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Abstract

The focus of this thesis is to analyse the grounds and judicial practises of piercing the corporate veil in the United States, the United Kingdom and Germany, as well as to present the flaws and problems of the current doctrine in the aforementioned jurisdictions, while providing solutions and recommendations on this topic.

This thesis provides an overview of the doctrine of piercing the corporate veil, focusing on the legal and economic approach to restricted liability. Following that, this thesis outlines the positive economic and legal paradox of limited liability. This thesis further discusses the concepts of piercing the corporate veil in the United States, the United Kingdom, and Germany, as well as the sorts of creditors, the fundamental preconditions for using the doctrine, and related judicial practise.

Keywords: Piercing the Corporate Veil, Limited Liability, Separate Personality, Corporation, Undercapitalisation, Disregarding the Corporate Formalities, Commingling of Assets, Konzern Law.

Deutscher Abstract

Der Schwerpunkt dieser Arbeit liegt auf der Analyse der Gründe und der Rechtspraxis für die Durchbrechung des Unternehmensschleiers in den Vereinigten Staaten, dem Vereinigten Königreich und Deutschland sowie auf der Darstellung der Mängel und Probleme der aktuellen Doktrin in den oben genannten Gerichtsbarkeiten und der Bereitstellung von Lösungen und Empfehlungen zu diesem Thema.

Diese Arbeit bietet einen Überblick über die Doktrin der Durchbrechung des Unternehmensschleiers und konzentriert sich dabei auf den rechtlichen und wirtschaftlichen Ansatz zur beschränkten Haftung. Anschließend skizziert diese Arbeit das positive wirtschaftliche und rechtliche Paradoxon der beschränkten Haftung. In dieser Arbeit werden außerdem die Konzepte der Durchbrechung des Unternehmensschleiers in den Vereinigten Staaten, im Vereinigten Königreich und in Deutschland sowie die Arten von Gläubigern, die Grundvoraussetzungen für die Anwendung der Doktrin und die damit verbundene Rechtspraxis erörtert.

Schlüsselwörter: Durchdringen des Unternehmensschleiers, beschränkte Haftung, eigenständige Persönlichkeit, Unternehmen, Unterkapitalisierung, Missachtung der Unternehmensformalitäten, Vermögenszusammenlegung, Konzernrecht.

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Abbreviations

AG	Aktiengesellschaft
AktG	Aktiengesetz
A.L.R.	Americal Law Report
AC	Appeal Court (UK)
ALI	American Law Institute
BGB	Bürgerliches Gesetzbuch
BGH	Bundesgerichtshof
C.A.	Companies Act
Co.	Company
Corp.	Corporation
Ctr	Center
Ed.	Edition
EWCA	England and Wales Court of Appeal
GmbH	Gesellschaft mit beschränkter Haftung
GmbHG	Gesetz betreffend die Gesellschaften mit beschränkter Haftung
Inc	Incorporated
L.L.C	Limited Liability Company
LLP	limited liability partnerships
Ltd	Private Limited Company (United Kingdom)

TVA	Tennessee Valley Authority
PCV	Piercing the corporate veil
SEC	Securities and Exchange Commission
UK	United Kingdom
U.S.	United States of America

I. Introduction

The concept of a company as a separate entity from its shareholders is widely accepted and recognised in many common law and civil law jurisdictions.¹ In general, courts are hesitant to diverge from this fundamental principle, of company law.² However, the principle of separate personality is usually not absolute.³ Courts in both common law and civil law jurisdiction have the authority to deviate from it. When the courts disregard a company's separate personality, generally in exceptional circumstances, it is commonly claimed that the courts "pierce" or "lift" the corporate veil.⁴

Despite the fact that veil piercing is the most litigated issue in corporate law, legal doctrine in this area is widely inconsistent.⁵ The doctrine of corporate veil piercing provides creditors and tort plaintiffs with a last-resort means of obtaining reimbursement or compensation in the event of an injury or harm.⁶ The courts will not consent to piercing the corporate veil in every case,⁷ but they acknowledge that, in some cases, the corporate body may be removed as a technical barrier between its owner(s) and the parties with whom the corporate body deals.⁸ Although different countries have different criteria, it is widely agreed that the veil may be pierced if some improper purpose is demonstrated.

¹ Manal Bensafi, Laura Gomez and Caroline Greco, 'Companies Capacity to Contract in European Civil Law and Common Law Countries | Association of Corporate Counsel (ACC)' <<https://www.acc.com/resource-library/companies-capacity-contract-european-civil-law-and-common-law-countries>> accessed 21 June 2023.

² Ross Lefoka, 'Separate Legal Personality: What Does It Mean for Companies and What Are the Limits?' (*De Beer Attorneys*, 9 June 2020) <<https://debeerattorneys.com/separate-legal-personality-what-does-it-mean-for-companies-and-what-are-the-limits/>> accessed 21 June 2023.

³ 'Piercing the Corporate Veil – What Is It and When Can It Happen? - SchoemanLaw Inc' (26 August 2019) <<https://schoemanlaw.co.za/piercing-the-corporate-veil-what-is-it-and-when-can-it-happen/>> accessed 21 June 2023.

⁴ 'Corporate Veil: Meaning, Piercing the Corporate Veil, Examples' (*Toppr-guides*, 1 September 2018) <<https://www.toppr.com/guides/business-laws/companies-act-2013/corporate-veil-theory/>> accessed 21 June 2023.

⁵ David K Millon, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability' (2007) 56 Emory Law Journal <<https://scholarlycommons.law.wlu.edu/cgi/viewcontent.cgi?article=1166&context=wlufac>>.

⁶ Edwin C Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after *Prest v Petrodel Resources Ltd*: Inching towards Abolition?' 29 <<https://repository.londonmet.ac.uk/4910/6/Article-on-veil-piercing-in-Prest-case.pdf>>.

⁷ Gregory Brown, 'What Does Piercing the Corporate Veil Mean?' (*Brown & Charbonneau, LLP*, 3 October 2019) <<https://bc-llp.com/what-does-piercing-the-corporate-veil-mean/>> accessed 21 June 2023.

⁸ Kenneth B Watt, 'Piercing the Corporate Veil: A Need for Clarification of Oklahoma's Approach' 28 Tulsa Law Journal <<https://digitalcommons.law.utulsa.edu/cgi/viewcontent.cgi?article=2256&context=tlr>>.

1. Statement of Purpose

This thesis presents an in-depth overview of key legal doctrines related to the corporation, its evolution, foundations, general characteristics, and inherent challenges. It also compares and critically assesses the conditions of veil piercing in relation to the incorporation objectives. This thesis discusses common law jurisdictions such as the United Kingdom and the United States and civil law jurisdictions such as Germany. Concerning the first objective, I would like to demonstrate to the reader the intrinsic qualities of the corporate entity, the characteristics inherent in the corporate form, the manner in which they function together and require each other, as well as challenges linked with or originating from these corporate features.

The second aim is to clarify the notion of corporate veil piercing. Furthermore, the primary objective of this comparison is to provide a reasonably comprehensive and detailed study of how different jurisdictions' courts use the notion of veil piercing, which has been formally accepted through case law or legislation.

In this thesis, I use the functional method of comparative law, but additionally, consider the law in context method and the historical method. The countries being analysed, whether they have common law or civil law systems, share numerous commonalities, partly because the historical circumstances that led to the formation of corporate personality were remarkably similar.

1.2. Disposition

The following chapter, Chapter II, begins with a brief history of the corporate form, followed by a discussion of its characteristics, specifically legal personality, limited liability, transferable shares, separation of ownership and control, and profit maximization, which can be helpful background for the discussion of the piercing the veil doctrine.

Chapter III discusses the general aspects of the corporate veil-piercing doctrine. The main focus of this chapter revolves around the goals of the veil-piercing doctrine and the types of creditors.

The doctrine of piercing the corporate veil in different jurisdictions is discussed in Chapter IV, which is divided into three sections: the United States, the United Kingdom, and Germany. All three parts begin with an examination of the courts' approach to veil piercing, followed by descriptive case law.

Chapter V

II. The Evolution, Foundations, and General Characteristics of the Modern Corporation in Common law jurisdictions

1. Introduction

In the world of business and trade, legal entities exist in a wide range of forms and sizes, each with its own set of legal and organisational characteristics. Simply put, a legal entity is a business unit that has legal rights and obligations that are distinct from those of its owners. Thus, a legal entity has the authority to enter into contracts, buy and possess property, create a bank account, sue and be sued, hire and fire personnel, and so on. A legal entity must also follow current regulations, such as registration, licencing, tax filing, regulatory compliance, and other applicable restrictions.⁹

The terms corporate entity and legal entity are frequently used interchangeably. In such cases (a broad interpretation of the term), a corporate entity is any business organisation, incorporated or unincorporated, including limited liability companies (LLCs), limited liability partnerships (LLPs), sole proprietorships, general partnerships, and others, each subject to differing liability regimes.¹⁰ On the other hand, when used in a narrower sense a corporate entity means an

⁹ Adrian Camara, 'What Is a Corporate Entity?' <<https://www.athennian.com/post/back-to-basics-what-is-a-corporate-entity>> accessed 25 July 2023.

¹⁰ Priyanka Prakash, 'Types of Business Entities' (*NerdWallet*, 16 December 2020) <<https://www.nerdwallet.com/article/small-business/business-entity>> accessed 25 July 2023.

incorporated legal entity that is taxed as a corporation. Therefore, the term 'corporate entity' refers to corporations only, while the term 'legal entity' encompasses all types of businesses.¹¹

This thesis focuses on corporations as a unique commercial entity and the numerous characteristics associated with them as well as the doctrine of veil piercing. It should be emphasised that the scope of this thesis excludes LLCs and other entity types subject to different liability rules. While corporations and LLCs are both types of commercial entities, they differ greatly in terms of legal structure, liability protection, taxation, and management. As such, this thesis will not explore the distinctive characteristics and rules pertaining to LLCs or any other legal entities other than typical corporations.

2. Modern Corporation

The modern corporation is one of the most successful inventions in history, as indicated by its wide adoption and survival as a primary vehicle of capitalism over the last century.¹² Over the centuries, the legal understanding of corporations has evolved. Before the early nineteenth century, the dominant legal view held that corporations were artificial, quasi-public institutions whose shareholders received corporate benefits in exchange for the provision of public goods.¹³ The United States Supreme Court Justice- John Marshall in the case *Trustees of Dartmouth College v. Woodward (1819)* stated that a "corporation is a mere creature of law," and it "possesses only those properties which the charter of creation confers upon it, either expressly or as incidental to its very existence."¹⁴ The idea that corporations were "creatures of the state" was so prevalent that, in 1805, Justice Locke of the North Carolina Supreme Court in the case of the *University of North Carolina*

¹¹ Camara (n 9).

¹² Henry N. Butler, 'The Contractual Theory of the Corporation' (1989) 11 George Mason University Law and Economics Research Paper Series 99.

¹³ 'How the Corporation Lost Its Image as a "Creature of State"' (*LPE Project*, 26 October 2022) <<https://lpeproject.org/blog/corporation-as-creature-of-state/>> accessed 15 March 2023.

¹⁴ Michael Kinsley, 'CORPORATE CREATURES OF THE STATE' *Washington Post* (21 April 1990) <<https://www.washingtonpost.com/archive/opinions/1990/04/21/corporate-creatures-of-the-state/b835ba7c-0fd8-400b-bd75-58d4c645d5bc/>> accessed 15 March 2023.

v. *Fox* noted, that “it seems difficult to conceive of a corporation established for merely private purposes.”¹⁵

The 'contractual' theory emerged in the late nineteenth and early twentieth centuries.¹⁶ This theory, was crucial in the expansion of corporate rights, as seen in the *Railroad Tax Cases (1875)*—a series of cases that culminated in the Supreme Court declaring corporations as a person.¹⁷ Under this theory, it is critical to recognise that most organisations are simply legal fictions that serve as nexus for a set of contractual relationships between individuals.¹⁸ This includes businesses, non-profit institutions such as universities, hospitals, and foundations, mutual organisations such as mutual savings banks, insurance companies, and co-operatives, some private clubs, and even governmental bodies such as cities, states, and the federal government, as well as government enterprises such as The Tennessee Valley Authority (TVA), the post office, and transit systems.¹⁹ The corporation can therefore be defined as simply one type of legal fiction that serves as a nexus of contractual relationships and is also characterized by the existence of divisible residual claims on the organisation's assets and cash flows, which can generally be sold without permission of the other contracting individuals.²⁰ Nowadays probably the most eloquent and frequently cited definition of a corporation is that a corporation is an entity with, authority under law to act as a single person distinct from the shareholders who own it and rights to issue stock and exist indefinitely.²¹

1. The Defining Attributes of the Corporation

¹⁵ ‘Amendment V: University of North Carolina v. Fox’ <https://press-pubs.uchicago.edu/founders/documents/amendV_due_process19.html> accessed 15 March 2023.

¹⁶ David Gibbs-Kneller, David Gindis and Derek Whayman, ‘Not by Contract Alone: The Contractarian Theory of the Corporation and the Paradox of Implied Terms’ (2022) 23 *European Business Organization Law Review* 573 <<https://doi.org/10.1007/s40804-022-00241-7>> accessed 15 March 2023.

¹⁷ ‘How the Corporation Lost Its Image as a “Creature of State”’ (n 10).

¹⁸ Michael C. Jensen and William H. Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 9.

¹⁹ *ibid.*

²⁰ *ibid.*

²¹ ‘Deed of Dissolution of Partnership’ (*The Lawyers & Jurists*) <<https://www.lawyersnjurists.com/article/deed-of-dissolution-of-partnership-2/>> accessed 18 March 2023.

The corporation has some distinct characteristics that define its anatomy. Most corporate law authors compile their own, usually a mutually overlapping list of these characteristics. For instance, when professor Jensen defined the corporation, he pointed out three main characteristics: 1) legal personality, 2) transferable shares and 3) shared ownership.²² On the other hand, judge Easterbrook and professor Fischel stated that the corporation's distinguishing features are limited liability and legal identity.²³ Therefore, a corporation can be conceptualised and thought of as a legal entity defined by a set of core legal characteristics. Scholars disagree on terminology, but all seem to agree that the defining characteristics of the corporate entity are (1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital.²⁴

1.1. Legal Personality

A fundamental principle of corporate law is that shareholders of a corporation are generally not liable for the enterprise's obligations over the capital contributed in exchange for their shares.²⁵ This principle implies that the corporation is distinct from its shareholders, directors, or officers.²⁶ In *Salomon v Salomon*, the House of Lords affirmed this legal principle in 1896 and stated that, upon incorporation, a company is generally regarded as a new legal entity distinct from its shareholders.²⁷ According to Professors Hansmann and Kraakman, the corporation has a strong form of legal personality.²⁸ The firm's ownership rights over its designated assets include the ability to use the assets, sell them, and, most importantly, make them available for attachment by its creditors. In contrast, because these assets are generally regarded as belonging to the firm rather

²² Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 9 <<https://www.sfu.ca/~wainwrig/Econ400/jensen-meckling.pdf>> accessed 14 March 2023.

²³ Frank H. Easterbrook and Daniel R. Fischel, 'The Corporate Contract' (1989) 89 Columbia Law Review 1416.

²⁴ Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press 2017) <<http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780198739630.001.0001/acprof-9780198739630>> accessed 16 March 2023.

²⁵ Robert B. Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 Cornell Law Review <<http://scholarship.law.cornell.edu/clr/vol76/iss5/2>>.

²⁶ *ibid.*

²⁷ *Salomon v Salomon & Co Ltd [1896] UKHL 1* (UKHL (1896)).

²⁸ Kraakman and others (n 21), p.7.

than the firm's owners, they are not subject to attachment by the personal creditors of these individuals.²⁹ The primary function of this separate patrimony has been termed "entity shielding," to emphasise that it involves protecting the entity's assets—the corporation—from the creditors of the owners.³⁰ Entity shielding takes two forms in modern legal entities: Weak entity shielding, on the one hand, also known as a priority rule, prioritises firm creditors over personal creditors in the division of firm assets, which means that personal creditors of owners may levy on firm assets only after firm creditors have been paid in full.³¹ As a result of this priority rule, a firm's assets are automatically made available for the enforcement of contractual liabilities entered into in the firm's name as a default rule of law.³² Strong entity shielding, on the one hand, adds a rule of liquidation protection to the protections of weak entity shielding. Liquidation protection limits the ability of both firm owners and their creditors to force the payout of an owner's share of the firm's net assets.³³ The modern business corporation is a familiar example of strong entity shielding: not only do corporate creditors have a first claim on the corporation's assets but they are also protected from attempts to liquidate those assets by a shareholder or his or her creditors.³⁴

1.1.1. Legal Personality of Parent and its Subsidiary

In what is generally understood to be universal bedrock principles of corporate law, corporations have separate legal personality, which distinguishes them from their shareholders, directors, officers, and other individuals, and shareholders have limited liability for the actions of the corporation. These principles, which can also be referred to as the corporate shield, are equally applicable to corporate groups. As a result, a parent company is usually not liable for legal violations and unpaid debts at the level of subsidiaries in which it has a direct or indirect stake.³⁵ This demonstrates that corporate law does not recognise parent and subsidiary companies as a

²⁹ *ibid.*

³⁰ *ibid.*

³¹ Henry Hansmann, Reiner Kraakman and Richard Squire, 'Law and the Rise of the Firm' [2005] Harvard Law Review 1338 <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1068&context=faculty_scholarship>.

³² Kraakman and others (n 21).

³³ Hansmann, Kraakman and Squire (n 21).

³⁴ *ibid.*

³⁵ Martin Petrin and Barnali Choudhury, 'Group Company Liability' (2018) 19 European Business Organization Law Review 771 <<https://doi.org/10.1007/s40804-018-0121-7>> accessed 31 March 2023.

single economic entity or consider parent-subsidary companies as a unified legal entity for liability purposes. Instead, it recognises that each component corporation of the group - whether parent, subsidiary, or affiliate - is legally separate and distinct from every other corporation in the group, and its rights and responsibilities are separate from and unaffected by those of the other constituent companies of the group.³⁶ The UK Court of Appeal emphasised this point in *Adams v Cape Industries Plc.* where judge Christopher Slade stated, “There is no general principle that all companies in a group of companies are to be regarded as one. On the contrary, the fundamental principle is that each company in a group of companies (a relatively modern concept) is a separate legal entity possessed of separate legal rights and liabilities.”³⁷

1.2. Limited Liability

Scholars widely believe that “the limited liability corporation is the greatest single discovery of modern times... Even steam and electricity are far less important.”³⁸ For the corporate shareholder, limited liability means that they are not liable for the enterprise's debts and obligations. In practice, limited liability refers to the ability of a shareholder to risk only the capital invested in the entity.³⁹ The traditional advantage of doing business in the corporate form is the capacity of business owners/shareholders to limit their personal liability to their actual and promised contributions.⁴⁰ For instance, a person who pays \$100 for stock risks only that \$100. A person who buys a bond for \$100 or sells goods to a firm for \$100 on credit risks \$100, but no more.⁴¹

³⁶ Phillip I Blumberg, *The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality* (Oxford University Press 1993).

³⁷ Brenda Hannigan, *Company Law* (OUP Oxford 2012).

³⁸ Nurup Upadhyay, ‘Piercing the Corporate Veil: An Analysis of Lord Sumption’s Attempt to Avail a Troubled Doctrine’ (2015) 2 Auckland University Law Review, p.114.

³⁹ Jeffrey K Vandervoort, ‘Piercing the Veil of Limited Liability Companies: The Need for a Better Standard’ (2004) 3 DePaul Business and Commercial Law Journal
<<https://via.library.depaul.edu/cgi/viewcontent.cgi?article=1211&context=bclj&httpsredir=1&referer=>>.

⁴⁰ John H. Matheson and Raymond B. Eby, ‘The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners’ Limited Liability Protection’ (2000) 75 Washington Law Review, p.154.

⁴¹ Frank H. Easterbrook and Daniel R. Fischel, ‘Limited Liability and the Corporation’ The University of Chicago Law Review, p.90. <<https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=4386&context=uclrev>>

Limited liability was created, among other things, to encourage economic growth through investment. Following the Industrial Revolution, capital-intensive businesses required large sums of capital that frequently exceeded the average entrepreneur's means. One solution for solving this problem was to encourage outside investment by, giving limited liability to those who contributed with capital. This encouraged such outside investment because investors could invest without risking all of their assets. While investors were frequently willing to risk their entire net worth in businesses they operated, they were not willing to invest such value in businesses they did not operate or closely monitor without limited liability. With limited liability, owners are free to invest in a variety of business ventures without incurring the high costs associated with closely monitoring and/or controlling each enterprise.⁴²

Limited liability, which is now a fundamental principle of corporate law, denotes that normally a corporation's shareholders are not liable for its obligations or debts.⁴³ The concept behind limited liability is that the corporation is a separate entity, and thus "it is the corporation that incurs debts, not the shareholders."⁴⁴ Professors Henry Hansmann and Reinier Kraakman have expanded the concept of limited liability to include a broader concept of "asset partitioning," which is the legal separation of firm assets from the personal assets of its owners and managers. According to these scholars, entity shielding safeguards the firm's assets from the creditors of the firm's owners, whereas limited liability shields the firm's owners' assets from the claims of the firm's creditors. They cooperate to establish an 'asset partitioning' regime in which business assets are pledged as security to business creditors while personal assets of the business's owners are reserved for the owner's personal creditors.⁴⁵

The corporate structure relies heavily on limited liability as it allows the allocation of the risk of an enterprise to a more efficient risk-bearer in particular circumstances.⁴⁶ Individual investments are aggregated to allow corporations to conduct business and invest on a large scale, but the risk and uncertainty of investing without limited liability would deter individual investors and hinder

⁴² Vandervoort (n 36).

⁴³ Andrew A. Schwartz, 'The Perpetual Corporation' 80 The George Washington Law Review, p.769, <<https://www.gwlr.org/wp-content/uploads/2018/04/80-Geo.-Wash.-L.-Rev.-764.pdf>>.

⁴⁴ *ibid*.

⁴⁵ Kraakman and others (n 21), p.10.

⁴⁶ Thompson (n 21).

a corporation's ability to operate.⁴⁷ Without limited liability (as in a partnership), it would be difficult to find investors to invest in a corporation because they would be rationally discouraged from putting their entire net worth at risk for firm debts.

1.2.1. *Parent Company Immunity from Liability*

Decades after the concept of limited liability was accepted, U.S. corporations still lacked the authority to own the shares of another corporation unless explicitly authorised by statute or charter.⁴⁸ The acceptance of companies as shareholders in the late nineteenth century, allowed them to own shares in other companies.⁴⁹ The change in the law paved the way for a significant shift in the corporate structure. Corporations began to form other corporations to conduct parts of their operations and to acquire other corporations as a means of expansion. As a result of this evolution, a corporation no longer represented the entire enterprise. The company's parent and subsidiary corporations became increasingly fragmented.⁵⁰

This has in turn led to a parallel acceptance of an extension of corporate privileges from the private investors to the corporate shareholder.⁵¹ The primary protection afforded to corporate shareholders is the normal presumption of non-liability. The consequence of the presumption of non-liability is that parent companies' liability is limited to payment for their shares and they are not liable for the subsidiaries' obligations and debts.⁵² Although corporate law permits a parent company to engage in commerce through its subsidiary, it does not transfer the corresponding liability arising from the subsidiary's operations to the parent. This was the point of view expressed in *Re Southard & CO Ltd.* (1979), where lord Templeman LJ stated as follows:

⁴⁷ Schwartz (n 40).

⁴⁸ Peter B. Oh, 'Veil-Piercing' 89:81 Texas Law Review
<https://core.ac.uk/display/33563083?utm_source=pdf&utm_medium=banner&utm_campaign=pdf-decoration-v1>.

⁴⁹ Linn Anker-Sørensen, 'Parental Liability for Externalities of Subsidiaries' (2014) 2 The Dovenschmidt Quarterly 102 <https://www.elevenjournals.com/tijdschrift/doqu/2014/3/DQ_2211-9981_2014_002_003_003> accessed 1 April 2023.

⁵⁰ Phillip Blumberg, 'Limited Liability and Corporate Groups' <<https://core.ac.uk/download/pdf/302392005.pdf>>.

⁵¹ Anker-Sørensen (n 46).

⁵² David Wisbey, 'Parent Company Liability for Acts of Subsidiaries - Birkett Long Solicitors' (*Birkett Long LLP*, 28 December 2017) <<https://www.birkettlong.co.uk/site/library/legalnews/parent-company-liability-for-acts-of-subsidiaries>> accessed 1 April 2023.

“company law possesses some curious features that generate some curious results. A parent company may spawn several subsidiary companies, all controlled directly or indirectly by shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, the parent company and other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.”⁵³

The *Pennsylvania Railroad v. Jones* (1894) was one of the first cases involving corporate group liability. In this case, the plaintiffs were hit by a train owned by a subsidiary of Pennsylvania Railroad Co. The plaintiffs then filed a lawsuit for damages against the parent company as well as its subsidiaries. The central question was whether the controlling parent company should be held liable for the actions of its subsidiaries. The court refused to pierce the controlling parent's corporate veil. The decision was justified by stating that the individual units operating within the group were separate legal entities, and thus the parent company could not be held liable.⁵⁴

1.2.2. Economic Justification for Limited Liability

The principle of limited liability has numerous benefits for the corporation. Based on principles of economic efficiency five reasons can be provided for why companies are granted limited liability. First, limited liability encourages the development of public stock markets, which aids in the liquidity and diversification benefits that these markets provide to investors.⁵⁵ Without limited liability, each investor's risk when investing in a business is determined in part by the wealth of other investors. Such a system would incur search costs and other costs, leading investors to make

⁵³ Sarah Worthington, *Sealy and Worthington's Text, Cases, and Materials in Company Law* (Oxford University Press 2016)

<https://books.google.ge/books?id=yaekDAAQBAJ&pg=PA51&lpg=PA51&dq=%5BU.K.%5D+company+law+possesses+some+curious+features+that+generate+some+curious+results.+A+parent+company+may+spawn+a+number+of+subsidiary+companies,+all+controlled+directly+or+indirectly+by+shareholders+of+the+parent+company.+If+one+of+the+subsidiary+companies,+to+change+the+metaphor,+turns+out+to+be+the+runt+of+the+litter+and+declines+into+insolvency+to+the+dismay+of+its+creditors,+the+parent+company+and+other+subsidiary+companies+may+prosper+to+the+joy+of+the+shareholders+without+any+liability+for+the+debts+of+the+insolvent+subsidiary&source=bl&ots=50GlppwQK5&sig=ACfU3U3QVLJjKEOjjB2bFD0GVrXKpsRPaQ&hl=en&sa=X&ved=2ahUKEwiGvIrW-Yj-AhXNR_EDHUDpA4wQ6AF6BAGHEAM#v=onepage&q&f=false>.

⁵⁴ ‘*Pennsylvania R. Co. v. Jones*, 155 U.S. 333 (1894)’ (*Justia Law*)

<<https://supreme.justia.com/cases/federal/us/155/333/>> accessed 1 April 2023.

⁵⁵ Henry G. Manne, ‘Our Two Corporation Systems: Law and Economics’ (1967) 53 *Virginia Law Review* 259.

only a few larger investments where risk-assessment information is available, and could result in a reduction in overall economic activity.⁵⁶

Second, limited liability is a necessary precondition for the free transferability, also referred to as alienability, of shares because it renders the identity and wealth of shareholders irrelevant. Without the safety of limited liability, a shareholder would be unable to freely sell his or her shares without the consent of other shareholders, who would then be held liable for the new buyer's actions.⁵⁷ In other words, limited liability renders shares fungible, which is required for them to be traded on a liquid market.

Third, because the financial consequences of company failure are limited, limited liability reduces the need for shareholders to monitor the agents and other shareholders of companies in which they invest. In addition, it is crucial to remember that, unlike in a public company, access to information in a private corporation is limited.⁵⁸ Shareholders are entitled to inspect only the relevant information essential to decide on a matter up for a vote at the general meeting. The shareholder has no right to request information and documents from the corporation for the sole purpose of gathering information. It is evident that, unlike public companies, the legislature has granted private companies, broad freedom in terms of disclosing information to their shareholders.⁵⁹ Therefore, shareholders may lack the ability, incentive (especially if they have a small shareholding) and the expertise to monitor managers' actions. Because limited liability makes shareholder diversification and passivity a more rational strategy, the potential costs of operating companies are reduced.⁶⁰

Fourth, limited liability can be used to share transaction risks with the firm's creditors, in situations where the latter are in a better position to identify or bear those risks in relation to the assets shielded by the corporate form. Thus, the use of the corporate form can help with debt financing

⁵⁶ Thompson (n 22).

⁵⁷ Schwartz (n 40).

⁵⁸ 'Shareholder Rights in a Private Company - Mor & Co. Adv.' <<https://www.morlawoffice.com/en/shareholder-rights/>> accessed 11 July 2023.

⁵⁹ *ibid.*

⁶⁰ Ian M. Ramsay and David B. Noakes, 'Piercing the Corporate Veil in Australia'.

even when there is no need for additional equity capital, as in the case of the parent company of a wholly owned subsidiary.⁶¹

Last but not least, limited liability facilitates optimal investment decisions by managers. As we know, limited liability encourages shareholders to keep diversified portfolios. In such cases, management should invest in projects with positive net present values, and can do so without jeopardising each shareholder's personal wealth. However, if the principle of unlimited liability applies, management may reject some investments with positive present values in order to minimise the risk to shareholders. "By definition this would be a social loss, because projects with a positive net present value are beneficial uses of capital."⁶²

1.2.3. Limited Liability and the Externalization of Risk

Because limited liability increases the likelihood that there will be insufficient assets to pay creditors' claims, a firm's shareholders may reap all of the benefits but bear none of the costs;⁶³ therefore, the true policy foundation for limited liability does not appear to be efficiency. Instead, it appears that the goal is to encourage investment by shifting risk from investors to creditors.⁶⁴ Individuals will be more willing to take on the risk of business failure if their loss exposure is limited to their initial investment. As a result, limited liability encourages entrepreneurial activity by attempting to shift the risk of corporate insolvency from shareholders to the business's creditors.⁶⁵

Risk externalisation imposes social costs and is thus undesirable. However, the implications of this point are unclear, both because modifying limited liability has costs and because moral hazard would exist in the absence of limited liability. The social cost of reducing investment in certain types of projects as a result of seriously modifying limited liability may far outweigh the benefits

⁶¹ Kraakman and others (n 21).

⁶² Ramsay and Noakes (n 57).

⁶³ Easterbrook and Fischel, 'Limited Liability and the Corporation' (n 38).

⁶⁴ Millon (n 5).

⁶⁵ *ibid.*

of reducing moral hazard. Even eliminating limited liability would not solve the moral-hazard problem. Although it may be more severe under limited liability, it exists under any rule.⁶⁶

The incentive for corporations to engage in excessively risky ventures stems directly from the limited liability for the full cost of the potential consequences- an outcome that could easily outweigh the initial investment. The concept of piercing the corporate veil is one possible countermeasure to a firms' little-to-lose behaviour.⁶⁷

1.3. Transferable shares

Another fundamental feature of the business corporation that distinguishes it from partnerships and other standard-form legal entities is full transferability of shares of ownership. Transferable shares are those that can be traded at a mutually agreed-upon price between buyers and sellers.⁶⁸ Transferability allows the firm to continue operating as its owners' identities change, avoiding the complications of member withdrawal that are common in, for example, partnerships and cooperatives. As a result, the liquidity of shareholders' interests improves, making it easier for shareholders to build and maintain diverse investment portfolios.⁶⁹

Transferability of shares is closely related to both the liquidation protection provided by strong form legal personality and limited liability. In the absence of either of these rules, the firm's creditworthiness as a whole could change, possibly fundamentally, as the identity of its shareholders changed. As a result, potential buyers would have a difficult time determining the value of their shares.⁷⁰

Although share alienability is considered necessary for a market, it can lead to difficulties for management, shareholders, and the corporation as the same shares that are so easily sold represent voting interests in the corporation. A shareholder who owns a controlling stockownership stake has proportional voting rights and thus has the ability to control the corporation by appointing

⁶⁶ Easterbrook and Fischel, 'Limited Liability and the Corporation' (n 38).

⁶⁷ *ibid.*

⁶⁸ 'Transferable Shares | Co-Operatives UK' <<https://www.uk.coop/resources/community-shares-handbook/2-society-legislation/22-share-capital-societies/222>> accessed 21 March 2023.

⁶⁹ Kraakman and others (n 21).

⁷⁰ *ibid.*

directors. A controlling shareholder would also have the right to sell the control block, usually at a premium over the price of a single share.⁷¹

Another issue arising from share transferability is that a disaggregated group of small shareholders who collectively constitute a majority could sell their shares in response to a tender offer. However, at the same time, this could create positive incentives for management to act in the best interests of the shareholders.⁷²

1.4. Centralised Management (Separation of Ownership and Control)

The phenomenon associated with both publicly traded business corporations and private corporations in which shareholders (the residual claimants) own the corporation but control over its management is centralised in the hands of a board of directors, which generally delegates day-to-day decision-making to executive officers and their subordinates are referred to as centralised management.⁷³

For both expertise and efficiency, centralised management is required. The expertise of management ensures that those who make complex business decisions for the corporation are qualified to do so. Furthermore, centralised management is far more efficient than asking thousands or even millions of shareholders to make business decisions collectively.⁷⁴

1.4.1. *The Decision System*

It is critical to distinguish between residual claimants, decision management, and decision control. A corporation's shareholders are the residual claimants. The status of residual claimant serves a significant economic and legal function in corporations and corporate law.⁷⁵ The contemporary

⁷¹ Schwartz (n 40).

⁷² *ibid.*

⁷³ *ibid.*

⁷⁴ Schwartz (n 40), p.771.

⁷⁵ Sung Eun Kim, 'Tracing the Diverse History of Corporate Residual Claimants' (*Southern California Law Review*, 12 January 2022) <https://southerncalifornialawreview.com/wp-content/uploads/2022/01/Kim_Final.pdf> accessed 12 July 2023.

doctrine of residual claimants in corporate law is based on a law and economics analysis established in the 1980s by Frank Easterbrook and Daniel Fischel, who describe the residual claim as the right to receive residual profits. Hence, the residual claimant theory has been employed to defend "shareholder primacy" in modern legal studies, with an assumption that shareholders are generally the only parties that receive the residual profits of corporations.⁷⁶

In exchange for the corporation's profits, the corporation's shareholders contribute capital and accept the risk of losing it.⁷⁷ Modern corporate law typically grants shareholders only limited legal rights to control the company. Shareholders have also no right to participate in the corporation's day-to-day management. They are also unable to direct policy or set compensation.⁷⁸ However, in public companies shareholder involvement in 'say-on-pay' votes is frequently cited as a mechanism by which shareholders express their views on executive remuneration,⁷⁹ as they are non-binding advisory votes cast by shareholders, most typically during the annual general meeting.⁸⁰ While 'Say-on-Pay' votes allow shareholders to voice their opinions on executive remuneration, they do not determine how much executives are paid.⁸¹

The second group is decision management. They generate options for the corporation that must be decided upon during the initiation process, and they make decisions about these options during the subsequent ratification process.⁸² The decision control group is typically comprised of a board of directors or similar committee organ that is elected on a regular basis, exclusively or primarily, by the firm's shareholders.⁸³ The board of directors oversees and controls the company's management

⁷⁶ *ibid.*

⁷⁷ Kraakman and others (n 12), pp. 11-12.

⁷⁸ Stephen G Marks, 'The Separation of Ownership and Control'.

⁷⁹ Barbara Novick, 'Executive Compensation: The Role of Public Company Shareholders' (*The Harvard Law School Forum on Corporate Governance*, 31 July 2019) <<https://corpgov.law.harvard.edu/2019/07/31/executive-compensation-the-role-of-public-company-shareholders/>> accessed 6 June 2023.

⁸⁰ *ibid.*

⁸¹ Jill E Fisch, Darius Palia and Steven Davidoff Solomon, 'Is Say on Pay All About Pay? The Impact of Firm Performance' (2018) 8 University of Pennsylvania Carey Law School 102. <https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2933&context=faculty_scholarship> accessed 6 June 2023

⁸² Eugene F. Fama and Michael C. Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301. <https://www.wiwi.uni-bonn.de/kraehmer/Lehre/SeminarSS09/Papiere/Fama_Jensen_Separation_ownership_control.pdf>

⁸³ Kraakman and others (n 12), p.13.

and operations. Their responsibility is to promote the interests of shareholders and the Group by overseeing the administration and proper operation organisation.⁸⁴

1.4.2. The Benefits of Separation of Ownership and Control

There are numerous advantages to separating ownership and management control. It is important to understand that the corporation referred to in the following paragraph is an publicly traded corporation with unrestricted common stock residual claims. Unrestricted common stock residual claims are distinguished by three characteristics: residual claimants are not required to participate in any way in the operation of the corporation, residual rights are transferable, and residual rights are unrestricted in the sense that they are limitless.⁸⁵

American economists Fama and Jensen argue that most complex organizations have a separation of ownership and control, as they put it, of decision management and residual risk. A complex organisation is one in which specialised knowledge required for specific decisions is distributed across all levels of the organisation. Because specific knowledge in complex organisations is diffused among agents, it can reduce costs by delegating decision initiation and implementation to agents with valuable relevant understanding.⁸⁶ The notion they put forward is that separation ensures the business's sustainability through management by a team of professionals with the diverse skills required to effectively run the company.

Fama and Jensen also discuss the advantages of delegation in light of the large number of shareholders that most modern corporations have. Because of a lack of qualifications, a lack of desire, or the sheer inefficiency of such an arrangement, all shareholders cannot be involved in the control and ratification of decisions.⁸⁷

Separation also makes capital maximisation easier. While every shareholder in the business will naturally have investment preferences, it is management's responsibility to identify the best ones

⁸⁴ 'Board of Directors Duties' (*Caverion*) <<https://www.caverion.com/investors/corporate-governance/BoD/board-of-directors-duties/>> accessed 23 March 2023.

⁸⁵ Fama and Jensen (n 79), p.312.

⁸⁶ Fama and Jensen (n 79), p.308.

⁸⁷ *ibid.*

and ways in which business assets can be effectively managed to maximise profits for all shareholders.⁸⁸

2. Chapter Summary

The chapter highlights the contemporary corporation as one of history's most successful inventions, that played a crucial part in capitalism throughout the last century. It illustrates the development of companies, beginning with the assumption that they were artificial, quasi-public institutions created to supply public goods. This position evolved in the late nineteenth and early twentieth centuries with the rise of the 'contractual' theory, which resulted in corporations having more rights, including the U.S. Supreme Court's legal proclamation of corporations as separate legal persons. The following defining characteristics of the corporation are then thoroughly assessed: Legal personality, transferable shares, separation of ownership and control, and economic justification for limited liability. Understanding the corporation and its key characteristics is critical for analysing the theory of veil piercing, which will be covered in detail in the next chapters.

III. A Theoretical Analysis of Veil Piercing Doctrine

Perhaps the most notable feature of the business corporation, and most likely its legal *raison d'être*, is the presumptive limited liability afforded to its shareholders. As a statutory creation, the modern corporation exists as a legal person distinct from its owners. It employs agents and employees, can enter into contracts with third parties, commit torts, make charitable contributions, grow and develop, and may eventually merge, be acquired, or dissolve. Corporate assets can be used to pay off corporate debts and obligations.⁸⁹ The recognition of the corporation's separate legal existence

⁸⁸ Francois Botha, 'The Importance of Separating Ownership And Management; 3 Steps To Get Families Started' (*Forbes*) <<https://www.forbes.com/sites/francoisbotha/2020/04/29/the-importance-of-separating-ownership-and-management-3-steps-to-get-families-started/>> accessed 23 March 2023.

⁸⁹ John H Matheson, 'The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context' 87 *North Carolina Law Review*.

protects shareholders from these claims.⁹⁰ Despite the significance of this distinction, courts have always been wary that the protection afforded by limited liability must be limited to ensure that business dealings remain honest.⁹¹ Notwithstanding the generality of the statutory rule of corporate law, limited liability has never been absolute.⁹² Corporate legislation frequently includes express exceptions to separate personality or limited liability. In addition, courts have never been completely comfortable with the concept of limited liability and have gone beyond legislative exceptions to disregard separate personality and extend liability to company shareholders or directors in extraordinary circumstances.⁹³ To impose shareholder liability, the claimant asks the court to disregard or "pierce" the statutory limited-liability shield, allowing corporate debts to be satisfied from the shareholders' or parent company's assets.⁹⁴ In other words, piercing the corporate veil (PCV) is a legal doctrine that allows courts to disregard the firm's default limited liability and a separate legal personality and impose the firm's debts on its owners in exceptional cases.⁹⁵

Courts pierce the corporate veil to protect third-party plaintiffs from unjust injury or harm inflicted by the corporation. It is an equitable remedy that may be applied in order to avoid injustice,⁹⁶ and the doctrine is recognised in most jurisdictions throughout the world. To pierce the corporate veil, it must be demonstrated that some injustice will occur if the veil is not pierced. To put it another way, the corporate veil is pierced when the corporation has abused its privilege of doing business in the corporate form in some way.⁹⁷

The PCV doctrine generally apply to all types of corporations. The majority of situations, however, involve two common categories: (1) close corporations, including solely owned and family-owned corporations, and (2) parent-subsidiary arrangements.⁹⁸ A review of the case law, reveals no

⁹⁰ *ibid.*

⁹¹ James Wiberley and others, 'Lifting, Piercing and Sidestepping the Corporate Veil' <<https://www.guildhallchambers.co.uk/uploadedFiles/PiercingtheCorporate%20Veil.JW,MDG.pdf>>.

⁹² Millon (n 5).

⁹³ Cheng Han Tan, Jiangyu Wang and Christian Hofmann, 'Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives', p.151 [2018] SSRN Electronic Journal <<https://www.ssrn.com/abstract=3254130>> accessed 30 March 2023.

⁹⁴ Matheson (n 82).

⁹⁵ Sharon Belenzon, Honggi Lee, and Andrea Pataconi, 'Towards a Legal Theory of the Firm: The Effects of Enterprise Liability on Asset Partitioning, Decentralization and Corporate Group Growth' [2018] NBER Working Paper <https://www.nber.org/system/files/working_papers/w24720/w24720.pdf> accessed 24 April 2023.

⁹⁶ *Roepke v Western Nat Mut Ins Co* (49602) 302 NW 2d 350 (Supreme Court).

⁹⁷ Watt (n 8).

⁹⁸ *ibid.*

instances in which the shareholders of a corporation whose stock was publicly traded or widely held were held personally liable for the corporation's obligations. As a result, the piercing doctrine primarily applies to close corporation, also referred to as privately held, corporation.⁹⁹

The PCV doctrine is generally vague and discretionary. Litigants generally cannot rely on uniform tests to predict how courts will approach their case, owing to the fact that veil piercing is widely justified on fact specific grounds that attempt to capture what types of owner-corporation relationships are illegitimate (and thus warrant veil piercing).¹⁰⁰ Typically, the PCV doctrine aims to eradicate the protection of limited liability in cases where owners have been identified as abusing the incorporation rationales. Both courts and legislatures have consistently struggled to formulate clear rules defining when the corporate veil should be pierced in order to translate this abstract purpose into concrete guidelines. Instead, they have developed broad frameworks in which a long list of variables can be considered in a two- or three-stage analysis.¹⁰¹ The following chapters will provide a more detailed discussion of how the PCV doctrine can apply to corporations in U.S., UK and Germany, depending on specific circumstances and judicial interpretation.

1. PCV is an Equitable Remedy

Equity, in a broad jurisprudential sense, refers to the ability to do justice in a specific case by exercising discretion to mitigate the rigidity of strict legal rules. In this broad sense, equity refers to the ability to tailor the relief to the specific circumstances of the case.¹⁰² In its simplest form, piercing the corporate veil is an equitable remedy available to creditors of corporate entities seeking to hold their owners liable for corporate debts.¹⁰³ Veil piercing, as an equitable remedy, is also subject to the established principles and maxims of equity. Among the maxims that are particularly applicable to veil piercing are the following: (1) equitable relief is available only when

⁹⁹ David H Barber, 'Piercing the Corporate Veil' (1980) 17 Willamette Law Review 371 <<https://ius.bg.ac.rs/wp-content/uploads/2020/12/Barber-Piercing-the-corporate-veil.pdf>>.

¹⁰⁰ Sharon Belenzon, Honggi Lee, and Andrea Pataconi (n 88).

¹⁰¹ *ibid.*

¹⁰² 'DeLuca v. Amica Mut. Ins. Co., 405 F. Supp. 3d 718' <<https://casetext.com/case/deluca-v-amica-mut-ins-co>> accessed 3 May 2023.

¹⁰³ Edward T. Kang, 'Piercing the Corporate Veil Under Pennsylvania Law' (*The Legal Intelligencer*, 20 June 2019) <<https://www.law.com/thelegalintelligencer/2019/06/20/piercing-the-corporate-veil-under-pennsylvania-law/>> accessed 24 April 2023.

there is no adequate legal remedy; (2) equity regards as done what ought to be done; (3) equity looks to the intent rather than the form; (4) equitable relief is extraordinary, not ordinary; and (5) equity only helps those who have done everything possible to help themselves.¹⁰⁴

If the person attempting to pierce an entity's veil has "unclean hands," the request may be denied.¹⁰⁵ In this context "unclean hands" refers to the principle of equity that states a party who seeks relief from the court must come to court with clean hands, meaning that they must have acted in good faith and have not done anything unethical in relation to the subject of the lawsuit.¹⁰⁶ For example, in *Tom Thumb Food Markets, Inc. v. TLH Properties LLC*, (1999)¹⁰⁷ Terry Hartmann, a commercial developer working through TLH Properties, LLC (TLH) (defendant), signed a lease agreement with Tom Thumb Food Markets, Inc. (Tom Thumb) (plaintiff) to develop the property. Hartmann attempted to obtain a bank construction loan for the property, which required financial details from Tom Thumb. After a little delay, Tom Thumb supplied the information to the bank, which denied the loan application since Tom Thumb had a negative net worth. Tom Thumb sued for breach of contract, claiming that Hartmann should be held personally liable under the doctrine of piercing the corporate veil. The Minnesota Court of Appeals denied Tom Thumb's attempt to pierce the veil of its LLC landlord in part because Tom Thumb had contributed to the failure to obtain the lease it sought by ignoring requests from the LLC and its bank for financial information from Tom Thumb.¹⁰⁸

*Truckstop.Net, L.L.C. v. Sprint Communications Company, L.P.*¹⁰⁹ involved a different but similar application of this doctrine. In that case, the court denied Sprint's motion to change its counterclaim

¹⁰⁴ Christopher W Peterson, 'Piercing the Corporate Veil by Tort Creditors' Journal of Business <<https://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1282&context=jbtl>>.

¹⁰⁵ Allen Sparkman, 'Will Your Veil Be Pierced? How Strong Is Your Entity's Liability Shield? — Piercing the Veil, Alter Ego, Ego, and Other Bases for Holding an Owner Liable for Debts of an Entity' (2016) 12 Hastings Business Law Journal <https://repository.uchastings.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1012&context=hastings_business_law_journal>.

¹⁰⁶ Kristen Johnson, 'Clean Hands Doctrine' (*LegalMatch Law Library*, 29 June 2006) <<https://www.legalmatch.com/law-library/article/clean-hands-doctrine.html>> accessed 13 July 2023.

¹⁰⁷ 'Tom Thumb Food Markets v. TLH Properties, No. C9-98-1277' <<https://casetext.com/case/tom-thumb-food-markets-v-tlh-properties>> accessed 7 June 2023.

¹⁰⁸ Sparkman (n 99).

¹⁰⁹ 'Truckstop.Net v. Sprint Communications Company, L.P., Case No. CV-04-561-S-BLW (Lead Case), Consolidated with CV-05-138-S-BLW' <<https://casetext.com/case/truckstopnet-v-sprint-communications-company>> accessed 7 June 2023.

to pierce the defendant LLC's veil and hold its members personally liable because Sprint knew of the LLC's financial condition and that its investors were refusing to bail it out long before it sought to amend its pleadings without good cause for the holdup.¹¹⁰

2. Objectives Behind the PCV Doctrine

All of the piercing cases can be explained as a judicial effort to achieve one of three goals which will be discussed in more detail below: (1) accomplishing the objectives of a specific regulatory or statutory scheme; (2) avoiding fraud or misrepresentation by shareholders seeking credit; and (3) promoting the bankruptcy value of eliminating favoritism among claimants to the cash flows of a firm.¹¹¹ First, piercing the corporate veil is used as a tool of statutory interpretation in the sense that it is used to bring corporate actors' behaviour into compliance with a specific statutory scheme, such as social security or state unemployment compensation schemes. For example, to achieve the specific legislative goal of a government benefit programme that distinguishes between owners and employees, the corporate form may be ignored at times. Of course, the corporate form will be abided by when it is necessary to achieve a result that is consistent with a specific state or federal statutory scheme.¹¹²

Second, courts also pierce the corporate veil to remedy what appears to be fraudulent behaviour that might not meet the strict elements of common law fraud.¹¹³ In particular, courts pierce as a remedy for "constructive fraud" in the contractual context. The United States and other common law jurisdictions generally identify nine elements to establish fraud: (1) a representation of fact; (2) that is false; (3) and that is material; (4) the representer's knows the statement of fact is false or is ignorant of its truth; (5) the representer intends that it should be acted upon by the person in the manner reasonably contemplated; (6) the injured party is ignorant of the statement's falsity;

¹¹⁰ Sparkman (n 99).

¹¹¹ Jonathan Macey and Joshua Mitts, 'Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil' 100 Cornell Law Review <<https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=4647&context=clr>>.

¹¹² Jonathan Macey and Joshua Mitts, 'The Three Justifications for Piercing the Corporate Veil' (*The Harvard Law School Forum on Corporate Governance*, 27 March 2014) <<https://corpgov.law.harvard.edu/2014/03/27/the-three-justifications-for-piercing-the-corporate-veil/>> accessed 6 April 2023.

¹¹³ Macey and Mitts (n 107).

(7) the injured party has relied on its truth; (8) the injured party had a right to rely thereon; and (9) the injured party experienced and proximate injury.¹¹⁴ A plaintiff must plead each element with detail and particularity in order to correctly assert a claim for common law fraud. For instance, in *In Re Jns Aviation, LLC*, (2009)¹¹⁵ which is the leading case in Texas, the court ruled that courts will pierce the corporate veil if the member(s) intended to use the business to commit fraud and the corporation actually perpetrated fraud "primarily for the direct personal benefit of the considered defendant." The court held that in order for the court to pierce the corporate veil, a company must be one of three things: (1) The corporation is the *Alter Ego* of the parent corporation or its shareholder(s), (2) the corporation is used to avoid legal limitations upon natural persons or corporations, (3) the corporation is a sham to perpetrate fraud. In addition, the court decided that "actual fraud" occurs when all four of the following occur: (1) "a party conceals or fails to disclose a material fact within the knowledge of that party", (2) "the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discover the truth", (3) "the party intends the other party to take some action by concealing or failing to disclose the fact", (4) "the other party suffers injury as a result of acting without knowledge of the undisclosed fact."¹¹⁶

However, a Fourth Circuit opinion in the case of *DeWitt Truck Brokers v. W. Ray Flemming Fruit* stated that "proof of plain fraud is not a necessary element in a finding to disregard the corporate entity."¹¹⁷ Unlike fraud constructive fraud is defined by Black's Law Dictionary as "all acts, omissions, and concealments involving breach of equitable or legal duty, trust or confidence, and resulting in damage to another."¹¹⁸ Simply put, if a court is convinced that a shareholder or other equity investor has, through words or actions, led a contracting party to believe that an obligation

¹¹⁴ Robert D Mitchell, 'The Elements of Common Law Fraud' <<https://www.robertdmitchell.com/common-law-fraud>> accessed 7 June 2023.

¹¹⁵ *In Re Jns Aviation, LLC*, 376 BR 500 – CourtListener.com [2007] United States Bankruptcy Court, ND Texas, Amarillo Division 19-30720. <https://www.courtlistener.com/opinion/1867114/in-re-jns-aviation-llc/> accessed 12 June 2023.

¹¹⁶ 'Piercing the Corporate Veil' (*LII / Legal Information Institute*) <https://www.law.cornell.edu/wex/piercing_the_corporate_veil> accessed 12 June 2023.

¹¹⁷ *DeWitt Truck Brokers v. W. Ray Flemming Fruit*, 540 F.2d 681 <<https://casetext.com/case/dewitt-truck-brokers-v-w-ray-flemming-fruit>> accessed 24 April 2023.

¹¹⁸ 'Constructive Fraud and Other Legal "Constructs"' <<https://www.stimmel-law.com/en/articles/constructive-fraud-and-other-legal-constructs>> accessed 7 June 2023.

is a personal liability rather than (or in addition to) a corporate debt, courts will sometimes use piercing theory rather than fraud theory to impose liability on the individual shareholder.¹¹⁹

The third ground on which courts pierce the corporate veil is the promotion of what we term accepted “bankruptcy values.” Particularly, courts will disregard the corporate form in order to prevent fraudulent conveyances and preferential transfers. The objective of corporate bankruptcy law is to maximise an insolvent company's value for the benefit of all creditors. An important component of achieving this goal is resolving the collective action problem facing a corporation's creditors, who have incentives to race for relief in order to get a jump on other creditors in the absence of rules such as the automatic stay, which prevents creditors from seizing a company's assets after it has filed for bankruptcy.¹²⁰ Similarly, bankruptcy law seeks an orderly disposition of the debtors' assets, whether through corporate reorganisation or liquidation. The way bankruptcy law achieves these goals is by preventing shareholders from moving corporate assets to themselves or to specific favoured creditors ahead of other creditors during times of severe economic duress. This result is achieved in the context of a formal bankruptcy proceeding by employing the doctrine of equitable subordination as well as the bankruptcy trustee's power to avoid and set aside preferential transfers and fraudulent conveyances. Outside of bankruptcy, the purpose of eliminating opportunism by companies in financial difficulties is achieved by disregarding the corporate form.¹²¹

Given the critical importance of limited liability in the economic and legal systems, "the burden on a party attempting to pierce the corporate veil" is "heavy."¹²² In the case of *Calvert v. Huckins*, the U.S. Court of Appeals for the Ninth Circuit ruled in 1997 that courts in the U.S. will only pierce the corporate veil in exceptional circumstances.¹²³ As a result, disregarding the corporate form and imposing liability on affiliated corporate entities is an "extreme remedy that should be used sparingly" and should be approached "with caution."¹²⁴

¹¹⁹ Macey and Mitts (n 107).

¹²⁰ Macey and Mitts (n 108).

¹²¹ *ibid.*

¹²² Douglas G Smith, ‘Piercing the Corporate Veil in Regulated Industries’ p.5.

¹²³ ‘*Calvert v. Huckins*, (E.D.Cal. 1995), 875 F. Supp. 674 | E.D. Cal., Judgment, Law, Casemine.Com’ (<https://www.casemine.com>) <<https://www.casemine.com/judgement/us/5914bd9fadd7b049347a3864>> accessed 30 March 2023.

¹²⁴ *Corona Summit, LLC and US Bank National Association vs SPUS05 Corona Summit, LP* The Court of Appeal of the State of California B231109.

Considering that veil piercing occurs only in exceptional cases where the use of the corporate vehicle is inconsistent with the legislative purpose underlying corporate personality and limited liability, the courts express a strikingly similar rationale underlying veil piercing.¹²⁵ For instance, Lord Sumption stated in *Prest v. Petrodel Resources Ltd.*(2013) that "recognition of a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is not to be disarmed in the face of abuse."¹²⁶ Lord Sumption reviewed the cases on piercing the corporate veil and concluded that the principle that a court may be justified in piercing the corporate veil if a company's separate legal personality is being abused is well established in the authorities and is consistent with the general approach of English law to the problems raised by the use of legal concepts to defeat mandatory rules of law is well established in the authorities. He did, however, point out that the actual challenge is determining what constitutes a significant infraction for the principle to be invoked, and that the phrases "façade" and "sham" raise too many difficulties to offer a satisfying response. He believed that these phrases were founded on two distinct principles, namely the concealment principle and the evasion principle. The concealment principle essentially states that the court will look behind a company to see who the real actors are. The evasion principle is applied when a firm is used to defeat or frustrate a legal claim.¹²⁷

In the United States and the United Kingdom, courts have also used abuse as the underlying principle to justify disregard for corporate personality. In *Glazer v. Commission on Ethics for Public Employees*, the Louisiana Supreme Court ruled in 1983 that, a court may "pierce the corporate veil when the established norm of corporateness has been so abused in conducting a business that the venture's status as a separate entity has not been preserved."¹²⁸ The following are the most common manifestation of abusive behaviour: mixed personality, mixed property, undercapitalization, parent company control over subsidiary enterprises, and so on.¹²⁹ Moreover, a party seeking to pierce the corporate veil must prove that the corporation was so ignored,

¹²⁵ Tan, Wang and Hofmann (n 86).

¹²⁶ *Prest v Petrodel Resources Limited and others* (Supreme Court of the United Kingdom).

¹²⁷ Neil Micklethwaite, Nicholas Tse and Roger Kennell, 'Piercing the Corporate Veil - a Limited Principle under English Law: *Prest v Petrodel*' (*Brown Rudnick*) <<https://brownrudnick.com/alert/piercing-the-corporate-veil-a-limited-principle-under-english-law-prest-v-petrodel/>> accessed 30 March 2023.

¹²⁸ Tan, Wang and Hofmann (n 86).

¹²⁹ Chan Hu, 'On the Perfect Path of the Company's Legal Person Deny System:' (2022) <<https://www.atlantispress.com/article/125973961>> accessed 12 June 2023.

controlled, or manipulated that it was merely an instrument of another and that misusing the corporate form would constitute fraud or promote injustice.¹³⁰

3. Types of Creditors of Piercing the Corporate Veil

In the early 1990s, Professor of Law Robert B. Thompson of Washington University conducted an empirical study that examined claims of piercing the corporate veil cases by analysing the nature of the corporations, the plaintiffs, the courts, and the reasons given by the courts for piercing or not piercing the corporate veil. Professor Thompson's most important discovery was that the piercing of the corporate veil in the U.S. occurred more frequently in contract cases than in tort cases.¹³¹ Therefore, under the PCV doctrine, a distinction can be made between voluntary (contractual) and involuntary (tort) creditors.¹³² No explanation for the "dominance" of veil-piercing for contract creditors versus tort creditors had emerged nearly two decades after Thompson published his study. Some commentators suggested that contract claims were simply a better way to get piercing cases in front of a judge, whereas others saw the findings as evidence of how poorly courts were handling the piercing doctrine. To gain clarity, Associate Professor of Law at the University of Pittsburgh School of Law, Peter Oh carried out a follow-up study.¹³³ Professor Oh's study covered a broader time span than Thompson's and examined a total of 2,908 piercing cases.¹³⁴ Many of Thompson's findings were confirmed by his findings, including that the most successful veil-piercing claims were and still are based on fraud or misrepresentation and are supported by specific evidence of such conduct. This strengthens the argument that limited liability should not permit shareholders to act opportunistically towards third parties, whether contract creditors or tort creditors. In stark contrast to Thompson's findings, Oh's findings indicated that

¹³⁰Podlaski LLP, 'Piercing the Corporate Veil' (*Podlaski LLP*, 1 June 2020) <<https://www.podlaskilegal.com/post/piercing-the-corporate-veil>> accessed 30 March 2023.

¹³¹ Lauren E. Douglas, 'Narrowing the Road to Recovery: A Proposal to Tighten the Reins on the Doctrine of Piercing the Corporate Veil' <<https://www.stetson.edu/law/business-law-review/media/Spring%202022%20Tightening%20the%20Reigns%20on%20Piercing%20the%20Corporate%20Veil.pdf>>.

¹³² Irakli Burduli, *Authorized Capital and Its Functions, Collection: Theoretical and Practical Issues of Contemporary Corporate Law* (2009) (in Georgian).

¹³³ Lauren E. Douglas (n 123).

¹³⁴ *ibid.*

tort creditors prevailed more frequently than contract creditors, respectively bringing the results back in line with intuitive thinking.¹³⁵

Just as veil piercing was intended to protect contract creditors from the costs of fraud and misrepresentation (due to their inability to demand adequate compensation *ex ante*), veil piercing for tort creditors arose, in part, as a result of such creditors' inability to negotiate adequate compensation for corporate activities that have social costs that outweigh their social benefits. Without the equitable remedy of veil piercing, tort creditors effectively subsidise corporations' excessive risk-taking.¹³⁶

The most significant distinction between a contract creditor and a tort creditor is that, unlike tort creditors, many contract creditors have real chances to evaluate credit risks and contract around the potential injury with the corporation prior to forming a relationship with the enterprise. This is arguably the most significant advantage that voluntary creditors have over involuntary creditors.¹³⁷ On the other hand, Oh's findings suggest that involuntary tort creditors have an easier path to recovery under the piercing doctrine due to their inability to protect themselves from potential injury ahead of time.¹³⁸

IV. Veil Piercing Doctrine in Different Jurisdictions

1. Context for Veil Piercing Doctrine in the United States

Perhaps the most litigated issue in U.S. corporate law is the doctrine of piercing the corporate veil.¹³⁹ The phrase ("piercing the veil") was initially coined in 1912 by Professor Maurice Wormser while the doctrine of limited liability had begun to emerge in the United States much earlier, with

¹³⁵ Lauren E. Douglas (n 123).

¹³⁶ Peterson (n 98).

¹³⁷ Lauren E. Douglas (n 123).

¹³⁸ *ibid.*

¹³⁹ Shahrokh Sheik, 'Veil Piercing Litigation (Part I)' (*Weinberg Gonser Frost LLP*, 28 February 2021) <<https://www.wgfcounsel.com/veil-piercing-litigation-part-i-ten-10-key-considerations-for-business-owners/>> accessed 29 April 2023.

no generally agreed upon specific start date.¹⁴⁰ An enactment of five variant statutes enacted by the Massachusetts legislature, from 1809 to 1830, legislation of shareholder liability appears to have been the first milestone of the expansive adoption of the limited liability doctrine in the United States.¹⁴¹ The principle was approved by the court in the case of *Wood v. Dummer*, (1824).¹⁴²

The reluctance of granting damages awards against corporations could be seen in early U.S. judicial decisions, and for this reason, the removal of the corporate veil was hardly expected, in accordance with the enormity and desirability of a corporate entity structure devoted to financial and economic advantages.¹⁴³ An example of this is the 18th Century Mill Acts in New England which stated that owners of land adjacent to mills could not sue for damages if their property flooded as a result of water storage and discharge.¹⁴⁴ However, in the landmark case of *United States v. Milwaukee Refrigerator Transit Co.* in 1905, the Circuit Court for the Eastern Division of Wisconsin first stated the general rule on veil piercing.¹⁴⁵ the court determined that "a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears." ¹⁴⁶ The court interpreted veil piercing as "when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons."¹⁴⁷ In other words, the Milwaukee ruling determined that the corporation would be regarded as a partnership in any of the scenarios described above, subjecting all of the partners to joint and unlimited liability. While this case is not regarded as a pivotal decision in contemporary legal debates, it is crucial to highlight that the legal precedent set in *Milwaukee Refrigerator Transit Co.* nevertheless had a substantial impact because the case first expressed the general rule on veil piercing.

¹⁴⁰ 'Piercing the Corporate Veil Law: Direction and Shareholder Liability in Japan, Thailand and USA' <<http://thailawforum.com/articles/Piercing-the-Corporate-Veil-Doctrine-in-Comparative-3.html>> accessed 29 April 2023.

¹⁴¹ *ibid.*

¹⁴² 'Wood v. Dummer, 30 F. Cas. 435' <<https://casetext.com/case/wood-v-dummer>> accessed 30 April 2023.

¹⁴³ Praphrut Chatprapachai, 'Piercing the Corporate Veil Doctrine in Comparative View' <file:///C:/Users/User/Downloads/Piercing_the_corporate_veil_doctrine_in.pdf> accessed 30 April 2013.

¹⁴⁴ Carsten Alting, 'Piercing the Corporate Veil in American and German Law - Liability of Individuals and Entities: A Comparative View' 2 <<https://digitalcommons.law.utulsa.edu/cgi/viewcontent.cgi?article=1166&context=tjcl>>.

¹⁴⁵ Dante Figueroa, 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' [2012] SSRN Electronic Journal <<http://www.ssrn.com/abstract=2148799>> accessed 13 April 2023.

¹⁴⁶ 'United States v. Milwaukee Refrigerator Transit Co.' (vLex) <<https://case-law.vlex.com/vid/united-states-v-milwaukee-890446018>> accessed 30 April 2023.

¹⁴⁷ *ibid.*

To establish the historical origins of veil piercing it is important to note another landmark and one of the earliest court decisions in *Booth v. Bunce*, (1865)¹⁴⁸ where the court stated that the corporate veil would be pierced if the corporation was formed to deceive and mislead creditors. Courts in the United States have since developed a variety of theories and methods for determining whether or not a corporate veil should be pierced. These theories serve as a sort of template for courts in their pursuit of a decision and will be analyzed in detail in the further chapters of this thesis.

2. The Notion of Fraud at the Epicenter of Veil Piercing Under Federal Law

In the U.S., fraud is generally a conspicuous ground for veil piercing since it arises in a variety of different contexts, including lies or misrepresentations about the purpose of the entity, its capital, debts, assets, independence, the identity of its representatives or on other representations made to third parties. Fraud may also involve greed, hence implying an illicit transfer of property (monies or assets) not belonging to the transferor. As a result, a plethora of stakeholders, including shareholders, directors, officers, accountants, and others, as well as corporations themselves, may be involved or colluded to commit fraud in a variety of and infinite contexts.¹⁴⁹ In 1910 the U.S. Supreme Court in the case of *J.J. McCaskill Co. v. United States*¹⁵⁰ ruled that veil piercing should be permitted when a shareholder was aware of a fraud committed by another shareholder. The Court also stated that limited liability should not be enforced to the extent that the corporation becomes a means of fraud or evasion of its responsibilities.¹⁵¹ In this manner, a notion of fraud can be dated back to the beginning of veil piercing jurisprudence in the United States.

In another decision, the U.S. supreme court noted that circumventions of the law would not be tolerated in order to avoid liability in a parent-subsidary scheme.¹⁵² The Court's landmark decision acknowledged Reading Co.'s complex corporate structure, which included a holding company that

¹⁴⁸ 'Booth v. Bunce, 33 N.Y. 139' <<https://casetext.com/case/booth-v-bunce-et-al>> accessed 30 April 2023.

¹⁴⁹ Irshad Hameed, 'The Doctrine of Limited Liability and the Piercing of the Corporate Veil in the Light of Fraud: A Critical Multi-Jurisdictional Study' [2012] SSRN Electronic Journal <<http://www.ssrn.com/abstract=2282306>> accessed 3 May 2023.

¹⁵⁰ 'McCaskill Co. v. United States, 216 U.S. 504 (1910)' (*Justia Law*) <<https://supreme.justia.com/cases/federal/us/216/504/>> accessed 3 May 2023.

¹⁵¹ *ibid.*

¹⁵² *United States v Reading Co* (1911) 226 US 324 (Supreme Court).

controlled Reading Co. and a wholly-owned subsidiary coal company that was originally organised by Reading Co. Because Reading Co. was engaged in both mining and transport services in interstate commerce, the Court upheld the finding that Reading Co. had committed an antitrust violation. Based on this abovementioned argumentation and because the corporate form was utilised fraudulently to violate the law, the Court eventually treated all of the corporations in the holding as a single entity.¹⁵³

In 1925, the U.S. Supreme Court clarified the broad rule on liability in the parent-subsidary context in the case of *Davis v. Alexander*.¹⁵⁴ The court concluded that where a subsidiary firm is controlled by a parent company and the two operate "as a single system, the dominant company will be liable for injuries due to the negligence of the subsidiary company."¹⁵⁵

Finally, in 1998, perhaps the best-known case on veil piercing is *United States v. Bestfoods*.¹⁵⁶ For the purposes of veil-piercing analysis, the U.S. Supreme Court primarily concentrated on the parent-subsidary relationship. In its decision, the Court acknowledged the importance of shielding parent corporation shareholders from liability for corporate debts and therefore, as a standard for veil piercing, it recognised involvement in the subsidiary's activities rather than control over the subsidiary. In this manner, the parent is liable not because of the subsidiary's actions, but because of its own. The Court stated that veil piercing is permissible under common law when "the corporate form was used to accomplish certain wrongful purposes, most notably fraud, on the shareholder's behalf."¹⁵⁷

As a result, the concept of fraud was central to the development of the veil-piercing theory over the twentieth century. It is still a highly essential concept in veil-piercing cases today, as there have been a number of recent significant federal cases involving fraud. Some of these will be discussed further down.

¹⁵³ *ibid.*

¹⁵⁴ 'Davis v. Alexander, 269 U.S. 114 (1925)' (*Justia Law*) <<https://supreme.justia.com/cases/federal/us/269/114/>> accessed 3 May 2023.

¹⁵⁵ *ibid.*

¹⁵⁶ 'United States v. Bestfoods, 524 U.S. 51 (1998)' (*Justia Law*) <<https://supreme.justia.com/cases/federal/us/524/51/>> accessed 3 April 2023.

¹⁵⁷ *ibid.*

For example, in the case of *SEC v. Wyly* (2014)¹⁵⁸ civil enforcement action was launched by the Securities and Exchange Commission ("SEC") against Samuel Wyly and Charles J. Wyly Jr. The Wyly brothers were well-known Texas businessmen who gained substantial fortune through multiple ventures such as Sterling Software Inc., Michaels Stores Inc., and others. However, the SEC charged them with breaching federal securities laws by engaging in fraudulent behaviour to conceal their ownership and trading of certain stocks. The main charge was that the brothers established a complex system of offshore trusts and corporations through which they conducted trades and exercised control over large assets. However, they neglected to report these assets and transactions to the SEC, as required by federal securities regulations. The SEC urged the court to breach the corporate veil of these offshore trusts and subsidiaries in order to hold the Wyly brothers personally responsible for securities law violations committed via those entities. The United States District Court for the Southern District of New York decided in favour of the SEC, holding the Wyly brothers liable for their acts via the offshore businesses. This decision is noteworthy because it highlights the principle of separate corporate personality and that the corporate form will not shield individuals from liability if they use it to carry out fraudulent or criminal conduct. The court's decision to pierce the corporate veil serves as a reminder to other business owners that merely establishing distinct legal enterprises will not protect them from accountability. Ultimately, the Wyly case is significant in terms of veil piercing because it reinforces the principle that a corporate form should not be misused to avoid legal responsibilities and obligations.

2.1.Veil piercing on the Federal level

The expansion of veil-piercing doctrine beyond fraud in the U.S. was the result of the decision of the Supreme Court in the case of *Anderson v. Abbott*, (1944).¹⁵⁹ In this case, the Court considered public policy considerations in corporate undercapitalization as a basis for veil piercing.¹⁶⁰

The case of *Fletcher v. Atex, Inc.* (1995)¹⁶¹ is another landmark ruling by the U.S. Court of Appeals for the Second Circuit. Eastman Kodak, Inc. (Kodak) (defendant) owned 100% of Atex, Inc.

¹⁵⁸ 'SEC v. Wyly, 10-Cv-5760 (SAS)' <<https://casetext.com/case/sec-exch-commn-v-wyly-6>> accessed 22 July 2023.

¹⁵⁹ *Anderson v Abbott* (3) 321 US 349 (Supreme Court).

¹⁶⁰ *ibid.*

¹⁶¹ 'Fletcher v. Atex, Inc., 68 F.3d 1451 | Casetext Search + Citator' <<https://casetext.com/case/fletcher-v-atex-inc>> accessed 23 July 2023.

(defendant). Fletcher and Hermanson, the plaintiffs, sued Atex and Kodak, claiming that Atex's keyboards caused repeated stress injuries. Individuals who claimed to have been damaged by the keyboards wanted Kodak to be held personally liable for their injuries, claiming that Kodak abused the corporate form and Atex was simply its *Alter Ego* since (1)Atex took part in a cash management system in which its funds were pooled with those of other Kodak companies and controlled by Kodak, (2)Kodak's approval was necessary for any important decisions or expenditures made by Atex, (3)there also was some overlap between the boards of Kodak and Atex. (4) some Kodak corporate documents mentioned a merger between Kodak and Atex, and Atex was referred to as a part of Kodak, (5) As part of a transaction with a third party, Atex allocated its CEO's mortgage to Kodak. It is important to note, that in terms of the mortgage assignment and corporate operations in general, Atex followed all corporate formalities. The court stated that in order to successfully proceed on an alter ego theory to impute liability for Atex's actions to Kodak, the plaintiff would have to demonstrate both that the two companies operated as a "single economic entity" and that there was some unfairness or inequity in not piercing the veil. The court emphasised that, while fraud could be employed to pierce the veil, it was not an obligatory element. The court could consider the following factors in determining whether the two companies formed a "single economic entity": "whether the subsidiary was adequately capitalised if it was solvent if it paid dividends, how the records were kept, how the officers functioned, whether corporate formalities were observed, whether funds were taken away for use by the parent company, and if it operated as a facade." The court found that these elements did not lead to a determination that it should pierce the veil, noting that the use of a cash management system and a small overlap in the boards of directors between the two firms was insufficient.

Another interesting case is *In Re: Essar Steel Minnesota LLC and ESML Holdings Inc.* (2018).¹⁶² The bankruptcy court in this case dealt with the complicated financial status of Essar Steel Minnesota LLC (ESML) and its parent, ESML Holdings Inc. The Debtors worked in the steel and iron industry and had invested much in the development of a steel manufacturing factory in Minnesota. However, due to a variety of financial problems, including cost overruns and delays, in 2016 Debtors declared bankruptcy. During the bankruptcy proceedings, creditors and the bankruptcy trustee expressed concerns about the possibility of a corporate veil between the

¹⁶² 'IN RE: ESSAR STEEL MINNESOTA LLC and ESML Holdings Inc. (2018)' (*Findlaw*)
<<https://caselaw.findlaw.com/court/us-ban-crt-d-del/1945079.html>> accessed 22 July 2023.

subsidiary and its parent company. Therefore, the U.S Bankruptcy Court for the District of Delaware had to decide whether to pierce the corporate veil and hold ESML Holdings Inc. liable for ESML's debts and obligations. The court considered various factors, including the parent company's level of domination and control over its subsidiary, whether ESML Holdings Inc. treated ESML's assets as its own, and whether the entities observed proper corporate formalities and financial separateness, and ruled in favour of the parent company, emphasising the importance of corporations maintaining separate legal identities. The court's decision and reasoning, in this case, were crucial because they established the circumstances under which a parent company could potentially be held liable for its subsidiary's obligations.

3. Most Common Grounds Used for Veil Piercing

In determining whether the corporate form should be ignored and the principle of limited liability pierced in exceptional circumstances, courts generally consider a number of factors, none of which is sufficient to establish liability on its own. These factors are usually intended to determine whether certain, more fundamental, elements are met and are generally looked at together.¹⁶³ To pierce the corporate veil, it is usually necessary to demonstrate that a parent or affiliated entity exercised dominance or control over the entity in question, such control is used by the defendant to commit fraud or wrong, to violate a statutory or other positive legal duty, or to commit a dishonest and unjust act in violation of the plaintiff's legal rights; and the aforementioned control and breach of duty must proximately cause the injury or unjust loss complained of.¹⁶⁴

3.1. Domination and Control

The most frequently addressed issue in piercing cases that can lead to the applicability of the PCV doctrine is dominance and control.¹⁶⁵ Ordinary control always accompanies the normal parent-

¹⁶³ Smith (n 114).

¹⁶⁴ *KC Roofing Ctr v On Top Roofing, Inc* (Missouri Court of Appeals).

¹⁶⁵ Matheson (n 64), p.36.

subsidiary relationship.¹⁶⁶ A parent corporation can be directly involved in the financing and management of its subsidiaries, however, without exposing itself to a charge that each subsidiary is merely its *Alter Ego*.¹⁶⁷ Moreover, parents and dominant shareholders are almost always "active participants" in an owned corporation's affairs. And, in most cases, exercising such control over a subsidiary's actions is entirely permissible and does not expose the owner to personal liability.¹⁶⁸ For instance, the parent company can elect the board of directors, which is the corporation's policy-making organ. The chosen board then selects the officers and managers for the subsidiary. Any core strategic or policy changes in the subsidiary's operations are often initiated by the parent, either directly or through the board, and must be approved by shareholders. This is control or dominance in the normal and commonly exists in the parent-subsidiary situation.¹⁶⁹ Appropriate parental involvement includes monitoring subsidiary performance, supervision of finance and capital budget decisions, and formulation of general policies and procedures.¹⁷⁰

On the other hand, this category of dominance addresses situations in which the courts found that the parent exercised extraordinary control over the subsidiary company.¹⁷¹ In *Lowendahl*, the court determined that domination necessitates greater control than that of a majority shareholder and that control of the subsidiary was required in the transaction at issue.¹⁷²

The court broadened this concept in *Ocala Breeders' Sales Co. v. Hialeah, Inc.*, where it pierced the corporate veil to pursue the personal liability of corporate officers, and found that the following were indicators of a showing that the subsidiary was merely an instrumentality of the parent corporation: (1) the same person controlled both the parent and subsidiary; (2) they operated out of the same facilities as the parent; (3) the subsidiary's contracts were performed by employees of

¹⁶⁶ 'Domination and Control Definition' (*Law Insider*) <<https://www.lawinsider.com/dictionary/domination-and-control>> accessed 3 April 2023.

¹⁶⁷ *Doe v. Unocal Corp.*, 248 F.3d 915 <<https://casetext.com/case/doe-v-unocal-corp-2>> accessed 3 April 2023.

¹⁶⁸ *Esmark, Inc. v. National Labor Relations Board*, 887 F.2d 739 (1989) <<https://cite.case.law/f2d/887/739/>> accessed 3 April 2023.

¹⁶⁹ Matheson (n 82).

¹⁷⁰ *United States v. Bestfoods*, 524 U.S. 51 (1998) (n 149).

¹⁷¹ Matheson (n 82).

¹⁷² Figueroa (n 137).

the parent; (4) the subsidiary was never capitalized; and (5) the subsidiary shared bank accounts and financial obligations with the parent.¹⁷³

In conclusion, it's important to note that to pierce the veil, "exclusive dominance and control... to the point where the subsidiary no longer has a legal or independent significance of its own" is required.¹⁷⁴

3.1.1. *Domination and Control by Nonowners*

Traditionally, under the veil-piercing doctrine, only a corporation's shareholders, directors, or officers can be held personally liable. However, courts have expanded this category and as a result, anyone who is not a shareholder, director, or officer of a corporation but has substantial control over it may be held personally liable to third parties for the corporation's obligations. This was discussed in the case of the Colorado Court of Appeals (the state's intermediate appellate court) *McCallum Family L.L.C. v. Winger*.¹⁷⁵ The case involved Manitoba Investment Advisors Inc. ("Manitoba") who entered into a commercial triple-net lease with McCallum Family L.L.C. ("McCallum") as the lessor. Despite a lease requirement, Manitoba neglected to pay property taxes in 2003, 2004, and part of 2005. Furthermore, Manitoba vacated the property seven months before the lease's end date and defaulted on its rent payments. McCallum obtained a \$76,000 judgement against Manitoba. The lawsuit's parties agreed that Manitoba became insolvent in September 2004. McCallum attempted to hold Marc Winger personally liable for the judgement, but the trial court refused to "pierce the corporate veil" and hold Mr. Winger personally liable. However, The Colorado Court of Appeals, imposed *Alter Ego* liability on Marc Winger, although he was not a shareholder, director, or officer of Manitoba. He was, nevertheless, married to one half-shareholder who was a director and officer of Manitoba, and he was the son of the other half-shareholder who was also a director and officer. In addition, the evidence suggested that Mr. Winger handled nearly all of Manitoba's business with McCallum, including signing checks and renegotiating leases.

¹⁷³ Jimerson, Cobb PA-Charles B Jimerson and Brittany N Snell, 'The Five Most Common Ways to Pierce the Corporate Veil and Impose Personal Liability for Corporate Debts' (*Lexology*, 2 March 2016) <<https://www.lexology.com/library/detail.aspx?g=4ff8ebf0-4bca-426e-8273-758140f6d0eb>> accessed 3 April 2023.

¹⁷⁴ 'Outokumpu Eng'g Enters., Inc. v. Kvaerner Enviropower, Inc., 685 A.2d 724' <<https://casetext.com/case/outokumpu-engineering-enterprises-v-kepi>> accessed 3 April 2023.

¹⁷⁵ *McCallum Family LLC v Winger* (2009) 221 P 3d 69 (Court of Appeals, 7th Div).

Furthermore, despite not being a shareholder, he received a number of "distributions" from Manitoba. In the state of Colorado, if a court determines that an *Alter Ego* relationship exists, then it must decide whether justice requires recognising the substance of the relationship between the person or entity sought to be held liable and the corporation over the form because the corporate fiction was "used to perpetrate a fraud or defeat a rightful claim." In the McCallum case, the Court of Appeals examined the facts and determined that Mr. Winger was Manitoba's *Alter Ego*. The court's general conclusion was that "an individual should not be able to defeat the *Alter Ego* prong of the veil-piercing analysis merely because he or she has no formal ownership interest in the corporation, and does not hold the title of officer or director."

The Minnesota Court of Appeals (State Court of Appeals) has also extended veil-piercing liability to non-shareholders and non-members. In *Equity Trust Company v. Cole*,¹⁷⁶ the court investigated several individuals' veil-piercing claims arising from an extensive fraudulent real estate investment scheme. The defendants suggested that because they were not shareholders or members of the defendant entities, they should not be held personally liable. The court did not share this view and stated:

"Much of the evidence suggests that the Thompsons did maintain an ownership interest in the entities. But whether a party holds an ownership interest in the entity is not dispositive. Veil piercing is an equitable remedy, and courts are to consider "reality and not form" in determining a party's involvement in a corporate enterprise. If veil piercing were solely dependent on a party's ownership interest in an entity, unscrupulous parties could avoid personal liability under the doctrine by simply acting in a capacity that does not involve ownership. Because veil piercing is grounded in equity and intended to prevent abuse of corporate protections, we hold that a district court may pierce the corporate veil to impose personal liability against any party who disregards the corporate form, regardless of whether the party holds an ownership interest in the entity."

It is now established that a corporation can be held to be the *Alter Ego* of a person who is not a shareholder, officer, or director of the corporation if the person has enough control over the corporation to warrant such a finding.

¹⁷⁶ *Equity Trust Co Custodian v Cole* (2009) 766 NW 2d 334 (Court of Appeals).

3.2. Disregard of Formalities

A number of factors are considered by courts in evaluating whether the threshold required to establish the necessary domination and control has been met. Adherence to corporate formalities is one of the most frequently cited variables when assessing whether there has been excessive dominance or control.¹⁷⁷ Corporate formalities encompass the holding of annual meetings of directors and shareholders or members, keeping accurate, detailed records ("minutes") of important decisions made at meetings, implementing company bylaws, and ensuring that officers and agents follow those bylaws,¹⁷⁸ as well as keeping separate corporate records, issuing stock, and avoiding commingling of funds. This must be followed to establish the corporation as a separate entity.¹⁷⁹ This requirement is known by several different names. For example, if the sole shareholder controls the corporation, the corporation may be the sole shareholder's "*Alter Ego*," or a total "unity of ownership and interest" may exist between the shareholders and the corporation, or the corporation may have become the shareholder's "mere instrumentality."¹⁸⁰ While the disregard for corporate formalities is widely emphasised, the reasoning behind this aspect of the test is hardly explained. When there are only one or a few shareholders, the shareholder-owners effectively control and direct the affairs of the corporation for their own personal gain by controlling shareholder meetings and serving as directors and officers of the corporation. As a result, there is typically a unity of interest between the shareholders of a closely owned firm. However, the aim behind the formalities prong is to prevent shareholder-owners from jeopardising the interests of other parties by taking unity of interest too far. How does failure to observe the formalities requirement justify piercing? First, a court may presume that failure to observe a certain corporate formality directly harmed the plaintiffs' interests in a particular case. For example, failure to keep the shareholder's assets separate and distinct from those of the corporation may result in insufficient corporate resources to satisfy the plaintiff's claim. Similarly, failure to hold directors' meetings could prevent the board from ensuring that the company has the financial resources to

¹⁷⁷ Smith (n 114).

¹⁷⁸ 'Piercing the Corporate Veil: When LLCs and Corporations May Be at Risk' (www.nolo.com) <<https://www.nolo.com/legal-encyclopedia/personal-liability-piercing-corporate-veil-33006.html>> accessed 3 April 2023.

¹⁷⁹ David H Barber, 'Piercing the Corporate Veil' (1980) 17 Willamette Law Review <<https://ius.bg.ac.rs/wp-content/uploads/2020/12/Barber-Piercing-the-corporate-veil.pdf>>.

¹⁸⁰ *ibid*.

insure against business risks.¹⁸¹ However, few courts directly analyse the effects of neglected formalities on the plaintiff's damages. *Harrison v. Puga* (1971)¹⁸² is one case in which the Court of Appeals of Washington did link a disregard for corporate formalities to the plaintiff's specific prejudice. There the court explained:

” The court must do so, however, for an adequate reason. Often the reason given is a public advantage, requirements of justice, *Alter Ego*, fraud, bad faith, or other wrong. Such cases often mean nothing more than that the violation of duty will result if the entity is not disregarded. First, when the corporate stockholder himself by his overt acts in dealing with the corporation disregards the separate entity of the corporation to the prejudice of such a third person, he can scarcely complain if the court judges him by his conduct and likewise disregards the corporate entity in order to enforce the right owed to the person dealing with that corporation. In the instant case, the defendant's overt intention to disregard the entity of Cascade Cablevision, Inc., is evidenced by the fact that he stripped the corporation of all its assets and took substantial assets in his own name for which he refuses to account to the corporation. He could scarcely have disregarded the corporation more”¹⁸³

Therefore, a second and more general rationale is that, in the absence of unfairness, if the shareholder-owner has disregarded corporate formalities, the court will overlook the distinction and hold the shareholder liable without considering whether the failure of formalities actually caused the plaintiff's injury.

3.3. Inadequate Capitalization

Undercapitalization is frequently cited as another key reason for piercing the corporate veil, and it is one of the first factors considered by courts when determining whether fraud or bad faith was involved.¹⁸⁴ Undercapitalization generally refers to a lack of capital contributions by shareholders

¹⁸¹ *ibid.*

¹⁸² ‘*Harrison v. Puga*, 4 Wn. App. 52 | Casetext Search + Citator’ <<https://casetext.com/case/harrison-v-puga>> accessed 13 July 2023.

¹⁸³ Barber (n 173)

¹⁸⁴ Rick Landers, ‘Piercing the LLC Veil: Is Undercapitalization of a Subsidiary or Start-Up Company Evidence of Fraud or Bad Faith’ (*Axilon Law*, 30 April 2021) <<https://www.axilonlaw.com/piercing-the-llc-veil/>> accessed 5 April 2023.

to the corporation. Inadequate capitalization "means capitalization that is very small in relation to the nature of the corporation's business and the risks the business necessarily entails."¹⁸⁵

This category addresses subsidiary undercapitalization when the parent did not properly capitalise the entity from the start when the subsidiary's funds were drained, or when a failure to recapitalize was determined.¹⁸⁶ Undercapitalization (at the time of incorporation) is strong evidence that the shareholders never formed a legitimate corporation. It reinforces the conclusion that they purposefully or recklessly created a company that would be unable to pay its debts.¹⁸⁷ Courts generally consider a corporation's capitalization insufficient if it is insignificant compared to the nature of the corporation's business and the risks associated with it. The bigger and riskier the business, the greater the capitalization requirement will be.¹⁸⁸ Furthermore, capitalization should be considered when the corporation is formed, not later, because a corporation that was adequately capitalised when formed but later suffers financial reverse is not undercapitalized.¹⁸⁹

To determine the adequacy of the corporation's capital in light of the nature and magnitude of the corporate undertaking, several tests and factors can be used to analyse the corporation's financial data. For example, the capitalization of other corporations in the same or similar line of business can be compared. Then the capitalization of the corporation in question could be compared with the average industry-wide ratios (current ratio, acid-test ratio, debt/equity ratio, etc.) obtained from published sources.¹⁹⁰ Grossly inadequate capitalization for the objectives of piercing the corporate veil would generally be reflected by a significant capital deficiency when compared to the level of capitalization deemed adequate in the case by financial analyst experts.¹⁹¹ For instance, *Gardner v. First Escrow Corp.* (1985) involved an escrow company whose shareholders initially contributed \$500, even though the corporation would handle millions of dollars in transactions and the risk that the corporation's potential liabilities could be substantial. The Oregon Court of

¹⁸⁵ Mark W. Page, 'The Undercapitalized Corporation and Illinois Corporate Veil-Piercing Law | Illinois State Bar Association' <<https://www.isba.org/ibj/2000/07/theundercapitalizedcorporationandil#24>> accessed 29 April 2023.

¹⁸⁶ Matheson (n 82).

¹⁸⁷ Mark W. Page (n 173).

¹⁸⁸ 'Inadequate Capitalization: Courts Know It When They See It' (28 September 2008) <<https://eminutes.com/inadequate-capitalization-courts-know-it-when-they-see-it>> accessed 5 April 2023.

¹⁸⁹ *Canter v. Lakewood of Voorhees*, 420 N.J. Super. 508' <<https://casetext.com/case/canter-v-lakewood-of-voorhees>> accessed 5 April 2023.

¹⁹⁰ *Laya v. Erin Homes, Inc.* (Justia Law) <<https://law.justia.com/cases/west-virginia/supreme-court/1986/16965-5.html>> accessed 5 April 2023.

¹⁹¹ *ibid.*

Appeals (state intermediate appellate court) pierced the corporate veil, allowing the plaintiff to recover losses from the shareholders.¹⁹²

However, in *DeWitt*, the court concluded that piercing the corporate veil could not be based on a single factor, such as undercapitalization or disregard for formalities, but must involve a number of factors and present an element of injustice or fundamental unfairness.¹⁹³

3.4. Commingling of Assets

Commingling of Assets is another factor frequently used in a veil-piercing analysis. Commingling of assets occurs when the owner uses business resources for personal reasons or when the business uses the owner's personal resources for business reasons.¹⁹⁴ Without a proper separation of assets and appropriate documentation of this separation, this practice is typically regarded as evidence of an alter-ego situation.¹⁹⁵ When a corporation's and its shareholders' assets are mixed, it demonstrates that the corporation is not a separate entity from its shareholders. In *GreenHunter Energy, Inc. v. Western Ecosystems Technology, Inc.* (2014) concerning intermingling, the Wyoming Supreme Court was very clear stating that “Funds and assets should be separated and not commingled. Failure to maintain an arms-length relationship between the member and company, as by not keeping separate bank accounts and bookkeeping records may be weighed along with other factors. If the member treats limited liability company property as if it were that person’s or company’s personal property, a court should consider also this fact. Manipulation of assets and liabilities between the member and company to concentrate the assets in the former and

¹⁹² Robert J McGaughey, ‘Disregarding the Corporate/LLC Veil: The Most Litigated Issue in Corporate Law’ <<https://static1.squarespace.com/static/5de94ffa54dcd254d5ca1ae9/t/5e20a9145b8828719109ad79/1579198740981/Disregarding+Corporate+Veil+4-19.pdf>>.

¹⁹³ Harvey Gelb, ‘Piercing the Corporate Veil—The Undercapitalization Factor’ *Chicago Kent Law Review* <<https://scholarship.kentlaw.iit.edu/cgi/viewcontent.cgi?article=2470&context=cklawreview&httpsredir=1&referer=>>>.

¹⁹⁴ Nikki Nelson, ‘Piercing the Veil of Limited Liability Results in Personal Exposure’ (16 February 2021) <<https://www.wolterskluwer.com/en/expert-insights/piercing-the-veil-of-limited-liability-results-in-personal-exposure>> accessed 5 April 2023.

¹⁹⁵ brinenlawdev, ‘Piercing the Corporate Veil: What It Means and How to Avoid It’ (*Brinen & Associates*, 15 March 2023) <<https://brinenlaw.com/limited-liability-company/piercing-the-corporate-veil-what-it-means-and-how-to-avoid-it/>> accessed 5 April 2023.

the liabilities in the latter can be suggestive of improper use of the LLC as well.”¹⁹⁶ In other words, once there is proof of a corporate purpose deviation and asset commingling, it is possible to pierce the veil.¹⁹⁷

4. Veil Piercing Tests

This section of the thesis will examine the most recognized approaches to veil-piercing doctrine—namely the Powell Rule, Wormser's Rule, Krendls' Theory, Judge McHugh's Amendment of the Third Prong and other tests identified by Mark Cohen.

4.1. Wormser's Veil Piercing Doctrine

Maurice Wormser's famous veil piercing test, presented in 1912, denied the corporate limited liability shield to shareholders when the concept of corporate entity was used to “defraud creditors, evade an existing obligation, circumvent a statute, achieve or perpetuate monopoly, or protect knavery or crime.”¹⁹⁸ Wormser highlights a number of cases in his work "Piercing the Veil of Corporate Entity" where courts serve to make it apparent that courts overlook the concept of legal corporate entity when employed as a cloak for fraudulent attempts to deceive.¹⁹⁹ For instance, F. C. Trebein, an insolvent individual, with his family members formed a corporation and then conveyed to it every vestige of tangible property which he owned. His creditors insisted and proved that the purpose of creating the corporation was to hinder and defraud them. The court held that “The corporation was in substance another F. C. Trebein,” and “His identity as the owner of the property was no more changed by his conveyance to the company than it would have been by taking off one coat and putting on another. He was as much the substantial owner of the property

¹⁹⁶ Sparkman (n 99).

¹⁹⁷ Leandro Amorim Coutinho Fonseca, ‘Commingling of Assets Justifies Inverse Piercing of Corporate Veil – Costa Tavares Paes Advogados’ (20 October 2016) <<https://www.ctpadv.com.br/en/commingling-of-assets-justifies-inverse-piercing-of-corporate-veil/>> accessed 5 April 2023.

¹⁹⁸ I Maurice Wormser, ‘Piercing the Veil of Corporate Entity’ (1912) 12 Columbia Law Review 496 <<https://www.jstor.org/stable/1110931>> accessed 11 April 2023.

¹⁹⁹ *ibid.*

after the conveyance as before.” It also was deemed unimportant that four out of five hundred shares of the stock were held by Trebein's relatives rather than by Trebein himself. That circumstance did not deter the Ohio Supreme Court from ruling that the corporation was "in substance another F. C. Trebein."²⁰⁰ The case of *First National Bank of Chicago v. Trebein Company* made it clear that the courts will disregard the concept of a legal corporate entity when it is used as a shield for fraudulent attempts to swindle creditors.

The abovementioned case illustrates that the concept of fraud is recognized as the centre of the veil-piercing theory and therefore, it is important to define the term. For instance, in Black's Law Dictionary fraud is defined as a "knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment".²⁰¹ A "fraud" argument refers to the controller's alleged use of a corporation to avoid a legal or fiduciary obligation. For the argument to be successful, the controller "must have the intention to use the corporate structure in such a way as to deny the plaintiff some pre-existing legal right."²⁰²

Wormser's veil-piercing doctrine was developed around the idea that to render the parent responsible for the subsidiary's debts or torts, the latter must have been used as a mere "business conduit" of the former.²⁰³ Wormser's test required no proof of actual fraud for veil piercing, only that the subsidiary was "an adjunct of the [parent's business]... a mere agency, or instrumentality... a mere business department, or bureau,... a mere sham or device to evade an existing legal obligation."²⁰⁴

4.2. Frederick Powell's Veil Piercing Test ("Powell Rule")

As a commercial centre, New York was the source of many of the most significant corporate veil cases. Frederick Powell was a New York attorney, so it's no surprise that his rule was based in part

²⁰⁰ *ibid.*

²⁰¹ 'Fraud 101: What Is Fraud?' <<https://www.acfe.com/fraud-resources/fraud-101-what-is-fraud>> accessed 11 April 2023.

²⁰² Jennifer Payne, 'Lifting the Corporate Veil: A Reassessment of the Fraud Exception' (1997) 56 *The Cambridge Law Journal* 284 <<https://www.jstor.org/stable/4508342>> accessed 12 April 2023.

²⁰³ David Millon, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability' [2006] *Washington & Lee Public Legal Studies Research Paper Series* 25.

²⁰⁴ Figueroa (n 137).

on a study of early New York cases. The Instrumentality Rule, commonly referred to as the "*Alter Ego*" or "mere instrumentality" test, provides that a corporate veil will be pierced only if the subsidiary operates not independently, but rather "under the dominion and control and for the purposes of" the parent corporation. Furthermore, veil piercing would apply when a corporation was a "shell," with "no assets... no furniture, no equipment, no space, no employees."²⁰⁵ Although the rule was designed with corporate parent-subsidiary relationships in mind, it is now also applied to private shareholders.²⁰⁶

The preliminary test of the Powell Rule includes three elements or rules: instrumentality, improper purpose, and proximate causation. In a strict application of the Powell test, each element must be proven to pierce the veil.²⁰⁷ These will be discussed in order.

4.2.1. *Powell's First Prong – Instrumentality*

This prong of the Powell rule has received the most attention, and it is likely the most difficult of the three to define. The idea is that a plaintiff must demonstrate that the subsidiary or other subservient corporation was not operated in a legitimate manner to serve the legitimate goals and purposes of that corporation, but rather that it functioned under the dominance and control of and for the benefit of some dominant party.²⁰⁸ In the *Lowendahl* case, which was the first case to apply the so-called Powell rule, the court determined that domination necessitates greater control than that of a majority shareholder and that control of the subsidiary was required in the transaction at issue.²⁰⁹ The doctrine also requires the identification of fraud, wrong, or injustice, which means that the parent's conduct in using the subsidiary was unjust, fraudulent, or wrongful in some way towards the plaintiff. In addition, an unjust "loss or injury" must occur, which means that the plaintiff must have suffered some harm as a result of the defendant's parent corporation's actions.²¹⁰

²⁰⁵ *ibid.*

²⁰⁶ Cathy S Krendl and James R Krendl, 'Piercing the Corporate Veil: Focusing the Inquiry' 55 *Denver Law Journal* <<https://digitalcommons.du.edu/cgi/viewcontent.cgi?article=3117&context=dlr>>.

²⁰⁷ *ibid.*

²⁰⁸ *ibid.*

²⁰⁹ Figueroa (n 137).

²¹⁰ *ibid.*

Powell compiled a list of eleven circumstances that, in various combinations, could indicate subsidiary instrumentality. These are as follows:

1. The parent corporation owns all or most of the capital stock of the subsidiary.
2. The parent and subsidiary corporations have common directors or officers.
3. The parent corporation finances the subsidiary.
4. The parent corporation subscribes to all of the capital stock of the subsidiary or otherwise causes its incorporation.
5. The subsidiary has grossly inadequate capital.
6. The parent corporation pays the salaries and other expenses or losses of the subsidiary.
7. The subsidiary has substantially no business except with the parent corporation, or no assets except the ones conveyed to it by the parent corporation.
8. In the papers of the parent corporation or in the statements of the officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own.
9. The parent corporation uses the property of the subsidiary as its own.
10. The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest.
11. The formal legal requirements of the subsidiary are not observed

Powell's eleven factors are far from a complete litmus test for determining whether one corporation is an instrument of another. However, they serve as a useful and specific starting point for an examination of the instrumentality metaphor.²¹¹

4.2.2. Powell's Second Prong – Improper Purposes

If the first question is answered affirmatively, the Powell Rule proceeds to ask whether the dominant party used its influence for fraud or improper purposes. Therefore, the second element of the Powell Rule's preliminary test is the improper purpose element, which is a component that requires fraud or wrongdoing on the part of the defendant and entails determining whether the use

²¹¹ Krendl and Krendl (n 194).

of the instrumental subsidiary is marred with a fraudulent or improper goal.²¹² Powell outlined seven criteria for determining improper purpose: 1. Actual fraud; 2. Violation of a statute; 3. Stripping the subsidiary of its assets; 4. Misrepresentation; 5. Estoppel; 6. Torts; 7. Other cases of wrong or injustice.²¹³ This requirement's underlying rationale is that the corporate veil should not be lightly pierced. The use of a corporation as a mere tool should not permit third parties to pursue the defendant unless actual fraud or other injurious acts can be proven.²¹⁴ Case law has led academics Cathy S. Krendl and James R. Krendl to the conclusion that a plaintiff seeking to pierce the corporate veil does not need to present evidence sufficient to establish ordinary fraud, but only needs to present proof of some sort of equitable wrong. For example, according to Professor Cohen, "an improper purpose may be as general or as vague as improperly capitalising the subsidiary corporation at its inception." Other examples include using the subsidiary to avoid a statute, putting the plaintiff through unnecessary procedural hurdles, and making false representations to a potential plaintiff."²¹⁵

A number of court decisions have held that once the instrumentality requirement is met, the improper purpose requirement is easily established. In *Consolidated Sun Ray, Inc. v. Oppenstein* (1964), for example, the United States Court of Appeals for the Eighth Circuit determined that the parent's undercapitalization or removal of assets from the subsidiary corporation established an improper purpose.²¹⁶

4.2.3. *Powell's Third Prong - Proximate Causation*

The Powell rule requires the plaintiff to demonstrate not only instrumentality and an improper purpose but also that both the parent's control and the subsidiary's improper act caused him direct damage. The Oregon Supreme Court acknowledged in *Schlecht v. Equitable Builders, Inc.* (1975) that it had "uniformly held that the corporate entity of a subsidiary corporation should be disregarded only to prevent fraud or injustice and to protect persons whose rights have been

²¹² Figueroa (n 137).

²¹³ Krendl and Krendl (n 194).

²¹⁴ *ibid.*

²¹⁵ Figueroa (n 137).

²¹⁶ Krendl and Krendl (n 194).

jeopardised by the parent corporation's conduct."²¹⁷ Thus, the third prong of the Powell rule supports the policy of limited liability by allowing the piercing of the corporate veil only where equity strictly requires that a particular defendant has caused injury to the plaintiff as a result of that defendant's wrongful acts. In most jurisdictions that follow the Powell rule, the plaintiff will not be allowed to recover unless all three prongs of the rule are proven.²¹⁸

Overall, Powell's veil piercing test is significant as it made one of the biggest attempts to develop a clear veil piercing rule. With the evolution of this test, the emphasis shifted from the plaintiff's harm to the triangle relationship between the corporation, its shareholders, and the plaintiff. The test focuses on the degree of control and influence that shareholders have. Domination is indicated by gross undercapitalization or a corporation's limited decision-making ability. In the parent/subsidiary context, which is the primary application area of this doctrine, decisive factors include common directors and officers of parent and subsidiary corporations, the subsidiary's lack of business with parties other than the parent corporation, and the subsidiary's complete financing through the parental enterprise.²¹⁹ Among others, courts in Alaska,²²⁰ North Carolina,²²¹ Delaware, California, New Jersey, New York and Florida have applied this doctrine.²²²

4.3. The Krendls' Theory

Cathy and James Krendl put forward a revised version of the Powell Rule in their well-known 1978 article. Their research focused on three factors to determine veil piercing only in the parent-subsubsidiary framework: (1) parent dominance over the subsidiary; (2) improper purpose; and (3) public policy considerations regarding who should bear the risks.²²³

²¹⁷ *ibid.*

²¹⁸ *ibid.*

²¹⁹ Michala Rudorfer, *Piercing the Corporate Veil* (2009) <<https://www.grin.com/document/125582>> accessed 18 July 2023.

²²⁰ Philip Reed Strauss, 'Control and/or Misconduct: Clarifying the Test for Piercing the Corporate Veil in Alaska' (1992) 9 *Alaska Law Review* <<https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1287&context=alr>>.

²²¹ 'Piercing the Corporate Veil - The Instrumentality Rule' (*Miller Law Group*) <<https://millerlawgroupnc.com/resources/piercing-the-corporate-veil-the-instrumentality-rule/>> accessed 18 July 2023.

²²² Michala Rudorfer (n 213).

²²³ Figueroa (n 137).

Furthermore, according to Cathy and James Krendl, court decisions have indicated a number of elements that should be considered when striving to maintain the corporate veil. One should try to adhere to as many of these factors as possible. To the extent that not all of the requirements can be met, it should be one's goal to stay on the right side of those that are clearly substantive matters leading to ultimate issues, as opposed to those that are likely to be found in any parent-subsidary relationship. The following aspects tend to favour separate corporate entities in cases:²²⁴

1. The shareholder is not a party to the contractual or other obligation of the corporation.
2. The subsidiary is not undercapitalized.
3. The subsidiary does not operate at a deficit while the parent is showing a profit.
4. The creditors of the companies are not misled as to which company they are dealing with.
5. Creditors are not misled as to the financial strength of the subsidiary.
6. The employees of the parent and subsidiary are separate and the parent does not hire and fire employees of the subsidiary.
7. The payroll of the subsidiary is paid by the subsidiary and the salary levels are set by the subsidiary.
8. The labour relations of the two companies are handled separately and independently.
9. The parent and subsidiary maintain separate offices and telephone numbers.
10. Separate directors' meetings are conducted.
11. The subsidiary maintains financial books and records which contain entries related only to its operations.
12. The subsidiary has a bank account.
13. The earnings of the subsidiary are not reflected in the financial reports of the parent in determining the parent's income.
14. The companies do not file joint tax returns.
15. The subsidiary negotiates its loans or other financings.
16. The subsidiary does not borrow money from the parent.
17. Loans and other financial transactions between the parent and subsidiary are properly documented and conducted on an arm's length basis.

²²⁴ Krendl and Krendl (n 194).

18. The parent does not guarantee the loans of the subsidiary or secure any loan with the assets of the parent.
19. The subsidiary's income represents a small percentage of the total income of the parent.
20. The insurance of the two companies is maintained separately and each pays its premiums.
21. The purchasing activities of the two corporations are handled separately.
22. The two companies avoid advertising as a joint activity or other public relations which indicates that they are the same organization.
23. The parent and subsidiary avoid referring to each other as one family, organization, or as divisions of one another.
24. The equipment and other goods of the parent and subsidiary are separate.
25. The two companies do not exchange assets or liabilities.
26. There are no contracts between the parent and subsidiary with respect to purchasing goods and services from each other.
27. The subsidiary and the parent do not deal exclusively with each other.
28. The parent does not review the subsidiary's contracts, bids or other financial activities in greater detail than would be normal for a shareholder who is merely interested in the profitability of the business.
29. The parent does not supervise how the subsidiary's jobs are carried out.
30. The parent does not have substantial veto power over important business decisions of the subsidiary and does not make such crucial decisions.
31. The parent and subsidiary are engaged in different lines of business.

The considerations listed above are not necessarily provided as a logical or desirable measure for evaluating when to pierce the corporate veil. They are, however, factors that have been identified by one or more courts as important considerations to be examined for making such a determination. Consequently, anyone attempting to set up a fully functioning subsidiary should endeavour to comply with as many of them as possible. It is worth noting that mere technical compliance with the aforementioned conditions does not guarantee an impenetrable veil. Such ultimate considerations, and the impact they have on each other, should be carefully considered while constructing any company relationship.²²⁵

²²⁵ Krendl and Krendl (n 194)

4.4. Mark Cohen's Identification of Veil-Piercing Theories

Professor Cohen identified five legal theories for determining veil piercing in the United States: (1) *Alter Ego theory*; (2) instrumentality theory; (3) equity or totality of circumstances tests; (4) sham to perpetuate a fraud theory; and (5) violation of public policy test.²²⁶

The separate company's existence shall be disregarded under the *Alter Ego* test if: (i) the corporation is so influenced by the controlling person(s) that there is such unity of both ownership and interest that the separateness of the corporation has ceased; and (ii) adherence to the separate corporate existence would perpetuate a fraud or promote injustice.²²⁷ The following factors are considered in the *Alter Ego* test: "(1) undercapitalization; (2) a failure to observe the formalities of corporate existence; (3) nonpayment or overpayment of dividends; (4) a siphoning off of funds by dominant shareholders; and (5) the majority shareholders having guaranteed corporate liabilities in their individual capacities."²²⁸ The *Alter Ego* test is based on the premise that "if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors."²²⁹

Cohen laid out that the Federal Unity or Interest Test is divided into two parts and consists of a two-part test. At first, courts will look If the shareholders' unity of interest and lack of respect for the corporation's separate identity is so strong that the personalities and assets of the corporation and the individual are indistinguishable. If the answer is affirmative, the court will investigate further and look at whether adhering to corporate fiction would sanction fraud, promote injustice, or result in the evasion of legal obligations. Under this theory, the factors subject to review are (1) disregard of corporate formalities; (2) inadequate capitalization; (3) intermingling of funds; (4) overlap in ownership, officers, directors, and personnel; (5) common office space, address and telephone numbers of corporate entities; (6) the degree of discretion shown by the allegedly dominated corporation; (7) whether the dealings between the entities are at arm's length; (8)

²²⁶ Matthew D Caudill, 'Piercing the Corporate Veil of a New York Not-For-Profit Corporation', p. 464, <<https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1179&context=jcfl>>.

²²⁷ *ibid*.

²²⁸ Figueroa (n 137).

²²⁹ Caudill (n 209).

whether the corporations are treated as independent profit centres; (9) payment or guarantee of the corporation's debts by the dominating entity, and (10) intermingling of property between the entities.²³⁰

The link between the *Alter Ego* and the instrumentality theory is hazy. Courts appear to use these terms interchangeably. However, according to Cohen, there is a difference. While The term "*Alter Ego*" was coined to describe the relationship between a corporation and its shareholders, the term "instrumentality" refers to the relationship between a parent and a subsidiary.²³¹

Courts that were dissatisfied with the ambiguity of both the *Alter Ego* and Instrumentality tests created their own equitable tests that focused on the distinct factors in a given case.²³² As an example, Cohen brought up the case of *White v. Winchester Land Development Corp.*, where the court introduced five elements that would determine veil piercing: (1) undercapitalization; (2) a failure to observe the formalities of corporate existence; (3) nonpayment or overpayment of dividends; (4) a siphoning off of funds by the dominant shareholder(s); and (5) the majority shareholders having guaranteed corporate liabilities in their individual capacities.²³³

Some courts, according to Cohen, will pierce if the defendant used the corporate form to violate a statute, perpetrate fraud, or violate other public policy. Improper conduct may include fulfilling unwanted obligations by forming new business entities with the same controlling persons while impeding the previous entity's ability to pay off its debts. Another possible application of this test is to avoid compliance with environmental, labour, and antitrust regulations.²³⁴

4.5. Van Doren Test

Another, newly emerged test for determining veil piercing is the Van Doren test. The test is crucial because of its role in preserving the corporate system's integrity and protecting the rights of creditors and other stakeholders. It contributes to ensuring that stockholders cannot simply hide

²³⁰ Figueroa (n 137).

²³¹ Mark Cohen, 'A Brief History of Piercing the Corporate Veil'.

²³² Caudill (n 209).

²³³ 'White v. Winchester Land Development Corp.' (*Justia Law*) <<https://law.justia.com/cases/kentucky/court-of-appeals/1979/584-s-w-2d-56-1.html>> accessed 23 April 2023.

²³⁴ Caudill (n 209).

behind the corporate entity to avoid personal liability for corporate debts or malfeasance. This notion is especially pertinent in circumstances where the corporation structure is used to commit fraud, deception, or achieve other unfair ends. The Van Doren test is mainly applied in the states of Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota and South Dakota.²³⁵

Like other veil-piercing theories, this test also requires a two-step analysis. According to the Van Doren Test, a court will hold a corporation's shareholder personally liable if, for starters, there is such a unified interest and ownership that separate personalities of the corporation and individual do not exist. The failure to keep proper, adequate corporate records and comply with corporate formalities; commingling of funds or assets; undercapitalization of the firm; and/or one corporation treating the assets of another corporation as its own are some of the factors the court may consider.²³⁶ Second, continuing to maintain the fiction of the separate corporation's existence would either sanction or promote fraud. The court may consider the following factors in determining this: fraud, deception, and compelling public interest. The injustice must extend beyond simply failing to repay a creditor. Instead, one example is unfairly enriching shareholders. The court may consider the following factors in determining this: fraud, deception, and compelling public interest. The injustice must extend beyond simply failing to repay a creditor. Instead, one example is unfairly enriching shareholders.²³⁷

5. Veil Piercing Under the U.S. State Law

In the United States, veil piercing is primarily a state doctrine.²³⁸ The severity of the conduct threshold for veil piercing has not been treated consistently by states, but in all jurisdictions, veil

²³⁵ Ann Hemmens, 'U.S. Federal Appellate Courts: Records and Briefs: Eighth Circuit Court of Appeals' <<https://guides.loc.gov/federal-appellate-court-records-briefs/eighth-circuit>> accessed 19 July 2023.

²³⁶ 'Disregarding the Corporate Entity' (*LII / Legal Information Institute*) <https://www.law.cornell.edu/wex/disregarding_the_corporate_entity> accessed 23 April 2023.

²³⁷ *ibid.*

²³⁸ Gregory S Crespi, 'Choice of Law in Veil Piercing Litigation: Why Courts Should Discard the Internal Affairs Rule and Embrace General Choice of Law Principles' (2008) 64 *Dedman School of Law* 90 <https://scholar.smu.edu/cgi/viewcontent.cgi?article=1380&context=law_faculty>.

piercing is the exception rather than the rule.²³⁹ In this following chapter, I will discuss legislation and case law of the three following states: Delaware, New York and Massachusetts.

These states were chosen for the following reasons. Delaware is the most progressive and flexible state in the United States in terms of developing corporate law.²⁴⁰ New York, being the country's premier business centre, was one of the first states to create the doctrine of piercing the corporate veil in case law and has generated a lot of piercing cases, which had a considerable impact on the scientific development of the doctrine.²⁴¹ In addition to being the first state that adopted the idea of limited liability of the corporation,²⁴² Massachusetts is notable for its long-standing precedent law.

5.1. Delaware

It is generally recognised that at least part of Delaware's dominant position in corporate law can be attributed to the Delaware Chancery and Supreme Court's special expertise in that area. This is the reason why in 2022 more than half of the 500 largest corporations in the United States were incorporated in Delaware, as were more than half of the corporations listed on the New York Stock Exchange.²⁴³ However, one of the few major corporate doctrines in which Delaware law does not play a significant role is veil piercing.²⁴⁴

²³⁹ 'Johnson v. Koplovsky Foods, Inc., 5 F. Supp. 2d 48 (D. Mass. 1998)' (*Justia Law*) <<https://law.justia.com/cases/federal/district-courts/FSupp2/5/48/2341445/>> accessed 7 May 2023.

²⁴⁰ 'About the Division of Corporations' (*Division of Corporations - State of Delaware*) <<https://corp.delaware.gov/aboutagency/>> accessed 20 June 2023.

²⁴¹ Robert B. Thompson (n 13).

²⁴² Ron Harris, 'A New Understanding of the History of Limited Liability: An Invitation for Theoretical Reframing' (2020) 16 Journal of Institutional Economics 643 <https://www.cambridge.org/core/product/identifier/S1744137420000181/type/journal_article> accessed 20 June 2023.

²⁴³ Jeremy Reed, 'Delaware Corporate Law Structure & the Corporate Veil | Harvard Business Services' (*The HBS Blog*) <<https://www.delawareinc.com/blog/delaware-corporate-law-structure-and-the-corporate-veil>> accessed 7 May 2023.

²⁴⁴ Stephen M Bainbridge and G Mitu Mitu Gulati, 'How Do Judges Maximize? (The Same Way Everybody Else Does - Boundedly): Rules of Thumb in Securities Fraud Opinions' [2001] SSRN Electronic Journal <<http://www.ssrn.com/abstract=283261>> accessed 6 May 2023.

Commentators regard the piercing laws of Delaware, alongside New York, and Pennsylvania as unusually favourable to corporate shareholders opposing such a claim.²⁴⁵ Delaware has clearly recognised that, in some cases, piercing the corporate veil is appropriate.²⁴⁶ Nonetheless, the courts have not always been forthcoming in defining those circumstances. In Delaware, piercing may be done only in the interest of justice. In cases of fraud, it is recognised that veil piercing is appropriate.²⁴⁷ Under Delaware law, conduct that is equivalent to fraud must typically involve a contravention of law or contract, a public wrong, or otherwise show compelling equitable considerations.²⁴⁸ In addition to outright fraud, "something like a fraud" may also suffice.²⁴⁹

In *Pauley Petroleum Inc. v. Continental Oil Company*²⁵⁰ (1968) the Delaware Supreme Court ruled that veil piercing should occur only "in the interest of justice, when such matters as fraud, contravention of law or contract, public wrong, or where equitable consideration among members of the corporation require it, are involved." In this way, new grounds for veil piercing have been included in addition to the traditional notion of fraud.

On the other hand, in *Trustees of Village of Arden v. Unity Construction Co*²⁵¹ (2000) plaintiffs claimed that two Delaware LLCs were *Alter Egos* of one another. Because the LLCs shared a common principal, the plaintiffs claimed that "there is a strong indication that one of the LLCs may have been acting as the mere instrumentality or *Alter Ego* of [the other LLC]." The court of Chancery of Delaware, however, was not convinced that the plaintiffs established a case of *Alter Ego* and ruled that "similar ownership is not sufficient to justify disregarding their business forms."

The Delaware Court of Chancery recently issued an opinion reiterating that "piercing the veil" of a Delaware LLC is an extraordinary equitable remedy, implying that the court disregards the LLC and imposes liability on the underlying owners. The court has the unusual authority to create a

²⁴⁵ Crespi (n 220).

²⁴⁶ Fredric J Bendremer, 'Delaware LLCs and Corporate Veil Piercing: Limited Liability Has Its Limitations' (2005) 10 Fordham Journal of Corporate & Financial Law 391 <<https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1191&context=jcfl>>.

²⁴⁷ *ibid*.

²⁴⁸ Fredric J Bendremer (n 220).

²⁴⁹ 'Mobil Oil Corporation v. Linear Films, Inc., 718 F. Supp. 260 (D. Del. 1989)' (*Justia Law*) <<https://law.justia.com/cases/federal/district-courts/FSupp/718/260/2268711/>> accessed 20 June 2023.

²⁵⁰ *Pauley Petroleum Inc v Continental Oil Company* (1968) 239 A 2d 629 (Supreme Court).

²⁵¹ *Trustees of Village of Arden v Unity Construction Company* [2008] Court of Chancery Case No. 15025-VCN.

remedy in cases where "the owner is utilising the LLC form to perpetrate fraud or an injustice."²⁵² When no legal remedy is available but fundamental fairness requires the court to intervene, equitable remedies are used. In determining whether corporate veil piercing is appropriate, the Delaware courts consider five factors: (1) whether the company was adequately capitalised for the undertaking; (2) whether the LLC was solvent; (3) whether LLC formalities were followed; (4) whether the dominant member(s) syphoned company funds; and (5) whether the company served as a front for the dominant member(s).²⁵³

To pierce the corporate veil in Delaware it is clear that an overall element of injustice or unfairness must always be present.

5.2. New York

Piercing corporations is a well-established doctrine in New York case law. However, courts in New York are especially hesitant to pierce the corporate veil because it is regarded as an extreme remedy that goes against the general rule of limited liability.²⁵⁴ *Morris v. New York State Department of Taxation and Finance* (1993) is a leading New York Court of Appeals case that lays out the elements of a successful corporate piercing claim, stating that courts have the authority to pierce the corporate veil and erode or eliminate shareholder limited liability when necessary "to prevent fraud or achieve equity."²⁵⁵ The Court of Appeals of the State of New York stated in *TNS Holdings v. MKI Sec. Corp.*²⁵⁶ (1998) that the corporate veil may be pierced to impose liability for corporate wrongs on individuals who have "misused the corporate form for their personal ends."

²⁵² Jarrod Melson, 'The High Burden To Justify Veil Piercing | Harvard Business Services, Inc.' (*The HBS Blog*) <<https://www.delawareinc.com/blog/high-burden-for-veil-piercing>> accessed 6 May 2023.

²⁵³ *ibid.*

²⁵⁴ Cohen Seglias and Thomas E. Raccuia, 'First Department of New York Loosens the Standard for "Piercing the Corporate Veil"' (*Cohen Seglias*, 6 November 2017) <<http://www.cohenseglias.com/>> accessed 7 May 2023.

²⁵⁵ Miriam R Albert, 'The New York LLC Act at Twenty: Is Piercing Still "Enveloped in the Midst of Metaphor"' (2015) 31 *Touro Law Review* <<https://digitalcommons.tourolaw.edu/cgi/viewcontent.cgi?article=2658&context=lawreview>>.

²⁵⁶ 'TNS HOLDINGS v. MKI SEC. Corp.' (*Justia Law*) <<https://law.justia.com/cases/new-york/court-of-appeals/1998/92-n-y-2d-335-0.html>> accessed 7 May 2023.

In addition, in *Conason v. Megan Holding, LLC*,²⁵⁷ (2012) the Supreme Court of the state of New York stated that “Generally, a plaintiff seeking to pierce the corporate veil must show that “(1) the owners exercised complete domination of the corporation in respect to the transaction attacked, and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury”

The "Ten Factors Test" has been developed by New York courts to assess whether one corporation has complete dominance over another corporation for veil-piercing purposes.²⁵⁸ These factors are (1)an absence of corporate formality in the dominated company; (2) inadequate capitalization; (3) Whether funds are put in or taken out of the corporation for other than corporate purposes; (4)overlap in ownership, officers, directors, and personnel; (5) common office space, addresses and telephone numbers; (6) what the amount of business discretion is that a dominated the company possesses; (7) corporations deal at arms-length [with each other]; (8) whether corporations are treated as independent profit centres; (9) the payment or guarantee of debts of the dominated corporation is made by the controlling corporation; and (10) dominated corporation's property was used by the controlling corporation as if it were its own.

It is worth mentioning that decision of the Appellate Division in the case of *91st Street Crane Collapse Litigation*²⁵⁹ made it easier for plaintiffs to “pierce the veil” and hold shareholders personally liable. This case involved the crane owner, a company called N.Y. Crane & Equipment Corp. which was owned by an individual named James F. Lomma. He also owned several other businesses, including J.F. Lomma, Inc. At trial, the jury determined that NY Crane's negligence was a contributing factor to the cranes collapse and pierced the veil, holding Mr. Lomma and JF Lomma inc. liable for NY Crane's negligence as Mr Lomma operated the two businesses as a single entity. As already mentioned above, New York courts apply a "clear abuse of the corporate form" standard, which generally required proof that (1) the owner had complete control of the corporation and (2) that such control was used to commit fraud or wrongdoing. The Appellate Division never addressed or applied the second prong (the "fraud or wrong" inquiry) in this case.

²⁵⁷ READ J, ‘CONASON v. MEGAN HOLDING, | 25 N.Y.3d 1 (2015... | 20150224357| Leagle.Com’ (*Leagle*) <<https://www.leagle.com/decision/innnyco20150224357>> accessed 7 May 2023.

²⁵⁸ Figueroa (n 137).

²⁵⁹ ‘Matter of 91st St. Crane Collapse Litig.’ (*Justia Law*) <<https://law.justia.com/cases/new-york/appellate-division-first-department/2017/117469-08-117294-08-771000-10.html>> accessed 7 May 2023.

Rather, its decision was based solely on the Lomma entities' overlapping operations, which included the following conduct that does not normally rise to the level of "fraud or wrongdoing" that litigants are typically required to show before a court will pierce a defendant's corporate veil: (1) Commonly owned companies renting out each other's equipment at will; (2) Shifting profits between commonly owned companies; (3) Signing blank crane/derrick forms so that the general manager could identify which company rented a crane on any particular job; (4) Storing equipment rent-free at a property owned personally by the common owner; (5) Shared offices and email systems among commonly owned companies; and (6) Overlap of management and administrative personnel.²⁶⁰

Overall, it should be noted that in the state of New York to pierce the corporate veil the plaintiff must show that the officer, director, or shareholder dominated and controlled the corporate entity. The plaintiff must demonstrate that the officer, director, or member used the corporation for personal gain and that the corporation was nothing more than the officer's or member's "*Alter Ego*" or instrumentality.²⁶¹

5.3. Massachusetts

To pierce the corporate veil in the state of Massachusetts, at least three factors must be present. First, the owner should be using his business entity or entities in a way that causes ambiguity or confusion.²⁶² In the case of *My Bread Baking Co. v. Cumberland Farms, Inc.*,²⁶³ (1968) the court stated that "[a]lthough common ownership of the stock of two or more corporations together with common management, standing alone, will not give rise to liability on the part of one corporation for the acts of another corporation or its employees, additional facts may be such as to permit the conclusion that an agency or similar relationship exists between the entities. Particularly when

²⁶⁰ Cohen Seglias and Thomas E. Raccuia (n 238).

²⁶¹ 'Want to Hold a Corporate Officer Personally Liable for an Alleged Wrong? Try Piercing the Corporate Veil ... If You Can' (*Freiberger Haber LLP*, 4 March 2019) <<https://fhnylaw.com/want-hold-corporate-officer-personally-liable-alleged-wrong-try-piercing-corporate-veil-can/>> accessed 7 May 2023.

²⁶² Justin R. McCarthy, "Piercing the Corporate Veil" in Massachusetts' (*Law Office of Justin R. McCarthy*, 8 June 2021) <<https://jrmccarthy-law.com/2021/06/08/piercing-the-corporate-veil-in-massachusetts/>> accessed 7 May 2023.

²⁶³ 'MY BREAD BAKING CO. vs. CUMBERLAND FARMS, INC., 353 Mass. 614' <<http://masscases.com/cases/sjc/353/353mass614.html>> accessed 7 May 2023.

there is a confused intermingling of activity of two or more corporations engaged in a common enterprise with substantial disregard of the separate nature of the corporate entities, or serious ambiguity about the manner and capacity in which the various corporations and their respective representatives are acting.”

Second, confusion and ambiguity are exploited for nefarious purposes such as fraud.²⁶⁴ The Massachusetts Appeals Court in *Evans v. Multicon Constr. Corp.* (1991) stated: “There is present in the cases which have looked through the corporate form an element of dubious manipulation and contrivance, finagling, such that corporate identities are confused and third parties cannot be quite certain with what they are dealing.”

Finally, to pierce the corporate veil, a plaintiff must demonstrate that the corporation in question failed to operate within a legal business structure. In other words, the decision to disregard the established corporate form necessitates a determination that the parent corporation directed and controlled the subsidiary and used it for an improper purpose.²⁶⁵

In addition, the Supreme Judicial Court of Massachusetts has ratified a 12-factor test, used by the trial courts, to determine whether the corporate or LLC veil should be pierced: (1) common ownership; (2) pervasive control; (3) confused intermingling of business assets; (4) thin capitalization; (5) nonobservance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at the time of the litigated transaction; (9) siphoning away of corporate funds by a dominant shareholder; (10) nonfunctioning of officers and directors; (11) use of the corporation for transactions of the dominant shareholders; and (12) use of the corporation in promoting fraud.²⁶⁶

6. Chapter Summary

²⁶⁴ Justin R. McCarthy (n 246).

²⁶⁵ Justin R. McCarthy (n 246).

²⁶⁶ Debra Rahmin Silberstein, ‘Limitations of Limited Liability - Single Member LLCs in Massachusetts’ (*Debra Rahmin Silberstein*, 10 December 2013) <<http://debrasilberstein.com/2013/12/limitations-of-limited-liability-piercing-the-llc-veil/>> accessed 7 May 2023.

In contrast to the approaches employed by the UK courts, U.S. courts take a more principled approach to the problem of veil piercing. In cases concerning the piercing of the corporate veil, the U.S. courts employ two main theories: 1) agency theory and 2) instrumentality/*Alter Ego* theory. The benefit of utilising such theories for judges is that each theory has a clear test composed of multiple requirements that serve as guidance, allowing the judges to standardise decisions in all cases involving veil piercing. This, in turn, increases the predictability of the law greatly, though possibly not to the amount that such predictability is attained through codification.²⁶⁷ For instance, the instrumentality/*Alter Ego* doctrine states that the corporate veil can be pierced where facts reveal that a business is merely an instrumentality, i.e. an alter ego of an individual. The doctrine outlines three requirements that must be followed in order for the veil to be lifted: 1) there is a unity of the interests of the shareholder and the company,²⁶⁸ 2) there was a wrongful or inequitable action taken by the company, and 3) the harm suffered by the party seeking to pierce the veil is a reasonably foreseeable result of the company's action.²⁶⁹ The first criteria is met when there is "such unity of interest and ownership that the separate personalities of the corporation and owners cease to exist."²⁷⁰ Whereas the second requirement is satisfied when "upholding the corporate entity and allowing shareholders to avoid personal liability for its debts would sanction a fraud or promote an injustice."²⁷¹ The application of the aforementioned standards provides the courts with a framework for decision-making that unifies and standardises the rationale of the courts behind their decisions concerning the piercing of the corporate veil. It also allows judges to consider the unique circumstances of each case when applying the test's requirements.

Nevertheless, if the use of the instrumentality/alter ego theory is insufficient to guarantee a fair outcome of the case, recourse to the agency theory may suffice.²⁷² The agency theory laid out in

²⁶⁷ Badar Mohammed Almeajel Alanazi, 'Piercing the Corporate Veil in Various Jurisdictions – Principled or Unprincipled?' (2020) 16 Corporate Board role duties and composition 47 <<https://www.virtusinterpress.org/Piercing-the-corporate-veil-in-various-jurisdictions-Principled-or-unprincipled.html>> accessed 26 May 2023.

²⁶⁸ 'Zaist v. Olson' (*Justia Law*) <<https://law.justia.com/cases/connecticut/supreme-court/1967/154-conn-563-2.html>> accessed 28 July 2023.

²⁶⁹ 'Wholesale and Retail Food Distribution Local 63 v. Santa Fe Terminal Services, Inc., 826 F. Supp. 326 | Casetext Search + Citator' <<https://casetext.com/case/wholesale-retail-food-v-santa-fe-term>> accessed 28 July 2023.

²⁷⁰ 'Dietel v. Day, 16 Ariz. App. 206 | Casetext Search + Citator' <<https://casetext.com/case/dietel-v-day>> accessed 28 July 2023.

²⁷¹ 'AUTOMOTRIZ DEL GOLFO DE CALIFORNIA DE v. RESNICK (1957)' (*Findlaw*) <<https://caselaw.findlaw.com/court/ca-supreme-court/1807904.html>> accessed 28 July 2023.

²⁷² Alanazi (n 267).

Berkey v. Third Avenue Railway Company (1926)²⁷³ suggests that the veil should be pierced in circumstances where "the dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent." Despite the appeal of relying on one of the aforementioned doctrines when deciding veil-lifting cases, U.S. courts occasionally depart from those set principles, which could be interpreted as evidence that even the principled approach to piercing the veil requires a certain level of flexibility in order to ensure justice.

7. Brief History of the English Corporate Veil Doctrine

The English corporate veil doctrine has had a turbulent history, in contrast to its American counterpart, which has consistently been upheld by the courts over time. The English courts' response to the doctrine has varied between enthusiasm and outright hostility. There are roughly three periods in the history of the English doctrine.²⁷⁴

The *Salomon v. Salomon* ruling in 1897 marked the start of the early experimental period, which lasted until World War II.²⁷⁵ In this case, House of Lords ruled that the shareholders should be treated detached from the company, as separate legal entities.²⁷⁶ However, it should be noted that Salomon's case itself did not establish the limited liability principle. Rather, the Limited Liability

²⁷³ 'Berkey v. Third Avenue Railway Co., 244 N.Y. 84 | Casetext Search + Citor' <<https://casetext.com/case/berkey-v-third-avenue-railway-co-1>> accessed 28 July 2023.

²⁷⁴ Thomas K Cheng, 'The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines' [2011] SSRN Electronic Journal 334 <<https://deliverypdf.ssrn.com/delivery.php?ID=631024088114105119126069090096084030097033001017049013093127095124025101066031093067106004003004103059109067000067113124064078019040011087093000031025089076088027068037043005091098084023073020117127110126012028123108019120073078084126117011090013121&EXT=pdf&INDEX=TRUE>> accessed 18 May 2023.

²⁷⁵ Mirka Balharova, 'Piercing Corporate Veil in U.S. and UK: Are We Witnessing the Downfall of the Doctrine?' [2016] HHS ILSA Law Journal <https://www.academia.edu/29262174/M_Balharova_Piercing_Corporate_Veil_in_U_S_and_UK_Are_we_witnessing_the_downfall_of_the_doctrine_2016_1_1_HHS_ILSA_Law_Journal> accessed 18 May 2023.

²⁷⁶ *Salomon v Salomon & Co Ltd* [1896] UKHL 1 (n 23).

Act of 1855, passed by the British Parliament, provided English companies with limited liability.²⁷⁷ Soon after Salomon, English courts started to pierce the veil. *Apthorpe v. Peter Schoenhofen Brewing*²⁷⁸ and *St. Louis Breweries v. Apthorpe*²⁷⁹ were two of these early cases. The courts did not have a well-defined strategy for piercing the corporate veil during this experimental period, so the actions taken in the cases decided during this time were rather unsure.²⁸⁰ Following that, there was a period of great enthusiasm for the corporate veil doctrine. In the first half of the twentieth century, successful cases of veil piercing consisted of *Gilford Motor v. Horne*,²⁸¹ *In re Darby, Brougham*,²⁸² *Trebanog Working Men's Club and Institute Ltd. V. Macdonald*,²⁸³ etc. Due to the lack of a well-defined approach to the doctrine, English courts were forced to experiment with existing common law concepts such as agency, trusteeship, and tort liability principles to resolve corporate personality issues.²⁸⁴ Judge Atkinson made the only significant attempt to develop criteria and a systematic approach for determining when the corporate veil should be pierced in *Smith, Stone, and Knight v. Birmingham*.²⁸⁵ He observed that whether a subsidiary can be said to be carrying on a business on behalf of its parent, which would justify veil piercing, is dependent on the facts of each case. Judge Atkinson then identified six guiding questions for each case: (1) Who was really running the business? (2) Were the profits treated as the parent company's profits? (3) Was the parent company the head and brain of the trading venture? (4) Did the parent company decide what should be done and how much investment to make in the business? (5) Did the parent

²⁷⁷ Holly Cameron, 'Limited Liability Act of 1855' (*eHow UK*) <https://www.ehow.co.uk/info_7945279_limited-liability-act-1855.html> accessed 18 May 2023.

²⁷⁸ 'APTHORPE (Surveyor of Taxes) v PETER SCHOENHOFEN BREWING COMPANY, Ltd' (*vLex*) <<https://vlex.co.uk/vid/apthorpe-surveyor-of-taxes-807425653>> accessed 18 May 2023.

²⁷⁹ 'ST. LOUIS BREWERIES, Ltd v APTHORPE (Surveyor of Taxes)' (*vLex*) <<https://vlex.co.uk/vid/st-louis-breweries-ltd-806489345>> accessed 18 May 2023.

²⁸⁰ Murray A Pickering, 'The Company as a Separate Legal Entity' (1968) 31 *The Modern Law Review* 481 <<https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1468-2230.1968.tb01206.x>> accessed 18 May 2023. <<https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1468-2230.1968.tb01206.x>>.

²⁸¹ 'Gilford Motor Co v Horne [1933] Ch. 935' (*Simple Studying*) <<https://simplestudying.com/gilford-motor-co-v-horne-1933-ch-935/>> accessed 19 May 2023.

²⁸² Simon Duncan, 'Piercing the Corporate Veil— a Doctrine or a Principle?' <<https://scoop-cms.s3.amazonaws.com/5b179b35ca2f3a89238b45a5/documents/prest-v-petrol-del-resources.pdf>>.

²⁸³ Matsiko Sam, 'A Critical Analysis at the Mask of Incorporation and the Circumstances under Which the Corporate Mask Is Pierced.' (*MATSIKO SAM.*) <http://samatsiko.blogspot.com/p/critical-analysis-at-mask-of_29.html> accessed 19 May 2023.

²⁸⁴ Cheng (n 253).

²⁸⁵ 'Smith, Stone and Knight Ltd v Birmingham' <<http://www.uniset.ca/other/pollypeck/19394AER116.html>> accessed 19 May 2023.

company make a profit based on its skill and direction?²⁸⁶ These guiding questions are identical to those used by US courts. In fact, there is significant overlap between these criteria and the eleven circumstances described by Frederick Powell as indicating that a corporation is merely a tool.

The second period started following the World War and lasted until *Woolfson v. Strathclyde Regional Council*²⁸⁷ was decided in 1978. During this period the English corporate veil doctrine became very popular.²⁸⁸ During this period, notable cases of veil piercing included *In re FG (Films)*,²⁸⁹ *Jones v. Lipman*,²⁹⁰ *Firestone Tyre and Rubber v. Lewellin*,²⁹¹ and *Merchandise Transport v. British Transport Commission*.²⁹² This period was considered a golden era, owing to Lord Denning's enthusiasm and involvement in a significant number of corporate veil-piercing cases between the 1950s and 1970s.²⁹³ His enthusiasm for the doctrine was best summed up in his decision in *Littlewoods*,²⁹⁴ where he warned against blind adherence to Salomon:

“The doctrine laid down in *Salomon v. Salomon & Co.* has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit.”

One of the most famous cases is *D.H.N. Food Distributions Ltd. v. Tower Hamlets London Borough Council*,²⁹⁵ in which the court ruled that a group of companies should be treated as a

²⁸⁶ ‘Birmingham Corporation Argued That Smith Stone Knight Ltd Could Not Succeed | Course Hero’ <<https://www.coursehero.com/file/p1r8n97/Birmingham-Corporation-argued-that-Smith-Stone-Knight-Ltd-could-not-succeed/>> accessed 19 May 2023.

²⁸⁷ ‘*Woolfson v. Strathclyde Regional Council*’ <<http://uniset.ca/other/cs5/1978SLT159.html>> accessed 19 May 2023.

²⁸⁸ Hameed (n 141).

²⁸⁹ Samridhi Arora, ‘Piercing of Corporate Veil’ (19 December 2014) <<https://www.lawctopus.com/academike/piercing-corporate-veil/>> accessed 19 May 2023.

²⁹⁰ ‘*Jones v Lipman* [1962]’ <<https://www.lawteacher.net/cases/jones-v-lipman-1962.php>> accessed 19 May 2023.

²⁹¹ ‘*Firestone Tyre And Rubber Co. Ltd vs Lewellin* (Inspector Of Taxes) on 13 February, 1956’ <<https://indiankanon.org/doc/1495135/>> accessed 19 May 2023.

²⁹² Paragee Patel, ‘Case Laws Pertaining to Lifting up of Corporate Veil Theory’ (*lawyersclubindia*) <<https://www.lawyersclubindia.com/articles/case-laws-pertaining-to-lifting-up-of-corporate-veil-theory-11776.asp>> accessed 19 May 2023.

²⁹³ Balharova (n 254).

²⁹⁴ Cheng (n 253).

²⁹⁵ ‘*D.H.N. Food Distributors Ltd. v. Tower Hamlets London Borough Council*’ <<http://www.uniset.ca/other/pollypeck/19761WLR852.html>> accessed 19 May 2023.

single economic entity. Furthermore, in *Adams v. Cape Industries plc*,²⁹⁶ the Salomon principle was extended and applied to a multinational inter-corporate group enterprise in which a controlling parent company conducted business through several smaller subsidiaries.

Woolfson marked the beginning of the third period, which has been distinguished by the doctrine's marked decline. *Adams v. Cape Industries*, decided in 1990 was the culmination of this downward trend.²⁹⁷

Woolfson v. Strathclyde Regional Council was contentious in the sense that it questioned the *DHN* decision, specifically whether the requirements for piercing the corporate veil in the case of a company's facade were correctly applied. Subsequent cases demonstrated that the single economic unit theory and the corporate veil doctrine were losing favour.²⁹⁸ For instance, in the case of *Bank of Tokyo v. Karoon*,²⁹⁹ the English Court of Appeal explicitly rejected the single economic unit argument, noting that “we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be abridged.” The corporate veil doctrine arguably reached its apex in *Adams v. Cape Industries plc*,³⁰⁰ in which the English Court of Appeal decided that using the corporate structure to limit future liabilities is an inherent feature of English company law and effectively barred veil piercing in tort cases.

Following the high-profile cases in the 1990s that came out strongly against the doctrine, the general consensus is that veil piercing is now uncommon under English law. However, two recent cases suggest that attitudes towards veil piercing may be changing.³⁰¹ On June 28th, 2007, the English Court of Appeal in *Beckett Investment Management Group v. Hall* pierced the veil between the parent company and its subsidiaries and thus gave effect to a covenant not to compete in an employment contract. Similarly, in *Stone & Rolls v. Moore Stephens*, [2009]³⁰² the sole shareholder and director of a company set up a fraudulent scheme that its external auditors missed

²⁹⁶ *Adams v Cape Industries plc* (Court of Appeal). <

file:///C:/Users/User/Downloads/Adams%20v%20Cape%20Industries[1990].pdf>

²⁹⁷ Liton Chandra Biswas, ‘Approach of the UK Court in Piercing Corporate Veil’ [2011] SSRN Electronic Journal <<http://www.ssrn.com/abstract=2438217>> accessed 19 May 2023.

²⁹⁸ Cheng (n 253).

²⁹⁹ ‘Bank of Tokyo Ltd. v. Karoon’ <<http://uniset.ca/other/cs4/karoon.html>> accessed 19 May 2023.

³⁰⁰ *Adams v Cape Industries plc* (n 275).

³⁰¹ Cheng (n 253).

³⁰² ‘Moore Stephens v. Stone Rolls Ltd., (2009) 396 N.R. 203 (HL)’ (vLex) <<https://ca.vlex.com/vid/moore-stephens-v-stone-681451057>> accessed 19 May 2023.

and swindled large sums of money from some banks. The company was later liquidated, and the liquidator filed professional negligence claims against the auditors. The question was whether the company's intents should be imputed to the responsible shareholder, which would preclude it from pursuing its claims against the auditors. The overwhelming majority of the House of Lords disregarded the company's separate legal personality and assigned the shareholder's fraudulent intentions to it. As a result, the company's claims against the auditors were disallowed.

8. Piercing vs Lifting the Corporate Veil

The terminology used is a common source of misunderstanding. The phrases 'piercing the corporate veil' and 'lifting the corporate veil' are frequently used interchangeably with the goal of implying the same thing. However, the UK courts have explicitly highlighted a distinction between the two terms' meanings. In *Atlas Maritime Co SA v Avalon Maritime Ltd (No 1)*³⁰³, Staughton LJ stated: “To pierce the corporate veil is an expression that I would reserve for treating the rights and liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose.”

According to the Companies Act of 2013, lifting the corporate veil involves ignoring the fact that a corporation is a separate legal entity with a corporate personality. Therefore, lifting the corporate veil under the Companies Act of 2013 disregards the separate identity of the company and instead focuses on the real owners of the company.³⁰⁴ On the other hand, Courts choose piercing option when the case involves a question of control rather than ownership.³⁰⁵

9. Grounds for piercing the veil in the U.K.

³⁰³ ‘Atlas Maritime Company SA v Avalon Maritime Ltd (The Coral Rose)’ (vLex) <<https://vlex.co.uk/vid/atlas-maritime-company-sa-793444717>> accessed 22 May 2023.

³⁰⁴ Priyanka Bajpayee, ‘What Is Lifting of Corporate Veil under Companies Act, 2013’ (*Corpbiz*, 24 March 2022) <<https://corpbiz.io/learning/what-is-lifting-of-corporate-veil-under-companies-act-2013/>> accessed 21 June 2023.

³⁰⁵ ‘Corporate Veil: Meaning, Piercing the Corporate Veil, Examples’ (n 4).

The UK courts differentiate between judicial and legal corporate veil piercing.³⁰⁶ Legal piercing arises as a result of the following statutory exceptions to limited liability: (1) fraudulent and wrongful trading,³⁰⁷ (2) abuse of company name and³⁰⁸ (3) other types of directors' liabilities.³⁰⁹ Case law contains the grounds for judicial piercing, implying that judges have considerable discretion. The approach employed by UK courts to lifting the corporate veil can be described as a largely unprincipled assessment of the individual circumstances of each case.³¹⁰ Previous cases can provide guidance on the scenarios in which the courts will decide to lift the veil. However, such guidance should not be interpreted as an exhaustive list of situations that will result in the veil being lifted.³¹¹ This implies that the UK courts have generally taken a *laissez faire* approach to assess the grounds for piercing the corporate veil.³¹² The obvious advantage of the courts' unprincipled approach is that it allows the judges to carefully evaluate the potential repercussions of each particular decision for future cases, as well as to consider the economic impact of the decision they are about to make. This flexible approach also allows judges to ensure that justice is served in each case, in the same way, that the law of equity allows them to avoid rigid common law principles in other areas of UK law where such principles would result in an unfair outcome of the case.³¹³ However, the lack of consistent rules or theories on lifting the veil contributes to a severe lack of clarity in the law in this area, making it impossible for firms, shareholders, directors, creditors, and other interested parties to foresee the likely outcome of a judgement. This is especially noticeable in cases involving a parent company's liability for the conduct of its subsidiaries. At a certain point, the courts questioned whether a group of corporations could be regarded as a single business unit in the case of *Adams v. Cape Industries* [1990]³¹⁴, only to take

³⁰⁶ Karen Vandekerckhove, 'Piercing the Corporate Veil: A Transnational Approach', p.57. (KATHOLIEKE UNIVERSITEIT LEUVEN) <file:///C:/Users/User/Downloads/Doctoraat.pdf>.

³⁰⁷ Sections 213-215, The UK Insolvency Act 1986.

³⁰⁸ Sections 216-217, The UK Insolvency Act 1986.

³⁰⁹ Section 212, The UK Insolvency Act 1986.

³¹⁰ Badar Mohammed Almeajel Alanazi, 'Piercing the Corporate Veil in Various Jurisdictions – Principled or Unprincipled?' (2020) 16 Corporate Board role duties and composition 47 <<https://www.virtusinterpress.org/Piercing-the-corporate-veil-in-various-jurisdictions-Principled-or-unprincipled.html>> accessed 26 May 2023. <file:///C:/Users/User/Downloads/Piercing_the_corporate_veil_in_various_jurisdictio%20(1).pdf>

³¹¹ *ibid.*

³¹² Balharova (n 254).

³¹³ Alanazi (n 289).

³¹⁴ *Adams v Cape Industries plc* (n 275).

that decision back over twenty years later in *Prest v. Petrodel Resources Ltd.* [2013]³¹⁵ In *Chandler v. Cape plc*, [2012]³¹⁶ the court went so far as to hold a parent firm liable for the carelessness of a defunct subsidiary that resulted in asbestosis among its employees. Only to subsequently claim in *His Royal Highness Okpabi v. Royal Dutch Shell Plc* [2021]³¹⁷ the claimants were unable to show that a parent oil corporation owed a duty of care to victims of leaks from pipes held by its subsidiary as part of a joint venture with certain Nigerian entities. In summary, UK courts commonly use judicial piercing of the corporate veil in three situations: (1) fraud doctrine, (2) agency doctrine, and (3) single economic unit theory.³¹⁸

In *Adams v Cape Industries*, the court reviewed all three concepts and emphasised that neither strict nor vicarious liability of shareholders could be established.³¹⁹ Each doctrine specifies a separate standard that must be met for the case to fall within the scope of the doctrine.

9.1. Legal Lifting of the Corporate Veil in the U.K.

The classic case for legislation for the legal lifting of the corporate veil was undoubtedly indicated in Lord Diplock's statement in the *Dimbleby & Sons v National Union of Journalists*³²⁰ case. Lord Diplock noted that:

“The “corporate veil” in the case of companies incorporated under the Companies Act is drawn by statute and it can be pierced by some other statute if such other statute so provides: but in view of its *raison d'être* and its consistent recognition by the courts since *Salomon v A Salomon & Co Ltd*, one would expect that any parliamentary intention to pierce the corporate veil would be expressed in clear and unequivocal language. I do not wholly exclude the possibility that even in the absence of express words stating that in specified circumstances one company, although separately incorporated, is to be treated as sharing the same legal personality of another, a purposive

³¹⁵ *Prest v Petrodel Resources Limited and others* (n 100).

³¹⁶ *Chandler v Cape Plc* [2012] EWCA Civ 525 (EWCA (Civ)).

³¹⁷ *Okpabi & Ors v Royal Dutch Shell Plc & Anor (Rev 1)* [2018] EWCA Civ 191 (EWCA (Civ)).

³¹⁸ Balharova (n 254).

³¹⁹ *Adams v Cape Industries plc* (n 275).

³²⁰ ‘*Dimbleby & Sons Ltd v National Union of Journalists*’ (vLex) <<https://vlex.co.uk/vid/dimbleby-sons-ltd-v-792875965>> accessed 27 May 2023.

construction of the statute may nevertheless lead inexorably to the conclusion that such must have the intention of the Parliament.”

There are a number of legislative acts in the UK that are significant when discussing the legal lifting of the corporate veil. In the following paragraphs, I will discuss the Insolvency Act of 1986, the Companies Act of 2006, and the Company Directors Disqualification Act of 1986. Each of these statutes has a unique role in piercing the corporate veil and holding directors responsible in specific circumstances. For instance, fraudulent trading (Sections 213-215) addresses purposeful actions to deceive creditors, whereas wrongful trading (Section 214) addresses the activities of directors in an insolvent scenario. Abuse of a company's name (Sections 216-217) is concerned with the creation of 'Phoenix companies' following insolvency. Other statutes address various examples of directors' liabilities, disqualification of directors, just and equitable dissolution, and remedies for undue prejudice. These statutes establish a framework for determining whether it is allowed to disregard a corporation's separate legal status and hold people liable for their actions or omissions.

9.1.1. Fraudulent and wrongful trading

Section 213-215 of the Insolvency Act 1986, regarding fraudulent and wrongful trade, contains a significant divergence from the limited liability rule.³²¹ A company engages in fraudulent trading when it conducts business with the deliberate goal of defrauding creditors.³²² In such a circumstance, the court may order that any persons who were knowingly involved in the carrying on of the business in that manner make such contributions to the company's assets as the court deems appropriate.³²³ This statutory provisions is limited to the context of insolvency.

Because of the requirement of fraudulent intent, section 213 of the Insolvency Act of 1986 does not provide an easy premise for shareholder liability. As a result, the Cork Committee, which worked on reforming English insolvency law throughout the 1980s, advocated extending the

³²¹ Karen Vandekerckhove (n 285).

³²² ‘What Is Fraudulent Trading for a Limited Company?’ (*Real Business Rescue*, 24 May 2023) <<https://www.realbusinessrescue.co.uk/company-insolvency/fraudulent-trading>> accessed 27 May 2023.

³²³ Section 213, The UK Insolvency Act 1986. <<https://www.legislation.gov.uk/ukpga/1986/45/contents>> accessed 27 May 2023.

provision of section 313 Companies Act 1948 to "wrongful" trading.³²⁴ A director is normally required to operate in the best interests of the company and its shareholders. When a corporation becomes insolvent, however, a director must act first and foremost in the interests of the company's creditors. If a director believes that a firm is or may become insolvent either on a balance sheet or cash flow basis, they must take all necessary efforts to minimise damages to creditors. Wrongful trading occurs when the company's directors continue to trade notwithstanding knowing or should have known, that the company has no reasonable possibility of avoiding insolvent liquidation or insolvent administration.³²⁵ This proposition from the Committee was implemented in section 214 of the Insolvency Act 1986 and it allows the court to declare that a former director is obligated to contribute to the assets of a firm that has entered into insolvent liquidation.³²⁶ The significance of section 214 for liability in corporate groups lies in the incorporation of shadow directors, which "raises the very real prospect of invoking section 214 against the company's parent company".³²⁷

9.1.2. Abuse of company name

Sections 216-217 of the Insolvency Act 1986 provide another key legal basis for piercing the corporate veil.³²⁸ The aforementioned provisions explicitly refer to the liability of directors or shadow directors who, after running a company that went insolvent, create another company with an identical or very similar name that buys the undertaking and assets from the original company and continues to trade within five years of the insolvency.³²⁹ These companies are known as the 'Phoenix companies'.³³⁰ More specifically, anyone who was a director of a company shadow or not, at any time during the 12 months preceding its insolvent liquidation, to be in any way involved

³²⁴ Karen Vandekerckhove (n 285).

³²⁵ Vince Green, 'What Is Wrongful Trading?' <<https://www.crowe.com/uk/insights/what-is-wrongful-trading>> accessed 27 May 2023.

³²⁶ Dov Ohrenstein and Radcliffe Chambers, 'Lifting the Corporate Veil' <<https://radcliffechambers.com/wp-content/uploads/2019/11/Lifting-The-Corporate-Veil-DO.pdf>>.

³²⁷ Karen Vandekerckhove (n 285).

³²⁸ Sections 216-217, The UK Insolvency Act 1986. <<https://www.legislation.gov.uk/ukpga/1986/45/contents>> accessed 27 May 2023.

³²⁹ Karen Vandekerckhove (n 285).

³³⁰ 'Phoenix Companies and the Role of the Insolvency Service' (GOV.UK) <<https://www.gov.uk/government/publications/phoenix-companies-and-the-role-of-the-insolvency-service/phoenix-companies-and-the-role-of-the-insolvency-service>> accessed 27 May 2023.

during the next five years in the formation or management of a company or a business with a name by which an earlier company was known or is so similar as to suggest an association, bears the liability, according to section 216 of the Insolvency Act.³³¹ Section 217 imposes joint personal and corporate accountability for debts incurred during that time period.³³² This set of statutory provisions is limited to the context of insolvency.

9.1.3. Just and Equitable Winding Up

A petition to wind up a corporation may be brought under section 122(1)(g) of the Insolvency Act 1986 on the grounds that it would be just and equitable to do so.³³³ This may entail lifting the veil of incorporation, for example, to investigate the foundation upon which the firm was founded.³³⁴

9.1.4. Other types of directors' liabilities

Outside of insolvency, if a parent corporation is a director of its subsidiary, it may incur regular directors' obligations. As a result, it may be held accountable for a breach of the general directors' duty of care and skill, as well as a breach of its fiduciary duties.³³⁵ A special sort of liability may arise, for example, if the parent caused harm to the firm in its capacity as director by keeping or misapplying its assets ("misfeasance").³³⁶ Under this provision, a director may be held liable for ordinary or gross negligence. This is the case, for example, when a director has a direct or indirect interest in a transaction at the expense of the firm.

³³¹ Section 216, The UK Insolvency Act 1986. <<https://www.legislation.gov.uk/ukpga/1986/45/contents>> accessed 27 May 2023.

³³² Section 217, The UK Insolvency Act 1986. <<https://www.legislation.gov.uk/ukpga/1986/45/contents>> accessed 27 May 2023/

³³³ Section 122, The UK Insolvency Act 1986. <<https://www.legislation.gov.uk/ukpga/1986/45/contents>> accessed 27 May 2023.

³³⁴ Ohrenstein and Chambers (n 305).

³³⁵ Karen Vandekerckhove (n 285).

³³⁶ Section 212, The UK Insolvency Act 1986. <<https://www.legislation.gov.uk/ukpga/1986/45/contents>> accessed 27 May 2023.

9.1.5. Failure to obtain a trading certificate (Pre-trading)

According to section 767(3) of the Companies Act 2006 (CA), if a public company fails to obtain a trading certificate in addition to its certificate of incorporation before trading, the directors will be obligated to indemnify the other parties in any transactions entered into by the company for any loss or damage suffered as a result of the company's failure to comply with its obligations.³³⁷

9.1.6. Disqualified Directors

Section 15 of the Company Directors Disqualification Act 1986 states that if a person who has been disqualified from being a director of or involved in the management of, a company acts in violation of his disqualification, he is liable for all of the company's debts incurred while so acting.³³⁸ The same applies to anyone who deliberately acts on the directions of a disqualified person or an undischarged bankrupt. Section 15 of the Company Directors Disqualification Act 1986 only applies to specific types of corporate organisations in the United Kingdom. It specifically applies to directors who have been barred from functioning as directors or managing limited companies in the UK.³³⁹ The Act defines a "limited company" as one incorporated by either the Companies Act of 2006 or any prior Companies Act. As a result, Section 15 primarily applies to directors of private limited companies (Ltd) and public limited companies (PLCs) authorised by the Companies Act.

9.1.7. Unfair Prejudice

³³⁷ Section 767, The UK Companies Act 2006. < <https://www.legislation.gov.uk/ukpga/2006/46/contents> > accessed 27 May 2023

³³⁸ Section 15, 'Company Directors Disqualification Act 1986'
<<https://www.legislation.gov.uk/ukpga/1986/46/contents>> accessed 27 May 2023.

³³⁹ 'Company Directors Disqualification Act 1986 and Failed Companies' (GOV.UK)
<<https://www.gov.uk/government/publications/company-directors-disqualification-act-1986-and-failed-companies/company-directors-disqualification-act-1986-and-failed-companies>> accessed 19 July 2023.

Section 994 of the Companies Act 2006 grants the Court's jurisdiction where "the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members (including at least himself)."³⁴⁰

9.2. Judicial Lifting of the Corporate Veil in the UK

Aside from statutory exceptions, courts in the UK have occasionally been willing to lift the corporation veil without a statutory foundation. For Gower, these cases are "opaque and impassable".³⁴¹ Griffin argues that shareholder liability is subject to "a degree of judicial subjectivity" and is "tangled in a mesh of uncertainty."³⁴² Traditionally, UK courts have resolved veil-piercing cases based on certain ambiguous and stringent criteria, such as agency, trusts, fraud, group enterprises, 'tort', enemy, revenue (taxation).³⁴³ Although there is no unifying concept that causes the courts to lift the corporate veil, the UK courts have established different judicial grounds for lifting the corporate veil via their rulings throughout the years. The following chapters are a generic summary, with the caveat that English courts generally adhere to the classic corporate entity concept.

9.2.1. Fraud

Fraud is any activity that relies on deception in order to achieve a gain.³⁴⁴ In the context of fraud as a contract vitiating factor, Lord Herschell observed in *Derry V. Peek* [1889] ³⁴⁵ that "fraud is

³⁴⁰ Section 994, The UK Companies Act 2006. < <https://www.legislation.gov.uk/ukpga/2006/46/contents> > accessed 27 May 2023.

³⁴¹ 'Principles of Limited Liability and Corporate Personality' <<https://www.lawteacher.net/free-law-dissertations/principles-of-liability-and-personality.php>> accessed 28 May 2023.

³⁴² Maka Mahbuba Mammadova, 'The Law Applicable to Attribution of Conduct and Veil Piercing. From a Single Parent Company to Global Corporations' (2019) 14 ECSA Moldova 132 <file:///C:/Users/User/Downloads/Re_Assesing_the_Depth_of_State_and_Inter.pdf>.

³⁴³ Biswas (n 276).

³⁴⁴ 'Fraud 101: What Is Fraud?' (n 189) 101.

³⁴⁵ 'Derry v. Peek House of Lords United Kingdom' (*Justia Law*) <<https://law.justia.com/cases/foreign/united-kingdom/14-app-cas-337-1889.html>> accessed 29 May 2023.

proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false.”

To begin, the first reported case can be traced back two years after the seminal *Salomon* ruling in *Apthorpe v Schoenhofen*, (1899)³⁴⁶ in which Lord Justice Smith established the notorious "head and brains" test to determine whether a parent company could be deemed to be carrying on the business of its subsidiary. This approach, which was used in both *St. Louis Breweries v Apthorpe* (1898)³⁴⁷ and *Gramophone v Stanley* [1908],³⁴⁸ indicated that, in the absence of proof that the subsidiary had become a cloak for the parent company, the Court could not regard the companies as a single entity. Since these two early cases, the dice had been cast, and the fraud exception has evolved as its own exception. Lord Reading in *Daimler*³⁴⁹ approved the exemption in 1916, deeming it applicable in circumstances where the corporation is merely a mask disguising the identity of the real actors or if it is founded for dishonest/fraudulent purposes. Nonetheless, in *Woolfson* [1978],³⁵⁰ Lord Keith justified any departure from the *Salomon* principles in circumstances where a company is a façade disguising the underlying facts, limiting the 'judicial abuse' of the separate corporate personality but facilitating its systemic abuse.

At present, when the courts believe that fraud is or may be conducted behind the corporate veil, they are more than willing to pierce it. The courts will not allow the *Solomon* principle to be utilised as a fraud engine.³⁵¹ The fraud doctrine employs the "façade test" to determine if the corporation has fraudulent intent or whether the company is being misused or improperly used. therefore, under the fraud doctrine, the court will analyse and examine the purpose of the company's formation.³⁵²

The two important cases of fraud exception are *Gilford Motor Company Ltd v. Horne* [1933]³⁵³ and *Jones v. Lipman* [1962].³⁵⁴ In the first case, Mr. Horne was the managing director of Gilford

³⁴⁶ ‘APTHORPE (Surveyor of Taxes) v PETER SCHOENHOFEN BREWING COMPANY, Ltd’ (n 257).

³⁴⁷ ‘ST. LOUIS BREWERIES, Ltd v APTHORPE (Surveyor of Taxes)’ (n 258).

³⁴⁸ ‘Gramophone & Typewriter, Ltd. v. Stanley (C.A.)’ <<http://www.uniset.ca/other/cs3/19082KB89.html>> accessed 1 June 2023.

³⁴⁹ ‘Daimler v. Continental. | 6th July 1916 | The Commercial Motor Archive’

<<https://archive.commercialmotor.com/article/6th-july-1916/10/daimler-v-continental>> accessed 1 June 2023.

³⁵⁰ ‘Woolfson v Strathclyde Regional Council’ (vLex) <<https://vlex.co.uk/vid/woolfson-v-strathclyde-regional-793248769>> accessed 31 May 2023.

³⁵¹ Ohrenstein and Chambers (n 305).

³⁵² Balharova (n 254).

³⁵³ ‘Gilford Motor Co v Horne [1933] Ch. 935’ (n 260).

³⁵⁴ ‘Jones v Lipman [1962]’ (n 269).

Motor. He had committed to a "non-compete" clause in his employment contract, which was intended to prohibit him from quitting Gilford Motor and forming a rival company. He was also bound by a contractual agreement not to solicit Gilford Motor clients. After resigning as managing director, he formed a limited company in his wife's name and solicited the company's clients. The corporation filed a lawsuit against him. The Court of Appeal determined that the company was formed as a device, a stratagem, to conceal Mr. Horne's effective carrying on of business. Court stated that "In this case, it was clear that the main purpose of incorporating the new company was to perpetrate fraud." Thus, the court of appeals viewed it as a simple ruse to conceal his wrongdoings.³⁵⁵

Similarly, in *Jones v. Lipman*,³⁵⁶ the defendant entered into a contract to sell the property but then attempted to evade the sale by transferring the property to a business controlled by him. Russel J expressly referred to the judgements in *Gilford v. Horne* and ruled that the corporation, in this case, was "a mask which (Mr Lipman) holds before his face in an attempt to avoid recognition by the eye of equity" and ordered specific performance against both Mr Lipman and the company.

It is interesting to note that in *Jones v. Lipman*, the Court resorted to veil piercing notwithstanding the availability of alternative means. It could have been argued that Lipman's company never truly secured clear ownership because it purchased the property knowing about Jones' claim. Nonetheless, these authorities aid in deciphering the scope of the concept of fraud, in which a company is used to fraudulently evade legal obligations. However, in the preceding cases, the court pierced the veil and held the controllers liable for the liabilities of the controllers who used the company as a sham to avoid their obligations.

The *Adams* [1990]³⁵⁷ case is particularly important in the 'group-fraud exception' because it clarified that the separate corporate personality will be disregarded when it can be demonstrated that the firm is nothing more than a 'sham/facade' that its incorporator has manipulated to conceal a legal irregularity. Importantly, Lord Slade's approach did not prompt the adoption of a lax interventionist strategy, but rather crystallised that the use of a corporation as a 'facade' inside a

³⁵⁵ 'Commercial Applications of Company Law'
<<https://www.law.uh.edu/assignments/spring2012/22237/ch03.pdf>>.

³⁵⁶ James Mendelsohn, 'Still "the Unyielding Rock"? A Critical Assessment of the Ongoing Importance of *Salomon V Salomon & Co LTD* [1897] AC 22 in the Light of Selected English Company Law Cases'.

³⁵⁷ *Adams v Cape Industries plc* (n 275).

group in order to apportion future liability will not justify the 'veil piercing'.³⁵⁸ In the absence of a pre-existing legal right, intention is considered speculative. Future cases strengthen Lord Slade's approach by revealing that the fraud exception is triggered by an obviously improper/fraudulent intent related to the use of the corporate structure.

Interestingly, this was not the end of judicial intrusions into "piercing the veil" among "grouping companies." In the recent English case of *VTB Capital plc v Nutritek International Corp* [2013]³⁵⁹ Mr. Justice Arnold concluded by quoting Justice Mumby in *Ben Hashem v Ali Shayif*³⁶⁰ that the courts have only gone so far as to pierce the corporate veil when "the company was being used by its controller in an attempt to immunise himself from liability for some wrongdoing which existed entirely dehors the company." He went on to clarify that a wrongdoing 'dehors' the company is 'anterior or independent' of it. This was the case in both *Jones v. Lipman* and *Gilford Motors v. Horne*. Mr. Lipman and Mr. Horne both attempted to avoid liability for their wrongdoing by utilising a firm they fraudulently controlled as a cover and hence as a tool. The courts were willing to lift the veil in specific stances to prevent litigants from being denied an appropriate remedy.³⁶¹ It is important to emphasise that after lifting the corporate veil, the court awarded an equitable remedy rather than damages in both cases.

In the same case,³⁶² Lord Neuberger remarked that the veil will be lifted only where both control corporation and misconduct have been established and advised against the use of terminology such as 'facade', which risk helping moral indignation to triumph over legal principle. Thus, judicial persistence to confound morality with bogus and fraudulent structuring is evident, even though *Adams* reiterated that there would be distinct cases and that the pre-existing right requirement is inherently unjust and the trigger for 'systemic' abuse of the separate corporate personality principle.

Subsequently, in *Prest*³⁶³, the Court felt it could no longer dodge the problem and was far more forthcoming. Lord Sumption stated that separate corporate personality is the entire foundation of English company law and that imposing a legal liability in the first place would not be an abuse,

³⁵⁸ *ibid.*

³⁵⁹ Lord Neuberger and others, '*VTB Capital Plc (Appellant) v Nutritek International Corp and Others (Respondents)*'.

³⁶⁰ '*Ben Hashem v Al Shayif*' (*vLex*) <<https://vlex.co.uk/vid/ben-hashem-v-shayif-792725965>> accessed 29 May 2023.

³⁶¹ Hameed (n 141).

³⁶² Neuberger and others (n 337).

³⁶³ *Prest v Petrodel Resources Limited and others* (n 100).

justifying the 'veil piercing' only on grounds of future abuse or other relevant conduct. Furthermore, the veil piercing' will not apply where the parent firm is held accountable for the contractual transactions of its subsidiaries or when other remedies are available.³⁶⁴

9.2.2. Agency

Many commentators in the United Kingdom have repeatedly referenced agency, which is sometimes referred to by the courts as "implied" or "constructive" agency, as a justification for lifting the corporate veil.³⁶⁵ Although *Salomon*³⁶⁶ made it obvious that a corporation is not inevitably the agent of its shareholders, such a relationship can exist in rare instances, and whether such a relationship exists in any individual case will be a question of fact. The agency doctrine's test is based on the establishment of an agency relationship. In the agency framework, the subsidiary is recognised as a separate legal person; but, due to the parent corporation's close control, it is considered to be used for the parent's activities.³⁶⁷ As a result, the parent corporation is held liable for the activities of its agent, notwithstanding the fact that the agent acted with the authority of its principal.³⁶⁸ Essentially, proof of control to the extent that the subsidiary is carrying on the parent's business is critical but extremely difficult to get.³⁶⁹ Case law backs up this position since courts have traditionally been hesitant to establish an agency relationship without proof of full control, limiting its application to cases where firm and intensive links of control and management decision can be demonstrated.³⁷⁰ It is important to note that the agency concept is not limited to the parent-subsidary concept. This means that courts will pierce the corporate veil even

³⁶⁴ Evangelos Kyveris, "'Grouping Liability" and the Salomon Principle: "Judicial" or "Systemic" Abuse?' (8 May 2015) <<https://papers.ssrn.com/abstract=2688430>> accessed 1 June 2023.

³⁶⁵ Karen Vandekerckhove (n 285).

³⁶⁶ Klaus Peter Berger, 'Salomon v. Salomon & Co Ltd [1897] AC 22' <https://www.trans-lex.org/310810/_/salomon-v-salomon-co-ltd-%5B1897%5D-ac-22/> accessed 30 May 2023.

³⁶⁷ 'Uncertainty Unravels Nothing: A Comment On The English Interpretation Of 'piercing' The Corporate Veil - Law Resource' <<https://www.tutorhunt.com/resource/18963/>> accessed 30 May 2023.

³⁶⁸ Karen Vandekerckhove (n 285).

³⁶⁹ Kyveris (n 342).

³⁷⁰ *ibid.*

if the corporation operated "merely as the agent of its shareholders for the specific transaction at issue."³⁷¹

In *Smith, Stone & Knight Ltd v. Birmingham Corporation* [1939]³⁷², Judge Atkinson J explored the considerations leading to a finding of agency in the context of whether a subsidiary company was the agent of its holding company. This was a case where the agency was established and the veil was lifted as the parent company had complete and exclusive access to the subsidiary's books, the subsidiary had no employees other than a manager, it occupied the parent's premises for no compensation, and the only evidence of its ostensibly independent existence was its name on stationery.³⁷³ The court stated that the subsidiary was the "agent or employee; or tool or simulacrum of the parent company".³⁷⁴

Atkinson J stated that whether a company was carrying on its own or its parent's business was a question of fact, and he identified six questions that he considered determinative:

- i. Were the profits of the subsidiary those of the parent company?
- ii. Were the persons conducting the business of the subsidiary appointed by the parent company?
- iii. Was the parent company the "head and brains" of the venture?
- iv. Did the parent company govern the venture?
- v. Were the profits made by the subsidiary company made by the skill and direction of the parent company?
- vi. Was the parent company in effective and constant control of the subsidiary?

It should be noted that the agency exception as codified in *Smith, Stone & Knight Ltd* [1939] has not been overruled, but subsidiaries are still presumed to be independent of their parent, "however complete the control might be," unless there is an express agency agreement. Except in extremely

³⁷¹ Jody J Brewster, 'Piercing the Corporate Veil in Montana' (1983) 44 4
<<https://scholarworks.umt.edu/cgi/viewcontent.cgi?article=1549&context=mlr#:~:text=18.,on%20behalf%20of%20the%20corporation.>>.

³⁷² 'Smith, Stone and Knight Ltd v Birmingham' (n 264).

³⁷³ 'Birmingham Corporation Argued That Smith Stone Knight Ltd Could Not Succeed | Course Hero' (n 265).

³⁷⁴ Berger (n 344).

extraordinary instances, *Knight* has been isolated to its facts, and the Courts have been hesitant to find an agency relationship.³⁷⁵

A recent influential case in this area was *Vedanta Resources PLC and another v Lungowe and others* [2019].³⁷⁶ Although English courts have traditionally held that parent companies can be held liable for subsidiaries that have "in substance taken over management of the subsidiary," the *Vedanta* case goes a step further.³⁷⁷ According to the United Kingdom Supreme Court, a parent's liability is also involved when the parent advises a subsidiary on "how it should manage a particular risk." This included establishing "group-wide policies" with "systemic errors" or taking "active steps" to ensure that subsidiaries implemented the policies. Indeed, the court went so far as to say that a parent can be held accountable to third parties harmed by subsidiaries even if it only "holds itself out" as exercising some kind of supervision over the subsidiary.³⁷⁸

9.2.3. *Single economic unit*

Most attempts to avoid separate corporate personalities within corporate groups can be summarised under the term "single economic unit," which implies that a single economic unit will be treated as one legal unit, with no "artificial" separation into different legal entities. The agency relationship is the decisive factor in the single economic unit doctrine. While companies within a group are distinct legal entities, there are times when a subsidiary acts as the parent company's agent. In such a case, the single economic unit test comes into play.³⁷⁹

The underlying basis of this theory is obvious because, while the aforementioned corporations are legally independent and different organisations, they comprise a single economic unit. As a result,

³⁷⁵ Kyveris (n 342).

³⁷⁶ *Vedanta Resources PLC and another (Appellants) v Lungowe and others (Respondents)* [2019] the supreme court of england [2019] UKSC 20.

³⁷⁷ Julius Melnitzer, 'Why Parent Companies May Soon Be Unable to Claim Immunity from Their Subsidiary's Liabilities' (*financialpost*) <<https://financialpost.com/legal-post/why-parent-companies-may-soon-be-unable-to-claim-immunity-from-their-subsidiarys-liabilities>> accessed 30 May 2023.

³⁷⁸ *Vedanta Resources PLC and another (Appellants) v Lungowe and others (Respondents)* (n 353).

³⁷⁹ Jessie Lee Suan Cui, 'Piercing the Corporate Veil – How Useful Is the Single Economic Unit Test?' (27 April 2021) <<https://legalatte.com/2021/04/27/piercing-the-corporate-veil-how-useful-is-the-single-economic-unit-test/>> accessed 31 May 2023.

liabilities should be assigned to the entire group to achieve a unified economic purpose.³⁸⁰ Surprisingly, the single economic unit argument was accepted positively in at least one well-known case. The test provided in *DHN Food Distribution* [1976]³⁸¹ specifies two conditions that must be met to treat the parent company and subsidiary as a single economic unit. These conditions are as follows: (1) the parent owns the majority or all of the shares in the subsidiary; and (2) the parent has a decisive influence over the subsidiary's business activities.³⁸²

Although the single economic unit argument was accepted in at least one prominent case, it was later explicitly questioned by the House of Lords in *Woolfson v. Strathclyde Regional Council*³⁸³ and purposefully distinguished in *Adams v. Cape Industries*.³⁸⁴ As the Court of Appeal stated in *Bank of Tokyo Ltd. v. Karoon* [1987]:³⁸⁵

"[Mr. Hoffmann] suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary company in this context; economically, he said, they were one. But we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be bridged".

In circumstances where the interpretation of statutory or contractual requirements is in question, the economic unity argument appears to have some possibility of success.³⁸⁶

9.2.4. Combination of Corporate and Aggregate Enterprise Group/Subsidiary

Sometimes the corporate personality corresponds to a fragment of the company or where a partnership or a holding company owns the controlling interest in one or more other corporations but has handled them in such a way that they no longer represent separate enterprises and have

³⁸⁰ Ranjan N Chandran, 'Hakem Arabi & Associates - Advocates & Solicitors'

<<https://www.hakemarabi.com.my/articles-lifting-of-the-corporate-veil.html>> accessed 31 May 2023.

³⁸¹ 'D.H.N. Food Distributors Ltd v Tower Hamlets London Borough Council' (vLex) <<https://vlex.co.uk/vid/d-h-n-food-793260125>> accessed 31 May 2023.

³⁸² *ibid.*

³⁸³ 'Woolfson v Strathclyde Regional Council' (n 328).

³⁸⁴ *Adams v Cape Industries plc* (n 275).

³⁸⁵ 'Bank of Tokyo Ltd v Karoon (Note)' (vLex) <<https://vlex.co.uk/vid/bank-of-tokyo-ltd-792793785>> accessed 31 May 2023.

³⁸⁶ Karen Vandekerckhove (n 285).

developed into, as a business matter, more or less indistinguishable from the larger enterprise.³⁸⁷ Judge Straughton L.J. described this phenomenon in *Atlas Maritime Co. Ltd v Avalon Maritime Ltd*, [1991] the Coral Case, as follows: “The creation or purchase of a subsidiary company with minimal liability, which will operate but not expose the parent to liability, may not seem to some the most honest way of trading. But it is extremely common in the international shipping industry and perhaps elsewhere. To find that it creates an agency relationship between the subsidiary and the parent would be revolutionary doctrine”.³⁸⁸

9.2.5. Trust

What is clear from English court case law is that, on occasion, the courts relied on the notion of trust in their reasoning for the implementation of the piercing of the corporate veil in order to evaluate the characteristics of the shareholders. Within this framework, "trust" refers to a fiduciary relationship in which one party (the Grantor) grants a second party (the Trustee) the authority to hold title to property or assets, including assets in the company on behalf of a third party (the Beneficiary).³⁸⁹ When a court in the context of trusts lifts the corporate veil, it indicates that the court looks past a company's separate legal personality to analyse the real ownership or control of the company's shares, particularly if such shares are held in trust. In the case of *Abbey Malvern Ltd v Ministry of Local Government and Planning case*,³⁹⁰ the court lifted the corporate veil to investigate the terms under which the trustees held the shares. In this situation, a school was administered like a business, but the shares were held by trustees on educational charitable trusts. They lifted the veil in order to investigate the terms under which the trustee held the shares.

³⁸⁷ Kathleen Okafor, ‘An Anatomy of the Grounds of Lifting the Corporate Veil: Steps to Codification’ (*Symbiosis*) <<https://symbiosisonlinepublishing.com/family-business-management/>> accessed 1 June 2023.

³⁸⁸ ‘Atlas Maritime Company SA v Avalon Maritime Ltd (The Coral Rose)’ (n 282).

³⁸⁹ ‘Trust Basics: What Is It, Types of Trusts, & Beneficiaries’ <<https://www.privatebank.bankofamerica.com/financial-empowerment/understanding-trusts.html>> accessed 20 July 2023.

³⁹⁰ Derek French, *Mayson, French and Ryan on Company Law* (Oxford University Press 2019) <https://books.google.ge/books?id=40KjDwAAQBAJ&pg=PR33&lpg=PR33&dq=The+Abbey+and+Malvern+Well+s+Ltd+v+Ministry+of+Local+Government+and+Planning+%5B1951%5D+1+Ch+728&source=bl&ots=EkTPTNsn8Z&sig=ACfU3U342XeFqMvNyQY6iY5KEyxLpJHm4A&hl=en&sa=X&ved=2ahUKEwim17iskaD_AhWmSPE DHXD7CngQ6AF6BAGXEA#v=onepage&q=The%20Abbey%20and%20Malvern%20Wells%20Ltd%20v%20Ministry%20of%20Local%20Government%20and%20Planning%20%5B1951%5D%201%20Ch%20728&f=false>.

9.2.6. Breach of duty to supervise

The UK courts have been faced with several piercing actions directed against UK parent corporations with regard to the industrial operations of their foreign subsidiaries.³⁹¹ *Adams v. Cape Industries* was an example of this type of case previously.³⁹² It has been suggested that a parent corporation may have a duty of care to the plaintiff/victim in the case of harmful or unsafe industrial operations. Such a duty may emerge if the parent purposefully forms a subsidiary abroad to participate in harmful or dangerous operations. It may also exist if the parent is actively involved in the subsidiary's operations, such as when it acts as the subsidiary's manager or when it devises the subsidiary's health, safety, and environmental policy and has an employee present at the subsidiary's premises to supervise its implementation.³⁹³ For example, In *Lubbe v. Cape plc*,³⁹⁴ 3,000 injured South African residents who had either worked at the asbestos mines or lived nearby filed a claim in English courts against the Cape group's parent for injuries caused by inhaling asbestos dust. According to the *Lubbe* judgement, a parent may be held liable for a breach of its duty of care if it exerted *de facto* control over the subsidiary and the parent's directors were aware or should have been aware of the dangers involved in the subsidiary's operations.

9.2.7. Enemy Character

In times of war, the court is willing to lift the corporate veil to uncover who the companies' actual controlling stockholders are. This was the case in the *Daimler Co Ltd v Continental Tyre and Rubber Co case*,³⁹⁵ where German shareholders held the shares of an English company during the time of the First World War. The *Daimler* case has importance for several reasons. First, it is perhaps the earliest case in which the House of Lords really set aside or pierced the corporate veil,

³⁹¹ Karen Vandekerckhove (n 285).

³⁹² *Adams v Cape Industries plc* (n 275).

³⁹³ Karen Vandekerckhove (n 285).

³⁹⁴ *Schalk Willem Burger Lubbe (Suing as Administrator of the Estate of Rachel Jacoba Lubbe) and 4 Others and Cape Plc and Related Appeals* (House of Lords).

³⁹⁵ 'Daimler v. Continental. | 6th July 1916 | The Commercial Motor Archive' (n 327).

making it a milestone decision. Second, it stated the fundamental principle that when a corporation is utilised to avoid the law, the veil should be pierced or set aside.³⁹⁶ However, while examining the case in relation to a specific modern fact pattern offered to any legal practitioner, it is vital to note that the case is more of a product of its time than a dependable predictor of how a court would rule in future cases.

10. General Comparisons Between the U.S. and the UK Corporate Veil Doctrines

10.1. *General Deference to the Separate Corporate Personality Principle*

There are many different types of corporate veil cases. The classic corporate veil case is one in which the distinct corporate personality is ignored and the shareholders are held liable for the corporation's debts. Because veil piercing results in shareholder liability for corporate debts, such cases are known as shareholder liability cases. There are, however, several types of corporate veil cases in which separate corporate personality is disregarded without imposing shareholder liability. For example, a subsidiary may be disregarded as a separate legal entity in order for a court to exercise jurisdiction over the corporate parent or demand the production of documents from a subsidiary or the parent and subsidiary corporate entities may be collapsed for the goal of assessing the scope of a managing director's responsibilities.³⁹⁷

A majority of corporate veil cases in the U.S. have been shareholder liability cases. Nonetheless, it is worth noting that shareholder liability is rarely applied in the UK. This happens for two main reasons. Firstly, unlike its counterpart in the U.S., the primary objective of the corporate veil concept in the UK has never been the imposition of shareholder liability. Instead, the emphasis has been broadened to include identifying circumstances in which a separate corporate personality is set aside. Second, attempts to pierce the veil of a genuine corporation are unlikely to succeed under UK law because UK courts have taken a more deferential attitude to limited liability than US

³⁹⁶ Peter N Levenberg, 'The Mystery of the Corporate Veil: Comparing Anglo-American Jurisdictions' [2019] International Affairs <<https://elibrary.law.psu.edu/cgi/viewcontent.cgi?article=1213&context=jlia>>.

³⁹⁷ Thomas K Cheng, 'The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines' [2011] SSRN Electronic Journal 334 <<https://deliverypdf.ssrn.com/delivery.php?ID=631024088114105119126069090096084030097033001017049013093127095124025101066031093067106004003004103059109067000067113124064078019040011087093000031025089076088027068037043005091098084023073020117127110126012028123108019120073078084126117011090013121&EXT=pdf&INDEX=TRUE>> accessed 18 May 2023.

courts, which have been quicker to pierce the veil of a valid business if specific circumstances are met.³⁹⁸

10.2. *Reliance on Traditional Common Law Concepts*

One notable difference between the judicial approaches of these two jurisdictions is that, while U.S. courts have been willing to fashion new doctrines to analyse corporate veil cases, such as the instrumentality doctrine and the alter ego doctrine, their English counterparts have frequently confined themselves to applying traditional common law concepts and principles, such as agency and trust.³⁹⁹

10.3. *Absence of Overarching Theory*

Unlike in corporate veil cases in the U.S., the UK doctrine lacks an overarching theory or analytical framework. For example, instrumentality theory was developed in the U.S. by Frederick J. Powell in 1931, and since then many state courts have adopted some variation of this doctrine. In UK cases, however, no comprehensive analytical framework can be identified, nor have the courts defined significant factors or considerations. The dominant analytical method used by UK courts is to categorise cases based on a combination of the legal concepts involved and the factual circumstances in which the case arises. Agency, trusts, fraud, group enterprises, enemy, revenue (taxation), and cases based on provisions of the Companies Act are among these categories. Agency and trusts are legal concepts-based categories. Cases involving fraud, taxation, and the Companies Act, on the other hand, are based on the nature or statutory foundation of the underlying claims. The group enterprise category includes instances that have one thing in common: the shareholder at issue is a corporation, and the plaintiff is attempting to impose enterprise liability on a corporate group. The enemy is a unique category illustrated by the *Daimler v. Continental Tyre and Rubber* case.⁴⁰⁰ These categories would have been useful if they could predict case

³⁹⁸ *ibid.*

³⁹⁹ *ibid.*

⁴⁰⁰ *ibid.*

outcomes. However, with the exception of fraud, this has not been the case. There is also no shared mode of analysis among cases in the same category. An examination of the most important cases demonstrates that no unifying analytical framework exists. For example, *Lonrho v. Shell Petroleum* [1980]⁴⁰¹ was not concerned with imposing liability. The question was whether the corporate parent had to produce records held by its subsidiaries. The meaning of the word "power" in the relevant discovery rule in the English High Court was important to the case. On the other hand, *Gramophone and Typewriter v. Stanley* [1908]⁴⁰² was a taxation case in which the primary issue was the parent's control over the subsidiary. Given the variety of facts and challenges provided in these group enterprise situations, the lack of a consistent analytical approach is unsurprising. Even if there was a uniform approach to these cases, it would almost certainly need to be modified before it could be applied to matters ranging from discovery to bankruptcy and taxation.⁴⁰³

10.4. The Role of Justice

There is a general consensus that one of the primary goals of the corporate veil theory in the U.S. is to promote justice.⁴⁰⁴ In *Anderson v. Abbott* (1944),⁴⁰⁵ the Supreme Court declared that "the courts will not permit themselves to be blinded or deceived by mere forms of law but will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require." In *Arnold v. Phillips* (1941)⁴⁰⁶ the Fifth Circuit Court of Appeals ruled that applicability of the corporate veil doctrine is dependent on the corporate entity being "a sham, a mere obstacle to justice, or an instrument of fraud." In more recent cases, such as *Fullerton Transfer & Storage* (1990),⁴⁰⁷ the Sixth Circuit Court of Appeals stated that the promotion of justice and the avoidance of fraud established two grounds for piercing the corporate veil. In

⁴⁰¹ 'Lonrho Ltd and Others v Shell Petroleum Company Ltd and Others (First Appeal)' (vLex) <<https://vlex.co.uk/vid/lonrho-ltd-and-others-793524813>> accessed 27 July 2023.

⁴⁰² 'Gramophone & Typewriter, Ltd. v. Stanley (C.A.)' <<http://www.uniset.ca/other/cs3/19082KB89.html>> accessed 1 June 2023.

⁴⁰³ Cheng (n 391).

⁴⁰⁴ *ibid.*

⁴⁰⁵ *Anderson v Abbott* (3) 321 US 349 (Supreme Court).

⁴⁰⁶ 'Arnold v. Phillips, 117 F.2d 497 (5th Cir. 1941)' (*Justia Law*) <<https://law.justia.com/cases/federal/appellate-courts/F2/117/497/1480280/>> accessed 27 July 2023.

⁴⁰⁷ 'Nat'l Labor Relations Bd. v. Fullerton Transfer & Storage Ltd., 910 F.2d 331 | Casetext Search + Citator' <<https://casetext.com/case/nlrb-v-fullerton-transfer-storage-ltd>> accessed 27 July 2023.

contrast, judges from the UK have shown an ambiguous stance towards justice considerations. Some UK judges hold similar views to their U.S. counterparts. For example, Lord Justice Cumming-Bruce stated in the case of *In re a Company* that “[i]n our view the cases before and after *Wallersteiner v. Moir* show that the court will use its powers to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficacy of the corporate structure under consideration.”⁴⁰⁸ Despite these positive sentiments, the current judiciary opinion is that it is not "open to this court to disregard the principle of *Salomon v. A Salomon & Co Ltd* merely because it considers it just to do so." This UK view of the role of justice in corporate veil instances represents a more formalistic approach to judicial decision-making.⁴⁰⁹

11. Chapter Summary

The courts of the United Kingdom distinguish between judicial and legal corporate veil piercing. Legal piercing arises as a result of the following statutory exceptions to limited liability: (1) fraudulent and wrongful trading, (2) abuse of company name and (3) other types of directors' liabilities. Case law, on the other hand, contains the grounds for judicial piercing, indicating that judges enjoy substantial discretion. The current state of UK law concerning corporate veil piercing is adequately explained in the case of *Ben Hashem v. Al Shayif* (2009).⁴¹⁰ The court set out the following rules for piercing the corporate veil:⁴¹¹

“In the first place, ownership and control of a company are not of themselves sufficient to justify piercing the veil. Secondly, the court cannot pierce the corporate veil, even where there is no unconnected third party involved, merely because it is thought to be necessary in the interests of justice. Thirdly, the corporate veil can be pierced only if there is some “impropriety”. Fourthly, the court cannot, on the other hand, pierce the corporate veil merely because the company is involved in some impropriety. The impropriety must be linked to the use of the company structure

⁴⁰⁸ Cheng (n 391).

⁴⁰⁹ *ibid.*

⁴¹⁰ ‘Ben Hashem v Al Shayif’ (vLex) <<https://vlex.co.uk/vid/ben-hashem-v-shayif-792725965>> accessed 29 May 2023.

⁴¹¹ Peter N Levenberg, ‘The Mystery of the Corporate Veil: Comparing Anglo-American Jurisdictions’ [2019] International Affairs <<https://elibrary.law.psu.edu/cgi/viewcontent.cgi?article=1213&context=jlia>>.

to avoid or conceal liability. Fifthly, it follows from all this that if the court is to pierce the veil it is necessary to show both control of the company by the wrongdoer(s) and impropriety, that is, (mis)use of the company by them as a device or façade to conceal their wrongdoing. Finally, and flowing from all this, a company can be a façade even though it was not originally incorporated with any deceptive intent. The question is whether it is being used as a façade at the time of the relevant transaction(s). And the court will pierce the veil only insofar as it is necessary to provide a remedy for the particular wrong that those controlling the company have done. In other words, the fact that the court pierces the veil for one purpose does not mean that it will necessarily be pierced for all purposes.”

In *Antonio Gramsci Shipping Corp v Stepanovs* (2011) the assertion that "the court will pierce the veil only insofar as is necessary to provide a remedy for the particular wrong which those controlling the company have done" has been deemed incorrect by the Commercial Court.⁴¹² In *VTB Capital*, the court rejected a claim that there was "no such principle as 'piercing the veil[.]'" In light of previous rulings, such as *Woolfson v. Strathclyde Regional Council* and *Adams v. Cape Industries*, the court concluded that it was no longer permissible to "question the existence of the 'veil piercing' principle."⁴¹³ An examination of the cases indicates that in recent years, the UK courts have handled corporate veil piercing in a more conservative manner; the UK courts regard the company as a vital tool for commerce and will not simply go behind the veil. The courts have demonstrated less reluctance to pierce the corporate veil where doing so will not result in holding a shareholder liable for the debt of the corporation over which it has control.⁴¹⁴ Courts are also more inclined to pierce the corporate veil to saddle a company with the liability of its shareholder in order to assist a plaintiff company in recovering funds transferred to another entity controlled by one of the plaintiff's directors in violation of that director's fiduciary duties.⁴¹⁵

The fact that the shareholder seeking to be held liable for the debts of the company is a corporation, not an individual, does not strengthen the claim to pierce the corporate veil. In the case of *Woolfson*

⁴¹² ‘Antonio Gramsci Shipping Corp v Stepanovs’ (*Practical Law*)
<[http://uk.practicallaw.thomsonreuters.com/Document/I1C28D250413E11E0B039E902482D73C1/View/FullText.html?transitionType=Default&contextData=\(sc.Default\)&comp=pluk](http://uk.practicallaw.thomsonreuters.com/Document/I1C28D250413E11E0B039E902482D73C1/View/FullText.html?transitionType=Default&contextData=(sc.Default)&comp=pluk)> accessed 27 July 2023.

⁴¹³ Levenberg (n 394).

⁴¹⁴ *ibid.*

⁴¹⁵ *ibid.*

the idea that companies in a group constitute a single economic unit and therefore should be treated as one that has been rejected.⁴¹⁶

12. Grounds for Piercing the Corporate Veil in German Legal Doctrine

How to best safeguard the interests of a company's creditors when the firm becomes insolvent due to the misfeasance of the company controllers is a question that courts in all jurisdictions are dealing with. This is especially important in Germany, where the corporation in question is a limited liability company (a *Gesellschaft mit beschränkter Haftung*, or *GmbH* for short), which is roughly equal to what is known as a private (limited) company in common law countries.⁴¹⁷ Until recently, the Federal Court of Justice of Germany (Bundesgerichtshof, BGH) had settled the matter using two alternative ways, both of which involved, to varying degrees, a lifting of the corporate veil.⁴¹⁸

Unlike the U.S. and UK veil piercing is relatively rare in Germany.⁴¹⁹ Direct claims of aggrieved creditors against shareholders are limited to instances in which assets have been commingled. In all other cases, German courts established and implemented principles that have lately changed.⁴²⁰ Shareholders who strip a corporation of its assets to the detriment of creditors may be held liable, but not on the basis of veil piercing.⁴²¹ Shareholders are usually never personally liable in instances of undercapitalization or abuse of the corporate form, and a dominant influence over the company is likewise generally not grounds for such liability.

⁴¹⁶ *ibid.*

⁴¹⁷ Steve Allen, 'Lowering the Corporate Veil in Germany: A Case Note on BGH 16 July 2007 (Trihotel) | Oxford University Comparative Law Forum' (27 July 2017) <<https://ouclf.law.ox.ac.uk/lowering-the-corporate-veil-in-germany-a-case-note-on-bgh-16-july-2007-trihotel/>> accessed 15 June 2023.

⁴¹⁸ *ibid.*

⁴¹⁹ Klaus J Hopt, 'Comparative Company Law' [2019] Max Planck Institute for Comparative and International Private Law and ECGI <https://www.ecgi.global/sites/default/files/working_papers/documents/finalhopt.pdf>.

⁴²⁰ Cheng Han Tan, JiangYu Wang and Christian Hofmann, 'Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives' [2018] SSRN Electronic Journal <<https://www.ssrn.com/abstract=3254130>> accessed 15 June 2023.

⁴²¹ Lydia Chao, 'VEIL-PIERCING UNDER AMERICAN, GERMAN, AND TAIWANESE COMPANY LAW' <https://europa-kolleg-hamburg.de/wp-content/uploads/2021/07/Lydia-Chao_-Study-Paper_01_21.pdf>.
<https://europa-kolleg-hamburg.de/wp-content/uploads/2021/07/Lydia-Chao_-Study-Paper_01_21.pdf>

12.1. Corporate Structure and Governance in German Company Law

Whereas UK law and the jurisdictions that have derived their corporate laws from it normally subject the private limited company to practically the same rules and obligations as the public limited company. German law, on the other hand, has developed two very different types of corporations.⁴²² They are each governed by their own different set of rules, the Aktiengesellschaft (AG - stock corporation) and the Gesellschaft mit beschränkter Haftung (GmbH - private limited company).⁴²³

GmbH is the company of choice for small and medium-sized businesses and is hence typically closely held.⁴²⁴ Because of its characteristic and structure, veil-piercing or a functional equivalent is a crucial issue for GmbH. Shareholders in closely held corporations might wield disproportionate power and seek to profit themselves at the expense of the company and its creditors. The shareholder meeting also has a dominating influence over the GmbH under German law.⁴²⁵ In contrast to other jurisdictions where directors may normally manage corporations independently of shareholder direction,⁴²⁶ section 37(1) of German GmbH (Gesetz über die Gesellschaften mit beschränkter Haftung – Law Concerning the Private Limited Companies) mandates directors to follow shareholder resolutions approved at meetings.⁴²⁷

The stock corporation (Aktiengesellschaft or “AG”), relies on a detailed regime underpinned by largely mandatory statutory law and is more than just a larger version of the GmbH. AG is particularly suitable for companies that require a large amount of capital and where corporate management is intended to be as autonomous from shareholders as feasible,⁴²⁸ as AG's corporate

⁴²² Tan, Wang and Hofmann (n 78).

⁴²³ Gregor Bachmann, ‘Introductory Editorial: Renovating the German Private Limited Company - Special Issue on the Reform of the GmbH’ (2008) 9 German Law Journal 1063 <https://www.cambridge.org/core/product/identifier/S2071832200000316/type/journal_article> accessed 16 June 2023.

⁴²⁴ *ibid.*

⁴²⁵ Global Legal Group, ‘International Comparative Legal Guides’ (*International Comparative Legal Guides International Business Reports*) <<https://iclg.com/practice-areas/corporate-governance-laws-and-regulations/germany>> accessed 16 June 2023.

⁴²⁶ Tan, Wang and Hofmann (n 78).

⁴²⁷ Act on Limited Liability Companies (Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG).

⁴²⁸ ‘AG in Germany | German Stock Corporation Attorneys’ <<https://www.winheller.com/en/business-law/company-law/aktiengesellschaft-ag-german-stock-corporation.html>> accessed 16 June 2023.

governance structure focuses decision-making power on its two-tier board rather than the shareholders.⁴²⁹

It is worth noting that once legally established, both AG and GmbH are legal persons independent and separate from their shareholders, who benefit from limited liability.⁴³⁰ Moreover, unlike corporations in the United States, which have no statutory minimum initial contribution requirement,⁴³¹ a GmbH must have a minimum of EUR 25,000 for its initial capital,⁴³² and an AG must have at least EUR 50,000 at the time of incorporation.⁴³³ German law, therefore, demands a substantial amount of initial capital for the incorporation of any company because even the so-called ‘Entrepreneurial Company’ (Unternehmergesellschaft), created by the 2008 reform of the GmbHG and sometimes referred to as “GmbH-lite,” is ultimately a GmbH with a minimum capital of EUR 25,000.⁴³⁴ As pointed out in various German legal pieces of literature, the underlying reasons for having these requirements are to “establish the integrity of the business that the founding members commit to”⁴³⁵ and “prevent insolvencies at an early stage of a company's life”.⁴³⁶ However, the minimum capital does not guarantee or indicate that the initial capital would be sufficient for the commercial endeavours that the company intends to pursue.⁴³⁷

In addition to the initial capital requirement, German company legislation has stringent capital maintenance rules.⁴³⁸ Assets of the company that are required to maintain the statutory level of capital may not be allocated to shareholders.⁴³⁹ When a corporation does not have enough assets to make distributions but yet makes them, the shareholders who got the payouts must repay the

⁴²⁹ Theodor Baums and Kenneth E Scott, ‘Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany’
<<https://deliverypdf.ssrn.com/delivery.php?ID=551078094095125007068006119025001095113049061083007066108125013002119094018006098090034029025017045016027096097013083123113007030040043045023117007011114077104094022060052075106123083064072067019066095120083114124074003120088105115069090102127119091065&EXT=pdf&INDEX=TRUE>>.

⁴³⁰ §1 AktG and § 13 GmbHG

⁴³¹ ‘Form of Entity around the World - DLA Piper Guide to Going Global’
<<https://www.dlapiperintelligence.com/goingglobal/corporate/>> accessed 17 June 2023.

⁴³² § 5 GmbHG

⁴³³ §7 AktG

⁴³⁴ Tan, Wang and Hofmann (n 78).

⁴³⁵ *ibid.*

⁴³⁶ *ibid.*

⁴³⁷ *ibid.*

⁴³⁸ Andreas Cahn, ‘Capital Maintenance in German Company Law’ (Institute for Law and Finance 2015)
<<http://publikationen.ub.uni-frankfurt.de/frontdoor/index/index/docId/42328>> accessed 17 June 2023.

⁴³⁹ § 30 GmbHG.

company.⁴⁴⁰ These minimum initial capital and capital maintenance rules could assist in clarifying why, in its new series of judgements, BGH finds shareholders liable to the company and why BGH remains hesitant to pierce the corporate veil in cases where capital appears to be insufficient for the business ventures pursued.

12.2. Liability within ‘qualified de facto groups’

Liability within qualified de facto groups is a concept developed by the BGH when considering the liability of a GmbH's controlling shareholder for the company's debt via an analogous application of the provisions governing enterprise groups in Germany's Stock Corporations Act (Aktiengesetz, AktG). As a result, I must first examine how the AktG deals with such enterprise groups for stock corporations, which are analogous to public (limited) companies in common law jurisdictions. The so-called 'de facto' or 'non-contractual' groups are one of two types of enterprise groups governed by the AktG's enterprise group regulations, the other being the so-called 'contractual groups'.⁴⁴¹ Contractual groups are formed when separate corporations that want to form corporate groups enter into controlling agreements and profit-and-loss transfer agreements. The goal of joining these types of business organisations is to maximise tax benefits.⁴⁴² When dependent enterprises join together under the uniform management of a controlling enterprise, a non-contractual or 'de facto' enterprise group is formed.⁴⁴³ Such an arrangement becomes a 'qualified de facto group' where the controlling enterprise abuses its controlling power.⁴⁴⁴ Contractual group relationships are addressed by §300 AktG, whilst de facto group relationships are governed by §311 AktG.⁴⁴⁵ However, there are no statutory rules governing GmbH groupings. As a result, the law on GmbH groups has evolved through case law and literature, principally through the comparable application of laws governing enterprise groups in the AktG.⁴⁴⁶ The most

⁴⁴⁰ § 31 GmbHG.

⁴⁴¹ Charles Zhen Qu and Björn Ahl, 'Lowering the Corporate Veil in Germany: A Case Note on BGH 16 July 2007 (Trihotel)' <https://research-repository.griffith.edu.au/bitstream/handle/10072/42148/74550_1.pdf?sequence=1>.

⁴⁴² Karen Vandekerckhove (n 261).

⁴⁴³ Steve Allen (n 356).

⁴⁴⁴ *ibid.*

⁴⁴⁵ Charles Zhen Qu and Björn Ahl (n 380).

⁴⁴⁶ *ibid.*

significant of the aforementioned provisions are §302, 311, and 317. §302 mandates the controlling company to settle a subordinate enterprise's annual deficit. § 311 forbids the controlling enterprise from using its influence to induce a subordinate enterprise to enter into a transaction that is detrimental to the subordinate enterprise without compensation. In the absence of such compensation, §317 provides the aggrieved subordinate enterprise with a claim for damages against the controlling enterprise.⁴⁴⁷ Examples include the BGH judgement in 1991-*Video*⁴⁴⁸ and also the BGH judgment of 1993- *TBB* cases,⁴⁴⁹ in which the Court upheld the claim of a subordinate company's creditor against the controlling person of the GmbH group. In both cases, the defendants were natural people who controlled the group as shareholders and directors, and the Court treated them as the 'controlling enterprise' for the purpose of an analogous application of §302 AktG.⁴⁵⁰ This idea of 'liability within a qualified de facto group' was heavily criticised⁴⁵¹ due to its lack of accurate definition and the uncertainty it caused as to whether a party would be liable under §302 AktG. However, a more troubling issue with the 'liability within a qualified de facto group' approach is that it is debatable whether a parallel should be formed between a contractual stock corporation group and a de facto limited liability company (GmbH) group. The analogy's flaw is that it leads to the application of provisions regulating contractual groups of stock corporations to situations in which relationships between firms in a company group are not at issue. In both the *Video* and *TBB* cases, the so-called 'controlling enterprise' was a natural person with controlling influence in a company inside the group, which was not a stock corporation group.⁴⁵² The qualified de facto group approach lifts the corporate veil by making the controlling person liable for the debt of a 'subordinate' company.⁴⁵³

⁴⁴⁷ *ibid.*

⁴⁴⁸ 'BGH, Az. Entscheidungssammlung von Bundesgerichten - Rechtsanwalt Matthias Prinz' <https://www.prinz.law/urteile/bgh/II_ZR_135-90> accessed 18 June 2023.

⁴⁴⁹ Ana Perestrelo de Oliveira, 'The Sins of the Son: PARENT COMPANY LIABILITY FOR COMPETITION LAW INFRINGEMENTS' 20.

⁴⁵⁰ Steve Allen (n 356).

⁴⁵¹ Frank Wooldridge, 'German Law Governing Private Companies in a Group' [2010] *Amicus Curiae* 21 <<https://journals.sas.ac.uk/amicus/article/view/1218>> accessed 18 June 2023.

⁴⁵² Steve Allen (n 356).

⁴⁵³ *ibid.*

12.3. Cases of undercapitalization and liability for “annihilating interference”

In some jurisdictions, it has long been assumed that regulated minimum capital ensures less undercapitalisation of corporations and less risk transfer from corporations to creditors.⁴⁵⁴ Economists usually believe that determining the minimum capital adequate for all enterprises is impossible. However, flexible capital based on business size and other factors is not set down by the law. Nonetheless, corporate shareholders are not entitled to shift all remaining risks to creditors after reaching the minimum capital requirements.⁴⁵⁵ According to German law, an insufficient capitalisation of a corporation is evident when current capital is insufficient for the corporation to carry on its activities with the assistance of specific financial aids, which will not secure the repayment of the business's debts.⁴⁵⁶ Germans distinguish between nominal and material undercapitalisation due to the minimum capital.⁴⁵⁷ During nominal undercapitalisation, the owners fail to fulfil the minimum requirement of nominal capital, whereas material undercapitalisation comprises insufficient refinancing of the capital after meeting the minimum capital requirement established by the law initially. The Ulmer formula is frequently applied to evaluate material undercapitalisation. According to the formula, undercapitalisation occurs when financial instruments, including shareholder loans, are insufficient or inadequate in comparison to the operated business.⁴⁵⁸ However, on 16 July 2007, the German Federal Supreme Court revised its approach to piercing the corporate veil in the case of "*Trihotel*," specifically where the corporation's assets are depleted and the corporation's "economic status is destructed." The court ruled that the shareholder's corporate liability is limited and that the partner of the LLC is not liable to creditors in the event of material undercapitalisation. Only in the case of intentional damage to the corporation can liability be imposed. Based on the court's new approach to imposing personal liability on the shareholder, it is clear that tort law protects the creditor more effectively.⁴⁵⁹

⁴⁵⁴ Olga Petroševičienė, 'EFFECTIVE PROTECTION OF CREDITORS' INTERESTS IN PRIVATE COMPANIES: OBLIGATORY MINIMUM CAPITAL RULES VERSUS CONTRACTUAL AND OTHER EX POST MECHANISMS'.

⁴⁵⁵ Carsten Alting (n 128).

⁴⁵⁶ Irakli Burduli (n 116).

⁴⁵⁷ Tobias Tillmann, 'Shareholder Liability for Undercapitalization- From a Shareholder Responsibility and Creditor Protection Perspective' 8 <https://tspace.library.utoronto.ca/bitstream/1807/122180/1/MQ95450_OCR.pdf>.

⁴⁵⁸ Carsten Alting (n 128).

⁴⁵⁹ Charles Zhen Qu and Björn Ahl (n 380).

Therefore, the partner of the LLC becomes personally liable to the creditor when the partner abuses the principle of separate personality.⁴⁶⁰

12.3.1. *The Trihotel judgment of the Federal High Court (BGH)*

In its 2007 landmark judgment, *Trihotel*,⁴⁶¹ BGH developed a new approach to hold shareholders liable for their improper conduct that resulted in company insolvency.⁴⁶² The court, however, made the criteria for such liability more onerous. This has resulted in shareholders being held personally liable to the company's creditors in cases when recourse under the statutory provisions guaranteeing the maintenance of GmbH's capital was insufficient to completely recompense them.⁴⁶³

The BGH explained that it deemed its previous judgements to be doctrinally questionable since they resulted in shareholders being held liable to creditors despite the fact that no responsibilities owed to creditors were infringed. The duties infringed were owed to the company and resulted in losses for the company. The BGH thought it was flawed to presume that any loss of business assets would instantly harm creditors.⁴⁶⁴ Instead, the losses were simply reflected, and reflective losses often did not provide creditors with a remedy.⁴⁶⁵ Previous judgements produced contradictory results since "annihilating interference" resulted in direct external liability of shareholders, although the legislative rules for capital maintenance (§§30 and 31 GmbHG) only resulted in internal liability of shareholders.⁴⁶⁶

The Court underlined that veil-piercing must be used with caution because it can undermine the notion of limited liability. It emphasised that losing the right of limited liability would jeopardise the GmbH's very existence as a popular and beneficial type of business entity, thereby going

⁴⁶⁰ § 13(2) GmbHG.

⁴⁶¹ *Bundesgerichtshof [BGH] [Federal Court of Justice] II ZR 3/04, Jul 16, 2007 (Trihotel), 2007 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 2689.*

⁴⁶² Lydia Chao (n 360).

⁴⁶³ Tan, Wang and Hofmann (n 78).

⁴⁶⁴ BGH *Trihotel*, 2007 NJW 2689

⁴⁶⁵ Tan, Wang and Hofmann (n 78).

⁴⁶⁶ *ibid.*

against the legislature's objectives. As a result, the court found that shareholders could not be held liable for "abuse of the corporate form" as defined in previous rulings.⁴⁶⁷

However, shareholders were still personally liable in circumstances of "annihilating interference" (Existenzvernichtender Eingriff), but not on the same grounds as before. The Court ruled that "annihilating interference" should now be interpreted as tortious liability for unlawfully tampering with company assets. These corporate assets are subject to severe capital maintenance rules in the best interests of creditors. Tampering with these assets results in tortious liability only when it causes or exacerbates corporate insolvency.⁴⁶⁸ Damages are owed solely to the corporation, not to its creditors because their losses are entirely reflective.⁴⁶⁹

To be held liable for "annihilating interference" under tort law, the shareholders' conduct must meet the strict requirements of §826 of the BGB (Bürgerliches Gesetzbuch- German Civil Code), which states: "A person who intentionally inflicts damage on another person in a manner contrary to public policy is liable to the other person to make compensation for the damage."⁴⁷⁰ This requires a shareholder to purposefully and maliciously hurt the company.⁴⁷¹ The provision's foundation is that the shareholder is aware that his behaviour is detrimental to the corporation's finances and equally aware of all facts that render the act contrary to public policy, but that he does not necessarily understand that the law holds his acts to be contrary to public policy, nor that he intends to harm the creditors.⁴⁷² As a result, a shareholder can be held liable only when the risk of insolvency is very substantial and obvious to the shareholder.⁴⁷³ Not only are the owners of the disadvantaged company liable, but so are the shareholders of a second company that owns shares in the disadvantaged company. The supporting argument is that no shareholder should be permitted to hide behind technicalities; that is, the fact that he is not a shareholder himself is no defence when the harm done is functionally the same as if he were.⁴⁷⁴

⁴⁶⁷ BGH Trihotel, 2007 NJW 2689.

⁴⁶⁸ *ibid.*

⁴⁶⁹ Tan, Wang and Hofmann (n 78).

⁴⁷⁰ 'German Civil Code BGB' <https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p3497> accessed 18 June 2023.

⁴⁷¹ Tan, Wang and Hofmann (n 78).

⁴⁷² *ibid.*

⁴⁷³ *ibid.*

⁴⁷⁴ *ibid.*

12.4. Disregarding Corporate Formalities

In Germany, similar to the United States, the court may pierce the corporate veil if the shareholder and the corporation fail to protect corporate formalities, resulting in an inaccurate evaluation of the corporation's identity by the creditor.⁴⁷⁵ The Nürnberg Regional Supreme Court and the German Federal Supreme Court do not take the same approach to the aforementioned corporate veil-piercing prerequisite. The former believes that if the corporation and shareholder cannot be distinguished due to the shareholder's failure to protect formalities, then the creditor's claim must be satisfied, even if there was no intent to mislead him/her. The latter believes that it is vital to verify that the creditor was not misled.⁴⁷⁶

12.5. Commingling of Assets

In one of its decisions,⁴⁷⁷ the BGH held that the company's limited liability may be overlooked if the corporation's and the shareholder's personal assets are commingled. The Karlsruhe Regional Court rejected the corporation's limited liability because the shareholder declared its personal property, including multiple loans and a residence, as the corporation's property, even though the corporation was bankrupt. The court determined that the shareholder had failed to differentiate between two assets and could no longer claim ownership of the assets. As a result, the court regarded the shareholder and the corporation as one and the same entity. In Germany, like in the United States, the foundation for piercing is inaccuracies in financial accounting and records that make distinguishing the assets of corporations and shareholders impossible. Furthermore, a property whose owner cannot be determined will be included in extended responsibility, and the shareholder will be unable to claim ownership of it.⁴⁷⁸

⁴⁷⁵ Carsten Alting (n 128).

⁴⁷⁶ *ibid*, 214-217.

⁴⁷⁷ BGH, 29111956 - II ZR 156/55 [1956] BGH II ZR 156/55.

⁴⁷⁸ Carsten Alting (n 128).

12.6. Special Regulations

12.6.1. Tort Liability

§826 of the BGB⁴⁷⁹ addresses tort liability ("Sittenwidrigkeit") where deliberate harm is caused by infringing economic or legal rules that are contradictory to moral principles.⁴⁸⁰ According to Section 2 of §823 of the German Civil Code tort can be used when private and public order, i.e., "Schutzgesetz," which protects persons from certain damages, is breached.⁴⁸¹ To use §826 of the German Civil Code, the shareholder's intent must be proven.⁴⁸² The German Imperial Court ("Reichsgericht") determined that shareholders are subject to tort liability where the choice not to adequately finance a corporation's capital, given its business area, was made on purpose in order to leave creditors unprotected during bankruptcy.⁴⁸³ The German Federal Supreme Court found that it is a violation of §826 of the BGB when a shareholder of a closed corporation that is no longer viable continues to conduct business via the corporation notwithstanding the fact that it is unable to meet its liabilities.⁴⁸⁴ Shareholders are also liable for delaying a bankruptcy notice in order to enhance the corporation's fund at the expense of creditors for personal gain, regardless of the corporation's situation.⁴⁸⁵

12.6.2. The Culpa in Contrahendo Doctrine

⁴⁷⁹ § 826 'German Civil Code BGB' (n 427).

⁴⁸⁰ Gert Bruggemeier, 'Perspectives on the Law of Contorts: A Discussion of the Dominant Trends in West German Tort Law' 29 <https://repository.uclawsf.edu/cgi/viewcontent.cgi?article=1120&context=hastings_international_comparative_law_review>.

⁴⁸¹ David Elischer, 'Wrongfulness As a Prerequisite Giving Rise to Civil Liability in European Tort Systems' [2017] SSRN Electronic Journal 2 <<https://www.ssrn.com/abstract=2934912>> accessed 19 June 2023.

⁴⁸² Karen Vandekerckhove (n 285).

⁴⁸³ Maximilian Schiessl, 'The Liability of Corporations and Shareholders for the Capitalization and Obligations of Subsidiaries under German Law' (1986) 7 Northwestern Journal of International Law & Business 492 <<https://core.ac.uk/download/pdf/230966777.pdf>>.

⁴⁸⁴ *ibid.*

⁴⁸⁵ *ibid.*

If a parent corporation is involved in negotiations between its subsidiary and a third party, the parent company may be held liable under the *culpa in contrahendo* doctrine.⁴⁸⁶ One type of *culpa in contrahendo* liability is "agency" liability. This doctrine holds an agent operating on behalf of one party in negotiations liable if the agent has strong business interests in the negotiated contract or if the third party places a high level of trust in the agent. In contrast to the agency doctrine used by some US state courts, the parent corporation is considered the subsidiary's agent under German law.⁴⁸⁷ In a number of judgements, the BGH established a rule requiring a shareholder of a corporation in financial trouble to inform the other party to a proposed transaction of the corporation's financial position if such a shareholder is involved in the negotiations. If the corporation later declares bankruptcy and the other party's claim is compromised in the bankruptcy case, the other party has a claim against the shareholder who failed to fulfil this duty. Commentators believe that such judgements are justified if they are founded on the creditor's significant trust in the shareholder. However, imposing personal liability under the *culpa in contrahendo* is beyond the scope of this theory if a shareholder believes in his or her corporate choice.⁴⁸⁸

12.6.3. Konzern Law

Nowadays, corporate groups are oftentimes truly global. If a subsidiary within a cross-border group is headquartered in Germany, the relationship between this company and its parent is mostly regulated by Konzernrecht (German group law).⁴⁸⁹ Unlike most other jurisdictions, German law has provided significant written rules regarding corporate groups for more than fifty years, since a full codification was attempted in 1965.⁴⁹⁰ The crucial norms were incorporated into the Aktiengesetz (AktG), the statute governing stock corporations (Aktiengesellschaft, or short AG).

⁴⁸⁶ *ibid.*

⁴⁸⁷ *ibid.*

⁴⁸⁸ *ibid.*

⁴⁸⁹ Alexander Scheuch, 'Konzernrecht : An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues' (2016) 13 European Company Law 191

<<https://kluwerlawonline.com/journalarticle/European+Company+Law/13.5/EUCL2016027>> accessed 19 June 2023.

⁴⁹⁰ *ibid.*

Among other things, Konzern Law regulates a corporation's liability to creditors. The third book of the Stock Corporation Act includes the regulations on conflict of interest in a group of corporations that require specific regulation under German law. The Konzern is formed when there is one controlling corporation and one or more controlled corporations on the one hand. Balance is violated when a majority shareholder has an interest in one or two corporations and there is a possibility that the dependent corporation will be influenced by another dominant corporation.⁴⁹¹

12.6.4. *De Facto Konzern (Faktischer Konzern)*

Corporations that are closely related but do not have a contract are de facto dependent on one another.⁴⁹² The obligatory rules of AktG ⁴⁹³ regulate de facto Konzern and obligate the parent corporation to reimburse the subsidiary for any loss or damage caused by transactions for which the parent corporation was liable. To calculate the damage, all transactions with the affiliated corporation and other legal entities in which the parent corporation was involved must be evaluated. Furthermore, it must be explained whether the transactions benefited the subordinated company.⁴⁹⁴ As a result, within de facto dominance, the law specifies that damages may only be claimed by a controlled corporation, which must demonstrate that particular transactions resulted in respective damages. In the majority of cases, it is difficult to argue that the specific transaction was not beneficial to the controlled corporation and resulted in an unfavourable outcome. As a result, researchers believe that the legal importance of de facto Konzern is less effective due to the difficulty of the burden of proof and the fact that it is assigned to controlled corporations.⁴⁹⁵

13. Chapter Summary

⁴⁹¹ Karen Vandekerckhove (n 261).

⁴⁹² *ibid.*

⁴⁹³ § 311, § 317 AktG

⁴⁹⁴ Carsten Alting (n 128).

⁴⁹⁵ *ibid.*

Perhaps the most praiseworthy aspect of the BGH's ruling in *Trihotel* is the Court's recognition of the importance of not lifting the corporate veil for more than is necessary. Any veil-lifting violates the fundamental concept of company law that a company has a legal personality distinct from its shareholders, and the feasibility of developing a theory on the formation of exceptions to this principle is unlikely. Lifting the corporate veil should thus be considered a last resort after all other options have been exhausted. *Trihotel* demonstrates that a type of case that was previously settled by lifting the corporate veil to a certain extent can now be resolved through the application and creative development of additional private law and company law standards. With this decision from Germany's highest civil court, it is highly likely that *Trihotel* will shift company law jurisprudence in a new direction where essential company law principles such as the doctrine of separate legal personality are not disregarded unless it is absolutely impossible to find a solution on the basis of, or through a legitimate extension of, other rules. I strongly support this approach to veil piercing given that it seeks to uphold the fundamental concept that a company has a legal personality separate from its shareholders while also acknowledging that there may be exceptional circumstances in which the veil must be pierced to achieve justice. Furthermore, by regarding corporate veil piercing as a last resort, this approach encourages courts and legal practitioners to seek alternative routes and legal considerations before piercing the veil. This could result in more innovative solutions and stronger compliance with existing regulatory frameworks. One major downside of this approach is that, while the *Trihotel* decision states that the veil-piercing doctrine should be applied only when absolutely necessary, deciding when it is absolutely necessary to lift the corporate veil can be difficult, and different cases may have different interpretations, resulting in potential ambiguity in the doctrine's application.

V. Conclusion

The academic community in multiple countries has demonstrated substantial interest in the topic of piercing the corporate veil due to the widespread lack of precise criteria providing when this legal remedy should be awarded by the courts. The piercing of corporate veil is an equitable remedy that is utilised at the discretion of the courts. However, in the three jurisdictions outlined

earlier in this thesis, the lack of clear guidelines on when the courts can do so is a fundamental setback for the business legal justice system. The mere existence of a company's separate legal personality brings major "overall benefits to society and is a justifiable and desirable feature of corporate and tort law." As such, the decision of the courts to remove the veil should be based on well-formulated criteria that provide the judges with clear direction on when the veil should be lifted as well as a certain level of flexibility to deviate from the standards, where doing so would plainly result in injustice. It is hard to foresee that this effect may be attained by common law, regardless of whether the courts base their rulings on pre-existing doctrines or principles. The availability of such doctrines or principles provides courts with a uniform test to follow in veil-piercing cases, considerably increasing the predictability of the law in this area. This is definitely necessary in order to maintain the state's stable and flourishing business environment. However, the doctrines created in the U.S. may be difficult to replicate in the UK or Germany, and they are not totally effective in maintaining the smooth operation of the law, given the need for courts to diverge from them in certain instances. Perhaps the most efficient way of accomplishing this goal in the three countries would be through legal codification, in the same way that the German parliament codified the laws on piercing the corporate veil to impose liability on company shareholders and/or directors.

Such an approach would likely be far easier to adopt in the UK and Germany rather than U.S., where certain statutory norms regarding veil piercing already exist. Due to the large number of commercial disputes handled by the courts each year, standardising the rules on veil-piercing in all three nations is deemed critical. Furthermore, leaving this area of law uncoded risks making it even more complex if courts continue to change their methods to veil-piercing in the future. The inclusion of even the most basic limitations on veil piercing in legislation would avoid this practise by urging courts to work within the bounds of the statutory regulations. It could also prevent veil-lifting instances from occurring in the first place by properly notifying shareholders and directors of the repercussions of certain illegal conduct they may take on behalf of the company for their personal financial gain. Codification is especially crucial when the corporate veil is pierced to make parent corporation liable for the actions or omission of its subsidiary, as it emphasises the necessity for corporate groups to accept responsibility for their subsidiaries. The status of corporate employees is deteriorating as the number of multinational corporate entities with significant

authority grows. Codification is important to minimise uncertainty in tort cases involving employees, such as the Adams and Chandler cases in the UK.

Ultimately, it should be underlined that piercing the corporate veil remains a safeguard against the abuse of separate legal personality. In other words, it is one of the legal reactions to the potential abuse(s) of limited liability. This thesis compared the reasoning of judges in three jurisdictions: the U.S., the UK, and Germany. Cases and scholarly studies show that the law governing veil piercing is insufficient and disoriented. It is undeniably true that a regulatory reform must assess the effectiveness of the present liability imposed on a company's limited liability. However, establishing an accountability mechanism for misconduct or malpractice of separate legal personality is critical for maintaining public trust and commercial development. As a result, it is critical to hold those charged with market regulation liable and to be able to reprimand them if necessary. Overall, it is critical to highlight that the law must intervene quickly in the corporate veil of a company's limited liability to safeguard all parties involved from unfair practises.

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