Liability*

November 2004

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Limited Liability

Limited liability has been the focus of much attention, from books and articles to legislative efforts in California based on Robert Hinkley's 28-word code. Starting in the early 1900's in this country it was inserted into the charters of corporations by state law. Prior to that time it had indeed existed in other nations for at least a century but the Framers in their inordinate wisdom, had removed it. In fact, there was almost inserted into the Constitution an item that would have disallowed corporations. And as early as Jefferson's late life their spectre was felt.

Limited liability alone suffices to engender externalization of costs and all its requisite harms. Under limited liability human beings can band together as a corporation and perpetrate harm upon other groups of human beings and not be held responsible because the entity we call a corporation bears the brunt of activity against it rather than those who work for or invest in what we call a company.

As a quick aside, and to help us focus here in this long and untended sentence, it is presumed that we are here not to discuss the good effects of corporations as something that needs to be exalted or moved against, but rather we gathered in Boston, and SF now, to determine ways we can reduce their harmful effects. Again, these include the externalizing of and the placement of such harmful costs upon the community in which they work and the society at large.

Corporations know very well that limited liability provides the quickest and best means to greater profits because impeding factors are removed. For example, here in California in the most recent election, Proposition 64 made it more difficult for humans to sue businesses.

"Are you going to incorporate?" is the question asked when the new venture begins to become successful. In that, the corporation becomes an entity separate from the people who worked together before incorporation. Marjorie Kelly differentiates between that veil and the one which protects those who work directly for the corporation, the directors, managers, and the workers.

* This document is part of a series of Issue Briefs to inform discussions within the Corporation 2020 process. It is a work in progress, and its content does not necessarily reflect a consenus view or the views of individual participants. Comments are welcome and may be addressed to: Erica Mintzer at emintzer@tellus.org.

Legally Mandated Profit Motive

The profit motive was first expressed in 1883 by Hutton v. West Cork Ry., 23 Ch.Div. 654, 673 (C.A.1883) as follows: "The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company."

Australian Adam Reynolds thought this was adapted from Shakespeare's 12 Night: "Dost thou think, because thou art virtuous, there shall be no more cakes an ale?" Dodge v. Ford (204 Mich. 459, 170 N.W. 668, 1919) made shareholder primacy the fashionable mode of corporations and has led directly to the quarterly profit maximization of stockholders to the detriment of other interested groups such as customers, the community in which the corporation has its main base, and the public at large. The profit motive has great measure for shareholders, those absentee owners (so named by Dean Rostow in 1959), who benefit from wealth without encumbrance of externalities.

These two legal pillars substantiate all the deleterious after-effects and externalities that we deal with today and which compel this conference. The banding together of these two concepts is not a new idea. Larry Mitchell, in his Corporate Irresponsiblity (Yale, 2001), talks about the same thing. He names limited liability as a device which has allowed corporations to "perfect their function," and "become all the more powerful when you add to the mix the mandate to maximize stock price." Here, he brings together the Twin Pillars.

What if there were no limited liability?

What would a corporation of the future look like without one of these pillars? And then what would our society look like if there were no LL? Hinkley's code is a direct carve into LL.

What about no profit motive?

What if there were no profit motive? How would we carve into Dodge v. Ford similar to how the Hinkley's corporate code carves into limited liability?

The Trusteeship model Terry Mollner has developed skirts these two pillars and moves the form to an entirely different realm.

Another view:

I had a brief email correspondence with Ted Nace about a month ago on these two subjects. Nace started Peachpit Press in the late '80's and sold it for a large profit within the last 5 years or so. He wrote an excellent layperson's historical guide to how corporations gained their power, called Gangs of America. Forthwith are his comments. On limited liability he wrote to me in an email:

> A lot of people seem to misunderstand limited liability. They think it is what protects investors from being responsible for the legal penalties that result from corporate misdeeds. They think that if limited liability were removed, then investors would have an

incentive to more actively hinder corporate misbehavior. Not so. Even if limited liability were gone, corporations would still pay fines out of their internal treasuries. It is only in the case of bankruptcy that limited liability comes to the aid of investors. Of course bankruptcy can be the result of some massive corporate misdeeds -- such as in the case of the asbestos industry. So there is a potential connection. But the practice of just constantly paying fines rather than changing their behavior, characteristic of companies like GE, would not necessarily be changed if limited liability were removed.

If limited liability were removed, then investors would be liable if a corporate went bankrupt. In order to avoid that kind of liability, a secondary insurance industry would probably spring up to sell investors protection against such a contingency. So the losses of bankruptcy would be spread across all the buyers of bankruptcy insurance rather than socialized onto society as a whole. It would be a good thing but I don't see how it would really affect the powers of corporations.

Note that there is one company that explicitly eschews limited liability: Lloyds of London. Investors in Lloyds take on unlimited liability. Of course, they can only be very rich people -- generally aristocrats with massive landholdings.

On the profit motive:

I very much liked Bakan's discussion of Ford v. Dodge and Hutton in The Corporation. It's true that Henry Ford (surprisingly) wanted to use retained earnings for the benefit of workers rather than shareholders, and it's true that this case stopped him. Yes, the case tied the hands of corporate managers - profit maximization can became the ONLY factor that can be considered. I agreed that this is a really bad way to hardwire corporate decisionmakers.

Dodge v. Ford - This case strikes me as rather toothless. After all, every time a corporation gives excessive compensation to a CEO, it is undermining the profits of its shareholders. But when have investors been able to invoke Dodge v. Ford as a reason for revoking an excessive pay package? Let's say Dodge v. Ford did not exist. How would corporations act differently? A maverick owner/founder like a Henry Ford or a Bill Gates or a Ben & Jerry would have more freedom of action. But for most corporations, I don't see that it would change anything.

In my opinion, the biggest villain at the national level is the Federal Election Commission's 1975 SUN-PAC ruling, which allowed corporations to fund the operations and control the actions of PACs. This has really tipped the balance of power in Washington toward corporate interests. At the state level, I think the Bellotti decision is the worst aspect, since it hinders states from controlling corporate money in citizen initiatives and referendum measures.