wealth-generating practices of the small fry.



pretend that six members of his family were members of his firm, something that, initially, the courts found to be a morally repugnant use of legislation merely intended to facilitate real wealth production.<sup>17</sup> All this changed when the matter got to the House of Lords,<sup>18</sup> for reasons that have been accepted by legions of lawyers, but were not then,<sup>19</sup> and are not now, socially or economically convincing. The House of Lords set its face against second-guessing the social or economic value of incorporation; all it demanded was that incorporators follow the rules. Inherent in that stance was an acceptance that there was nothing wrong with self-seeking uses of the law as written, regardless of the wider impact this might have.<sup>20</sup> This has remained the dominant approach, at least in Anglo-American jurisdictions. It has had less than a positive impact on the corporate form's public image and courts are often asked to undo the problem they have created. They have found it difficult, to say the least. When clear abuses of the corporate form have cried out for tearing the corporate veil away from human actors hiding behind it, they have struggled to find a rationale for doing so. Unsurprisingly, it is mostly in the small corporate setting that courts have pierced the corporate veil and, equally unsurprisingly, they have never been able to counter the suspicion that such piercing is capricious.<sup>21</sup> At the end of the day, neither the ineffective prescriptions for taking away the privilege of limited responsibility, nor the occasional piercing of the veil, do much to safeguard

17 In *Broderip v. Salomon* [1895] 2 Ch D 323, the Court of Appeal was scathing about Salomon's machinations: 'Mr Aron Salomon's scheme is a device to defraud creditors' (Lindley LJ at 339): 'To legalize such a transaction would be a scandal' (Lopes LJ at 341); '[The statutes] were not intended to legalize a pretended association for the purpose of enabling an individual to carry on his own business with limited liability in the name of a joint stock company' (Kay LJ at 344).

18 *Salomon v. Salomon & Co.* [1897] AC 22.

19 P. Ireland, n. 2 above.

20 Lord McNaughten, confronted by a judicial statement in an earlier case that the law would be in a lamentable state if it could be used to avoid incurring personal liability, approved another judge's view that it was 'the policy of Companies Act to enable this to be done'. This understanding has worried critics ever since. O. Kahn-Freund, 'Some Reflections on Company Law Reform' (1944) VI MLR, 54 noted (at 57) the abuse of legal personality and limited liability that gave all incorporation a bad name and argued that, at the very least, there should be more technical barriers to registration and a requirement of better capitalization as a way for Parliament, 'to go some way towards restoring to the limited company its original function and to the partnership its proper place in business life'.

21 Wilson J in *Kosmopoulos v. Constitution Insurance Co. of Canada* [1987] 1 SCR 2, noted that, 'The law on when a court may disregard this principle [separate personality]... follows no consistent principle. The best that can be said is that the "separate entities" principle is not enforced when it would yield a result too "flagrantly opposed to justice..."'. See also M.A. Pickering, 'The Company as a Separate Legal Entity' (1968) 31 MLR, 481, for a list of the subterfuges and empty slogans used by courts when piercing the veils of mostly small corporations; in the US, W.A. Klein and J.C. Coffee Jr, *Business Organization and Finance: Legal and Economic Principles* (Foundation Press, Thomson West, 2002), noted that the law on 'piercing the veil...to hold shareholders liable for corporate debts...is exceedingly murky', 142.