

30. THE PRINCIPLE OF LIMITED LIABILITY

By Justice Mohammad Taqi Usmani

The concept of 'limited liability' has now become an inseparable ingredient of the large-scale enterprises of trade and industry throughout the modern world, including the Muslim countries. The present chapter aims to explain this concept and evaluate it from the Shariah point of view in order to know whether or not this principle is acceptable in a pure Islamic economy.

The limited liability in the modern economic and legal terminology is a condition under which a partner or a shareholder of a business secures himself from bearing a loss greater than the amount he has invested in a company or partnership with limited liability. If the business incurs a loss, the maximum a shareholder can suffer is that he may lose his entire original investment. But the loss cannot extend to his personal assets, and if the assets of the company are not sufficient to discharge all its liabilities, the creditors cannot claim the remaining part of their receivables from the personal assets of the shareholders.

Although the concept of 'limited liability' was, in some countries applied to the partnership also, yet, it was most commonly applied to the companies and corporate bodies. Rather, it will be truer, perhaps, to say that the concept of 'limited liability' originally emerged with the emergence of the corporate bodies and joint stock companies. The basic purpose of the introduction of this principle was to attract the maximum number of investors to the large-scale joint ventures and to assure them that their personal fortunes will not be at stake if they wish to invest their savings in such a joint enterprise. In the practice of modern trade, the concept proved itself to be a vital force to mobilize large amounts of capital from a wide range of investors.

No doubt, the concept of 'limited liability' is beneficial to the shareholders of a company. But, at the same time, it may be injurious to its creditors. If the liabilities of a limited company exceed its assets, the company becomes insolvent and is consequently liquidated, the creditors may lose a considerable amount of their claims, because they can only receive the liquidated value of the assets of the company, and have no recourse to its shareholders for the rest of their claims. Even the directors of the company who may be responsible for such an unfortunate situation cannot be held responsible for satisfying the claims of the creditors. It is this aspect of the concept of 'limited liability' which requires consideration and research from the Shariah viewpoint.

Although the concept of 'limited liability' in the context of the modern commercial practice is a new concept and finds no express mention as such in the original sources of Islamic Fiqh, yet the Shariah viewpoint about it can be sought in the principles laid down by the Quran, the Sunnah of the Prophet (Allah bless him and give him peace) and the Islamic jurisprudence. This exercise requires some sort of ijтиhad carried out by the persons qualified for it. This ijтиhad should preferably be undertaken by the Shariah scholars at a collective level, yet, as a pre-requisite, there should be some individual effort, which may serve as a basis for the collective exercise.

As a humble student of the Shariah, this author has been considering the issue since long, and what is going to be presented in this article should not be treated as a final verdict on this subject, nor an absolute opinion on the point. It is the outcome of initial thinking on the subject, and the purpose of this article is to provide a foundation for further research.

The question of 'limited liability' it can be said, is closely related to the concept of juridical personality of the modern corporate bodies. According to this concept, a joint-stock company in itself enjoys the status of a separate entity as distinguished from the individual entities of its shareholders. The separate entity as a fictive person has legal personality and may thus sue and be sued, may make contracts, may hold property in its name, and has the legal status of a natural person in all its transactions entered into in the capacity of a juridical person.

The basic question, it is believed, is whether the concept of a 'juridical person' is acceptable in the Shariah or not. Once the concept of 'juridical person' is accepted and it is admitted that, despite its fictive nature, a juridical person can be treated as a natural person in respect of the legal consequences of the transactions made in its name, we will have to accept the concept of 'limited liability' which will follow as a logical result of the former concept. The reason is obvious. If a real person i.e. a human being dies insolvent, his creditors have no claim except to the extent of the assets he has left behind. If his liabilities exceed his assets, the creditors will certainly suffer, no remedy being left for them after the death of the indebted person.

Now, if we accept that a company, in its capacity of a juridical person, has the rights and obligations similar to those of a natural person, the same principle will apply to an insolvent company. A company, after becoming insolvent, is bound to be liquidated: and the liquidation of a company corresponds to the death of a person, because a company after its liquidation cannot exist any more. If the creditors of a real person can suffer, when he dies insolvent, the creditors of a juridical person may suffer too, when its legal life comes to an end by its liquidation.

Therefore, the basic question is whether or not the concept of 'juridical person' is acceptable to the Shariah.

Although the idea of a juridical person, as envisaged by the modern economic and legal systems has not been dealt with in Islamic fiqh, yet there are certain precedents wherfrom the basic concept of a juridical person may be derived by inference.

1. Waqf

The first precedent is that of a Waqf. A Waqf is a legal and religious institution wherein a person dedicates some of his properties for a religious or a charitable purpose. The properties, after being declared as Waqf, no longer remain in the ownership of the donor. The beneficiaries of a Waqf can benefit from the corpus or the proceeds of the dedicated property, but they are not its owners. Its ownership vests in Allah Almighty alone.

It seems that the Muslim jurists have treated the Waqf as a separate legal entity and have ascribed to it some characteristics similar to those of a natural person. This will be clear from two rulings given by the fuqaha (Muslim jurists) in respect of Waqf.

Firstly, if a property is purchased with the income of a Waqf, the purchased property cannot become a part of the Waqf automatically. Rather, the jurists say, the property so purchased shall be treated, as a property owned by the Waqf. It clearly means that a Waqf, like a natural person, can own a property.

Secondly, the jurists have clearly mentioned that the money given to a mosque as donation does not form part of the Waqf, but it passes to the ownership of the mosque.

Here again the mosque is accepted to be an owner of money. Some jurists of the Maliki School have expressly mentioned this principle also. They have stated that a mosque is capable of being the owner of something. This capability of the mosque, according to them, is constructive, while the capability enjoyed by a human being is physical.

Another renowned Maliki jurist, namely, Ahmad Al-Dardir, validates a bequest made in favor of a mosque, and gives the reason that a mosque can own properties. Not only this, he extends the principle to an inn and a bridge also, provided that they are Waqf.

It is clear from these examples that the Muslim jurists have accepted that a Waqf can own properties. Obviously, a Waqf is not a human being, yet they have treated it as a human being in the matter of ownership. Once its ownership is established, it will logically follow that it can sell and purchase, may become a debtor and a creditor and can sue and be sued, and thus all the characteristics of a 'juridical person' can be attributed to it.

2. Baitul-Mal

Another example of 'juridical person' found in our classic literature of Fiqh is that of the Baitul-mal (the exchequer of an Islamic state). Being public property, all the citizens of an Islamic state have some beneficial right over the Baitul-mal, yet, nobody can claim to be its owner. Still, the Baitul-mal has some rights and obligations. Imam Al-Sarakhsy, the well-known Hanafi jurist, says in his work "Al-Mabsut": "The Baitul-mal has some rights and obligations, which may possibly be undetermined."

At another place the same author says: "If the head of an Islamic state needs money to give salaries to his army, but he finds no money in the Kharaj department of the Baitul-mal (wherefrom the salaries are generally given) he can give salaries from the sadaqah (Zakah) department, but the amount so taken from the sadaqah department shall be deemed to be a debt on the Kharaj department."

It follows from this that not only the Baitul-mal, but also the different departments therein can borrow and advance loans to each other. The liability of these loans does not lie on the head of state, but on the concerned department of Baitul-mal. It means that each department of Baitul-mal is a separate entity and in that capacity it can advance and borrow money, may be treated a debtor or a

creditor, and thus can sue and be sued in the same manner as a juridical person does. It means that the Fuqaha of Islam have accepted the concept of juridical person in respect of Baitul-mal.

3. Joint Stock

Another example very much close to the concept of 'juridical person' in a joint stock company is found in the Fiqh of Imam Shafi'i. According to a settled principle of Shafi'i School, if more than one person run their business in partner-ship, where their assets are mixed with each other, the Zakah will be levied on each of them individually, but it will be payable on their joint-stock as a whole, so much so that even if one of them does not own the amount of the nisab, but the combined value of the total assets exceeds the prescribed limit of the nisab, Zakah will be payable on the whole joint-stock including the share of the former, and thus the person whose share is less than the nisab shall also contribute to the levy in proportion to his ownership in the total assets, whereas he was not subject to the levy of Zakah, had it been levied on each person in his individual capacity.

The same principle, which is called the principle of 'Khultah-al-Shuyu' is more forcefully applied to the levy of Zakah on the livestock. Consequently, a person sometimes has to pay more Zakah than he was liable to in his individual capacity, and sometimes he has to pay less than that. That is why the Prophet (Allah bless him and give him peace) has said: 'The separate assets should not be joined together nor the joint assets should be separated in order to reduce the amount of Zakah levied on them.'

This principle of 'Khultah-al-Shuyu' which is also accepted to some extent by the Maliki and Hanbali schools with some variance in details, has a basic concept of a juridical person underlying it. It is not the individual, according to this principle, who is liable to Zakah. It is the 'joint-stock' that has been made subject to the levy. It means that the 'joint-stock' has been treated a separate entity, and the obligation of Zakah has been diverted towards this entity which is very close to the concept of a 'juridical person', though it is not exactly the same.

4. Inheritance under debt

The fourth example is the property left by a deceased person whose liabilities exceed the value of all the property left by him. For the purpose of brevity we can refer to it as 'inheritance under debt.'

According to the jurists, this property is neither owned by the deceased, because he is no more alive, nor is it owned by his heirs, for the debts on the deceased have a preferential right over the property as compared to the rights of the heirs. It is not even owned by the creditors, because the settlement has not yet taken place. They have their claims over it, but it is not their property unless it is actually divided between them. Being property of nobody, it has its own existence and it can be termed a legal entity. The heirs of the deceased or his nominated executor will look after the property as managers, but they are not the owners. If the process of the settlement of debt requires some expenses, the same will be met by the property itself.

Looked at from this angle, this 'inheritance under debt' has its own entity which may sell and purchase, becomes debtor and creditor, and has the characteristics very much similar to those of a

'juridical person.' Not only this, the liability of this 'juridical person' is certainly limited to its existing assets. If the assets do not suffice to settle all the debts, there is no remedy left with its creditors to sue anybody, including the heirs of the deceased, for the rest of their claims.

These are some instances where the Muslim jurists have affirmed a legal entity, similar to that of a juridical person. These examples would show that the concept of 'juridical person' is not totally foreign to the Islamic jurisprudence, and if the juridical entity of a joint-stock company is accepted on the basis of these precedents, no serious objection is likely to be raised against it.

As mentioned earlier, the question of limited liability of a company is closely related to the concept of a 'juridical person.' If a 'juridical person' can be treated a natural person in its rights and obligations, then, every person is liable only to the limit of the assets he owns, and in case he dies insolvent no other person can bear the burden of his remaining liabilities, however closely related to him he may be. On this analogy the limited liability of a joint-stock company may be justified.

The Limited Liability of the Master of a Slave

Here I would like to cite another example with advantage, which is the closest example to the limited liability of a joint-stock company. The example relates to a period of our past history when slavery was in vogue, and the slaves were treated as the property of their masters and were freely traded in. Although the institution of slavery with reference to our age is something past and closed, yet the legal principles laid down by our jurists while dealing with various questions pertaining to the trade of slaves are still beneficial to a student of Islamic jurisprudence, and we can avail of those principles while seeking solutions to our modern problems and in this respect, it is believed that this example is the most relevant to the question at issue. The slaves in those days were of two kinds. The first kind were those who were not permitted by their masters to enter into any commercial transaction. A slave of this kind was called 'Qinn.' But there was another kind who were allowed by their masters to trade. A slave of this kind was called Abde Mazoon in Arabic. The initial capital for the purpose of trade was given to such a slave by his master, but he was free to enter into all the commercial transactions. The capital invested by him totally belonged to his master. The income would also vest in him, and whatever the slave earned would go to the master as his exclusive property. If in the course of trade, the slave incurred debts, the same would be set off by the cash and the stock present in the hands of the slave. But if the amount of such cash and stock would not be sufficient to set off the debts, the creditors had a right to sell the slave and settle their claims out of his price. However, if their claims would not be satisfied even after selling the slave, and the slave would die in that state of indebtedness, the creditors could not approach his master for the rest of their claims.

Here, the master was actually the owner of the whole business, the slave being merely an intermediary tool to carry out the business transactions. The slave owned nothing from the business. Still, the liability of the master was limited to the capital he invested including the value of the slave. After the death of the slave, the creditors could not have a claim over the personal assets of the master.

This is the nearest example found in the Islamic fiqh, which is very much similar to the limited liability of the share holders of a company, which can be justified on the same analogy.

On the basis of these five precedents, it seems that the concepts of a juridical person and that of limited liability do not contravene any injunction of Islam. But at the same time, it should be emphasized, that the concept of 'limited liability' should not be allowed to work for cheating people and escaping the natural liabilities consequent to a profitable trade. So, the concept could be restricted, to the public companies only who issue their shares to the general public and the number of whose shareholders is so large that each one of them cannot be held responsible for the day-to-day affairs of the business and for the debts exceeding the assets.

As for the private companies or the partnerships, the concept of limited liability should not be applied to them, because, practically, each one of their shareholders and partners can easily acquire knowledge of the day-to-day affairs of the business and should be held responsible for all its liabilities.

There may be an exception for the sleeping partners or the shareholders of a private company who do not take part in the business practically and their liability may be limited as per agreement between the partners.

If the sleeping partners have a limited liability under this agreement, it means, in terms of Islamic jurisprudence, that they have not allowed the working partners to incur debts exceeding the value of the assets of the business. In this case, if the debts of the business increase from the specified limit, it will be the sole responsibility of the working partners who have exceeded the limit.

The upshot of the foregoing discussion is that the concept of limited liability can be justified, from the Shariah viewpoint, in the public joint-stock companies and those corporate bodies only who issues their shares to the general public. The concept may also be applied to the sleeping partners of a firm and to the shareholders of a private company who take no active part in the business management. But the liability of the active partners in a partnership and active shareholders of a private company should always be unlimited.

At the end, we should again recall what has been pointed out at the outset. The issue of limited liability, being a modern issue, which requires a collective effort to find out its solution in the light of the Shariah, the above discussion should not be deemed to be a final verdict on the subject. This is only the outcome of an initial thinking, which always remains subject to further study and research.