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THE IMMUNITY FROM PERSONAL LIABILITY PROVIDED TO THE SHAREHOLDERS OF THE LIMITED LIABILITY COMPANY BY THE ROMANIAN LAW

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Abstract *The concept of limited liability represents the cornerstone of the legal institution of the company as a professional operating an enterprise. There is a main consequences of incorporation of the company, namely the company becomes a legal entity separate from their shareholders (members who control it). Also based on the incorporation of the company, it is possible that the shareholders gain immunity from personal liability for the debts of this company. However, when the shareholders abuse the immunity provided by the legal personality of the company, courts will hold them individually liable for the company's debts. Therefore, in the exceptional circumstances, when shareholders commit a fraud in establishing the business or in conducting the business, they are held liable for the damages caused to the third parties.*

Keywords

Legal personality, limited liability, protection of the shareholder, fraud, exceptions

1. Introduction

„The company, with legal personality, limited liability and transferable shares, is one of the most ingenious inventions of humanity. The company is an all-important vehicle for allocating and efficiently employing capital in our societies, providing goods, services, jobs–and revenue. It is a vehicle for economic efficiency" (Sjåfjell, 2004).

Therefore, the company, as the most important legal institution involved in economic environment, represents „the most favoured and common asset protection mechanism which serves to successfully externalise risk arising from business and other transactions" (Hameed, 2012).

But not all the types of the companies meet the above cited characteristics, only those having both legal personality and limited liability, namely joint-stock companies and limited liability companies, according Romanian Companies Law, no.31/1990. (Stoica and Ene, 2016)

2. The effects of the legal personality of the companies

According to Art.1, para.2 of the Law no. 31/1990, republished, all the business organisations governed by this normative act –partnerships and companies- are legal persons.

Legal personality renders the company a specific subject of law capable of engaging in legal relationships by contracting with anybody including its members, incur liabilities and own property. So, the assets of the company are the exclusive property of this company itself and not of its shareholders, who control it. Also, it provides the company with the right to sue and to be sued in its own name; retain and enjoy its profits.

As a general rule, the company, a different legal entity from its members, has own assets, incomes and debts, and it is directly and personally responsible for its obligations and commitments.

The principal condition to be accomplished in order to acquire the legal subjectivity, the company has to be incorporated following the special procedure developed by Law no.31/1990 (Ene, 2010).

Based on these facts, the legal doctrine develops the „veil" theory according to which, there is a separation between the company, as legal entity, and its members who own and control it (Boros and Dunns, 2013). The veil marked the distinctive existence of the company, as well a partition between company and its shareholders.

This veil operates as an efficient device for those who exist behind it, meaning the members of the company who generally are not liable for the debts of the company. Therefore, the incorporation of the company casts a metaphorical protective veil over the true controllers of the company, a veil through which the law will not usually penetrate (Han).

As the Lord Bingham of Cornhill observed, "In the ordinary way acts done in the name of and on behalf of a limited company are treated in law as the acts of the company, not of the individuals who do them. That is the veil which incorporation confers."

Company with legal personality and limited liability, offers a good protection of shareholders against to the claims of the company' creditors and a way of protection of their assets against to the claims of same social creditors. (Cristea, Ene, Voica *et al*., 2009) "Entity shielding and limited liability are forms of asset partitioning, in that they allocate claims to the assets of a firm and claims to the personal assets of the firm's owners to different groups of creditors" (Hansmann, Kraakman, Squire, 2005).

Thus, incorporation also bring about the limited liability of the members, with the effect that they are generally not liable for the debts of the corporation. In other words, members of a company benefit from the limited liability principle according to which none of them are liable for actions taken on behalf of their company. (Ene, 2016)

3. Concept of limited liability

The extensive immunity from personal liability for the actions of the company granted to the shareholders represents one of the cornerstones of Company Law developed by legal systems around the world. (Ştefanescu, Ene, Lupulescu, Vartolomei, 2003)

The concept of limited liability represents the legal basis for the transferability of shares, otherwise the buyer of share would have to take into account the assets of all other shareholders for determine the risk of this acquisition. Also, limited liability makes possible to multiply the investments since the investors have not to monitor all these investments in order to reduce the potential risks.

As Llanillo demonstrates, the limited liability has two main practical grounds: to encourage economic development based on investment and to allow to the wealth to be spreaded and accumulated.

Furthermore, he argues that the businesses require a huge amounts of capital and one way to obtain this is to ensure the investors that their investments are not risky, they not peril their assets.

Because the investors will have no personal liability for the company's debts, they are „set free to invest in various business ventures without the need to incur the excessive costs necessary to monitor each enterprise closely" (Krendl, 1978)

As Sheahan observes the limited liability of shareholders „ decreases the costs to shareholders of monitoring the actions of managers; increases the incentive to act efficiently and in the interest of shareholders by promoting the free transfer of shares; increases the efficiency of securities markets since share trading does not depend on an evaluation of the wealth of individual shareholders, only the company itself; encourages shareholders to hold diverse share portfolios, thereby permitting companies to raise capital at lower costs because of the shareholders reduced risks and the facilitation of optimal investment decisions by managers by pursuing projects with positive net present values rather than being concerned with the risk to shareholders that such projects may bring." (*apud* Hameed, 2012).

The limited liability principle is the main reason for the use of both joint-stock company and limited liability company as the „viable asset protection mechanism" (Hameed, 2012).

4. Exceptions to the immunity of the shareholder provided by the limited liability principle

Normally, the veil of the company protects its members from liability for company's debts, but when these individuals abuse the corporate privilege, courts will disregard the legal personality of the company and hold them personally liable.

The overlooking of the limited liability principle and retaining responsability on shareholders is an exceptional procedure known as piercing the corporate veil. Therefore, only in exceptional circumstances the court shall go beyond the veil and override the company's legal personality in order to examine and ascertain the true state of affairs.

So immunity of the shareholder provided by the limited liability principle is not without its exceptions.

One of the most important exceptions is founded on the concept of the fraud occurred at the moment of setting up of the company or later on in running the enterprise. So, the occurrence of fraud would permit the piercing of the veil assured by company's legal personality and recovering the personal assets of the shareholders.

Fraud is *inter alia an unconscionable dealing, a knowing misrepresentation of the truth or concealment of a material and in equity means an unconscientious dealing*.(Black's Law Dictionary)

Usually, courts stated that where an individual creates or runs a company to act as a shield for fraudulent purposes or as a facade, in order to avoid personal liability by the shareholders amounts to *'fraud'* for the purposes of veil piercing.

As Wormser concluded „When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate monopoly, or to protect knavery or crime, the courts will draw aside the web [i.e., veil] of entity, will regard the corporate company as an association of live, up-and-doing, men and women shareholders, and will do justice between real persons."

However, the legal parameters of the ground of fraud, where a company is employed as a facade for fraud, as an instrument used by shareholders to avoid their obligations are not well established, have to be find out case by case. For example, it must be proved the intention of the shareholder „to use the corporate structure in such a way as to deny the plaintiff some pre-existing legal right" (Payne, 1997).

Also, Romanian Company Law stipulates the exceptions to the immunity of the shareholder from personal liability under Art. 237[1],

(3) The associate who, by defrauding the creditors, abuses of the limited nature of its responsibility and of the distinct legal personality of the company, is unlimitedly responsible for the unpaid obligations of the company dissolved, liquidated respectively.

(4) The associate's responsibility becomes unlimited under paragraph (3), especially when it disposes of the company's assets, such as they were its own assets or if it reduces the company's asset to its personal benefit or to the benefit of third parties, being aware or having to be aware of the fact that this way the company can no longer be able to perform its obligations.

Another provision regarding to the direct liability of the shareholders for the company's debts is the Art.169 of Law no.85/2014 on preventing insolvency procedures and insolvency. According to this normative text, the syndic judge could dispose that a part of the bankrupt company's debts shall be paid by the company's shareholders, directors or any other controllers who caused the creditor's state of insolvency, in the case when the report issued by the official receiver identifies such persons to whom it would be imputed the occurrence of the debtor's insolvency state. Thus, the syndic judge shall determine the amount of the personal liability of the shareholder to the extent to which it is proven the existence of one of the facts restrictedly mentioned in the Art.169, para.1, which he circumstantiates within the context of flagrant liability, which presumes the existence of the prejudice (caused to the creditor), of the illicit fact, of the guilt and the relationship of causality between fact and prejudice.

5. Conclusions

Based on the above mentioned normative texts, the exceptions to the immunity of the shareholder from personal liability is provided only in the cases of cessation of the legal personality as a consequence of the dissolution, or bankruptcy of the company.

Therefore, the Romanian legislation enshrines the inviolability of the principle of the legal personality of the company, separate from its shareholder, and the sanctity of the principle of the limited liability.

As Hameed concluded, limited liability is undoubtedly a *sine qua non* for successful trade for it perpetuates the entrepreneurial spirit of industry and encourages economic investment by protecting the shareholder.

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