PIERCING THE CORPORATE VEIL: HISTORICAL, THEORETICAL AND COMPARATIVE PERSPECTIVES

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INTRODUCTION

The concept of a company as a separate entity from its shareholders is well known and recognized in many common law and civil law countries. Generally, this is a fundamental aspect of corporate law and courts hesitate to depart from it. Nevertheless, the principle of separate personality is not absolute. In both, common law and civil law countries, the courts have the power to depart from it. Where the courts do not give effect to separate personality, it is often said that the courts “pierce” or “lift” the corporate veil. This will usually, but not

inevitably, lead to liability being imposed on another person, perhaps in addition to the corporate vehicle.[1]

This paper aims to compare and critically examine the circumstances under which veil piercing takes place against the objectives of incorporation. Both common law jurisdictions, including England, Singapore, and the United States, and civil law countries, including China and Germany, are discussed in this paper. The main purpose of this comparison is to offer a reasonably comprehensive and thorough examination of how courts in these jurisdictions apply the principle of veil piercing, which has been formally adopted either through case law or legislation. This paper employs the functional method in comparative law, but we also consider other aspects, including the law in context method and the historical method. The countries being compared, whether they use common law or civil law systems, share many parallels in part because the historical circumstances leading to the rise of corporate personality were very similar, and also because the corporate laws in Asian countries referred to in this paper are legal transplants. The paper argues that in almost all the jurisdictions examined, some cases of veil piercing ought not to have been decided as such because such decisions give rise to sub-optimal outcomes. Instead, other legal tools should have been used, particularly those in the law of torts. We believe this paper fills a gap in the literature of comparative corporate law, as the doctrine of veil piercing has been frequently misapplied and there is a paucity of academic commentary in this area.[2]

This paper proceeds as follows. In the next part, we will outline the historical context that led to the rise of the modern corporation. After this, the paper sets out the conceptual framework behind separate personality and veil piercing. Thereafter, it will discuss the approaches to veil piercing in the jurisdictions mentioned earlier and critically evaluate these approaches in light of the rationale behind separate personality and other relevant objectives in corporate law.

HISTORICAL CONTEXT

Certain business arrangements, including forms approximating to the modern partnership, can be traced back to ancient Rome and perhaps even before. Today, we are familiar with the limited partnership as well as the general partnership, both of which have roots in Roman times. The Roman *societas* (partnership) allowed the *socius* (partner) to contribute capital or labor towards any enterprise,

1. It does not mean that the corporate entity ceases to exist but simply that corporate personality is not given its full effect.

2. In writing this paper, we have borne in mind the excellent advice to approaching comparative corporate law given by David C. Donald, *Approaching Comparative Corporate Law*, 14 FORDHAM J. CORP. & FIN. L. 83 (2008), in particular to be aware (as much as we can) of the natural distorting tendencies of one's own perspective.

commercial or otherwise, unless the enterprise was illegal.[3] The relationship between the partners was contractual. Typically, the partners were responsible for the *societas'* debts and had rights to the *societas'* claims. However, it was possible to also structure the *societas* in a manner where a partner could be exempt from all losses.[4] Therefore, the agreement between the partners resembles a current general or limited partnership. The essential difference was that in relation to third parties, a partner could not act for the *societas* or for other partners so as to bind them to such third parties. Any contract entered into by a particular *socius* on behalf of the *societas* was the responsibility of that *socius* only vis-à-vis the other contracting party.[5] The contract between the *socii* determined the extent to which a *socius* could ask other *socii* to bear losses arising out of business transactions (as well as how gains were to be shared).

The *societas* proved to be a convenient and flexible basis for business associations and influenced the development of business forms throughout Europe, although over time some of its more individualistic characteristics were abandoned to facilitate management. For example, one important development was the idea of agency, which brought the *societas* closer to the modern conception of partnership. Agency allowed a *socius* to act in a manner that was binding on other *socii* if he acted for the *societas* and not in his own name.[6] This made the other *socii* directly liable to creditors. Over time, this development and other concepts that formed part of the written, common laws of medieval Europe (the *ius commune*) helped give partnership law more of the characteristics that modern lawyers can identify with. This brief foray into Roman law illustrates that from early times there was a need for business forms that facilitated associations of persons wishing to engage in transactions with a view to profit.

The main disadvantage of the *societas* (and the modern partnership) was the absence of limited liability. The *societas* (and, subject to the terms of the partnership agreement, the general form of partnership) also did not have perpetual succession and would be terminated upon the withdrawal or death of one of the partners.[7] Notwithstanding this, the Romans understood the benefits of the modern company. The *societas publicanorum* was a variation of the *societas* used by private entrepreneurs who entered into public contracts with the state. The *societas publicanorum* resembled the modern shareholder company with its ability to issue traded, limited liability shares, and the departure of *socii* did not affect its existence. A single person could contractually bind the firm and

3. Henry Hansmann et al., *Law and the Rise of the Firm*, 119 Harv. L. Rev. 1335, 1356–57 (2006).

4. ULRIKE MALMENDIER, SOCIETAS, THE ENCYCLOPEDIA OF ANCIENT HISTORY 6304, 6304–06 (2013).

5. REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 455 (1996).

6. *Id.* at 469.

7. *Id.* at 455–56; Ulrike Malmendier, *Law and Finance "at the Origin"* 47 J. ECON. LITERATURE 1076, 1088 (2009).

assume rights in the name of the firm. Some sources even describe it as equivalent to a legal person.[8] The private entrepreneurs constituting the *societas publicanorum* were known as "government leaseholders" or publicans.[9]

Therefore, unsurprisingly, from the 16th century in England there were attempts to create business organizations that had the same characteristics as the *societas publicanorum*. In England, the early forms of corporateness were the ecclesiastical and the lay. Of the latter, there were municipal corporations during the time of William the Conqueror. These corporations had the right to use a common seal, make by-laws, plead in the courts of law and hold property in succession. Boroughs, whether they had or did not have a royal charter, also apparently held these privileges.[10] However, the rights that were not held through a charter were not safe until the Crown recognized them. The authority of the Crown supplemented natural prescriptive right.[11]

The *gilda mercatoria*, which was an incorporated society of merchants having exclusive rights of trading within a borough, was another early form of corporateness. As they were associated with boroughs there is some controversy about whether the grant of *gilda mercatoria* to the merchants of a borough was a grant of corporateness to the borough as well. The intimate connection between them makes it difficult to separate the two as distinct organizations.[12] Nevertheless, the fact that, occasionally the status of *liber burgus* (free borough) and *gilda mercatoria* were granted separately suggests they were distinct.[13]

Subsequently, the grant of royal charters extended to commercial enterprises beyond those linked to a borough.[14] A few of the most famous commercial enterprises included the East India Company, Standard Chartered Bank and Royal Bank of Scotland. Aside from royal charters, the corporate form could also be attained through an Act of Parliament. These were not frequently granted and likely required either political connections, wealth or a combination of both. Accordingly, a substitute developed. By the end of the seventeenth century, some idea had been gleaned of one of the primary functions of the corporate concept, namely the possibility of combining the capitalist with the entrepreneur.[15] This

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8. Malmendier, *supra* note 7, at 1084–89.

9. *Id.* at 1085.

10. *See* Cecil Thomas Carr, *Early Forms of Corporateness*, in 3 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 129 (1909).

11. *Id.* at 138.

12. COLIN ARTHUR COOKE, CORPORATION, TRUST AND COMPANY: AN ESSAY IN LEGAL HISTORY 21 (1950).

13. *Id.* at 177–78.

14. The grant of royal charters also extended to other bodies, such as universities and professional organizations. Further, s*ee* STEPHEN BAINBRIDGE & TODD HENDERSON, LIMITED LIABILITY: A LEGAL AND ECONOMIC ANALYSIS 27–31 (2016).

15. PAUL L. DAVIES, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 23 (6th ed. 1997).

was effected through the formation of large quasi-partnerships known as joint stock companies.[16]

The term 'company' in this context was of course a misnomer by modern standards as it simply meant association. Joint stock companies were unincorporated associations,[17] many of which were originally formed as partnerships by agreement under seal, providing for the division of the undertaking into shares which were transferable by the original partners.[18] In England they emerged in the 16th century because of the demands of foreign trade which required capital in large amounts to be tied up for lengthy periods.[19] In essence, such 'companies' continued to be partnerships. They differed from a typical partnership because they generally consisted of many members, and this meant that the articles of agreement between the parties were usually very different.[20] This structure was not without its problems as partnership law was not well suited for a large association. For example: (1) each of the investors was liable for the joint stock company's debts; (2) each investor had power to bind the others to a contract with outsiders; and (3) if the joint stock company wanted to sue a debtor all investors had to be joined as plaintiffs.[21] The converse was also true if the joint stock company was to be sued; all investors had to be joined as defendants.[22]

As a result of the transferability of shares, speculative activity took place. The British Parliament intervened to curb the gambling mania by enacting the 'Bubble Act' of 1720.[23] The purpose of the Act was to prevent persons from acting as if they were corporate bodies, or to have transferable shares without any authority from the British Parliament.[24] Throughout the eighteenth century and beyond the shadow of 1720 retarded the development of incorporated companies.[25]

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16. *Re Agriculturist Cattle Ins. Co.* (1870) LR 5 Ch. App. 725, 733–34 [hereinafter *Baird's Case*]. As a result of this historical fact, the term "joint stock company" is today sometimes used synonymously with "company" in its modern form. For example, in Europe, the term joint stock company is used to refer to a corporation limited by shares such as the French *societe anonyme* and the German *Aktiengesellschaft*.

17. ROBERT P. AUSTIN ET AL., FORD, AUSTIN & RAMSAY'S PRINCIPLES OF CORPORATIONS LAW ¶ 2.110 (17th ed. 2018).

18. DAVIES, *supra* note 15, at 21.

19. *See* C. E. Walker, *The History of the Joint Stock Company*, 6 ACCOUNTING REV. 97, 99 (1931).

20. WILLIAM WATSON, A TREATISE OF THE LAW OF PARTNERSHIP 3, 101 (2d ed. 1807); *see also* NATHANIEL LINDLEY, A TREATISE ON THE LAW OF COMPANIES, CONSIDERED AS A BRANCH OF THE LAW OF PARTNERSHIP 608–09 (5th ed. 1889).

21. AUSTIN ET AL., *supra* note 17, at ¶ 2.110.

22. *See also* Paul G. Mahoney, *Contract or Concession: An Essay on the History of Corporate Law*, 34 GA. L. REV. 873, 888–89 (2000).

23. Royal Exchange and London Assurance Corporation Act, 1719, 6 Geo. 1, c. 18 (Eng.).

24. COOKE, *supra* note 12, at 85.

25. DAVIES, *supra* note 15, at 28; *see also* WILLIAM ROBERT SCOTT, THE CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720, at 438 (1912).

Notwithstanding the Bubble Act, unincorporated joint stock companies continued to exist. An important provision of the Act was in section 25, that exempted 'trade in partnership' that 'may be lawfully done.' Given that joint stock companies were in essence partnerships, there was considerable scope to work around the Bubble Act. This manifested itself in the 'deed of settlement company' which was linked to the two equitable forms of group association, the partnership and the trust.[26] Many such 'companies' were established during the period the Bubble Act was in force.[27] In this incarnation, the 'company' would be formed under a deed of settlement (something approximating to a cross between a modern corporate constitution and a trust deed for debentures or unit trusts), whereby the subscribers would agree to be associated in an enterprise with a prescribed joint stock divided into a specified number of shares; the provisions of the deed could be varied with the consent of a specified majority of the proprietors; management would be delegated to a committee of directors; and the company's property would be vested in a separate body of trustees, some of whom would also be directors.[28] The deed of settlement would also provide that the trustees could sue or be sued on behalf of the company to get around the difficulty of claims by or against an unincorporated body with a potentially large membership.[29]

In addition, the deed would provide that each shareholder was to be liable only to the extent of his share in the capital stock. Although such a provision could only apply to the shareholders *inter se* and not be binding on third parties dealing with the company,[30] limited liability could be achieved if contracts between the company and third parties stipulated that the other party to the contract could only look to the common stock of the company and not the assets of individual shareholders.[31] A number of English cases in the insurance context held that policyholders were bound by the terms of the deed of settlement of the insurance company if such terms were incorporated into the insurance contract.[32]

Holdsworth, writing about the joint stock company of the seventeenth century, said that this and other advantages which followed from the corporate form meant that the promoters were able to secure the supreme advantage of attracting capital more easily to finance their undertakings.[33] It gave capitalists an opportunity for investment and made available trade capital that would not

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26. COOKE, *supra* note 12, at 85.

27. DAVIES, *supra* note 15, at 30; ROB MCQUEEN, A SOCIAL HISTORY OF COMPANY LAW: GREAT BRITAIN AND THE AUSTRALIAN COLONIES 1854–1920 20 (2009).

28. DAVIES, *supra* note 15, at 29. See also COOKE, *supra* note 12, at 86–87.

29. *See Baird's Case*, LR 5 Ch. App. at 734–35 (James L.J.).

30. *Hallett v. Dowdall* (1852) 18 QB 2, 50-51, 118 Eng. Rep. 1, 20 [hereinafter *Hallet*].

31. *See* COOKE,, *supra* note 12, at 87.

32. *Hallett*, 21–22; *Re. Family Endowment Soc'y* (1870) L.R. 5 Ch. App. 118, 136–37; *Re European Assurance Soc'y* (*Hort's Case*) (1875) 1 Ch. D. 307, 323–25.

33. *See* WILLIAM SEARLE HOLDSWORTH, A HISTORY OF ENGLISH LAW 205 (3rd ed. 1925).

otherwise have been employed in trade.[34] Nevertheless, there was ambivalence towards the corporate form. Adam Smith, for example, had reservations about joint stock companies on the basis that directors of such companies, being the managers of money from others, could not be expected to watch over it with the same vigilance as partners would watch over their own.[35] Negligence and profusion must therefore "always prevail, more or less, in the management of the affairs of such a company."[36] Joint stock companies were less efficient than private individuals and could usually succeed only with monopoly rights.[37] Despite such ambivalence, the Joint Stock Companies Act was passed in 1844 and marked the beginning of modern company law in England.[38] The Act of 1844 came about because of the continued importance of joint stock companies. In addition, concerns over dishonest promoters gave rise to a view that such entities had to be regulated.[39]

Nonetheless, limited liability was not a feature of the Act of 1844 and it did not arrive easily. It had not been included in the 1844 Act because there continued to be strong reservations against any extension of limited liability.[40] For instance, according to the 1854 report of the Royal Commission on Mercantile Laws appointed in 1853, a majority opposed extending limited liability to joint stock companies.[41] The commercial community also expressed dissenting views. For example, the Manchester Chamber of Commerce thought that limited liability was subversive of the high moral responsibility that was the hallmark of the law of partnership.[42] A Manchester manufacturer said limited liability "would become the refuge of the trading skulk; and, as a mask cover the degradation and moral guilt of having recklessly gambled with the interests of traders; and then the stain which now attaches to bankruptcy would cease to exist."[43] In this, we find the familiar concern over unscrupulous promoters using corporate vehicles as an instrument of fraud or other sharp practice, and the lessening of incentive for personal responsibility and vigilance. Yet one wonders if some of the concern might not have been motivated by self-interest on the part

34. *See id.* at 213.

35. An early observation of what is today known as the 'agency' problem.

36. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 326 (1869).

37. *Id.*

38. The Act provided *inter alia* for incorporation by registration thereby paving the way for incorporation to be available widely, and disclosure of key information relating to the company which continues to be seen as an important safeguard to third parties dealing with corporate vehicles.

39. MCQUEEN, *supra* note 27, at 44–46; COOKE, *supra* note 12, at 123; BISHOP CARLETON HUNT, THE DEVELOPMENT OF THE BUSINESS CORPORATION IN ENGLAND 1800–1867 at 90–95 (1936); RON HARRIS, INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION, 1720-1844, at 281, 287 (2000).

40. HARRIS, *supra* note 39, at 282.

41. DAVIES, *supra* note 15, at 42.

42. COOKE, *supra* note 12, at 156–57.

43. Quoted in HUNT, *supra* note 39, at 117–18.

of those who did not welcome the democratisation of a business vehicle that could lead to more competition.[44]

Evidently, these concerns did not prevail.[45] One reason was capital flight as money flowed overseas, particularly into joint stock companies that offered limited liability.[46] Allowing limited liability would potentially raise the investment opportunities available domestically. This is an early illustration of how, in some areas, the power of the marketplace can bring about greater legal convergence. Another was "social amelioration".[47] Limited liability would allow the middle and working classes not to be excluded from fair competition through the fear of personal bankruptcy. It would open up more opportunities for them. It was also thought that the ability to involve a wider segment of people in business might unleash creative energies and revitalise English industry that was in danger of losing its edge and being overtaken by overseas capitalists.[48] Accordingly, the Limited Liability Act of 1855 was passed. It was soon repealed but substantially re-enacted in the Joint Stock Companies Act 1856.

The incorporated form, and limited liability, came about in England because of the utility of a business organization that could effectively accumulate capital for more productive use.[49] There is an economic purpose, but more broadly the corporation and limited liability are regarded as beneficial to society as a whole.[50] Their purposes are as much social and political[51] as they are economic. Ultimately, corporations, like other institutions, must continue to justify their existence by demonstrating that whatever their faults, they bring utility to society that is not easily substitutable. It follows (or at least is implied) that in principle incorporators, owners and managers of companies ought not to expect the full benefits of incorporation if their conduct undermines faith in the institution, and therefore its utility to society. The next part of this paper will discuss this further.

The experience of England is mirrored in other jurisdictions that over time adopted liberal corporate laws to facilitate development. In the United States, as in England, a number of alternatives to the corporate form were used from time to time. These included the limited partnership, the business trust, and the joint stock company and it was by no means certain that a corporation was the best way to raise and manage money for enterprise.[52] After the American Revolution,

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44. *See* MCQUEEN, *supra* note 27, at 81–86.
45. Mahoney, *supra* note 22.
46. MCQUEEN, *supra* note 27 at 99–100.
47. HUNT, *supra* note 39, at 120.
48. *See* MCQUEEN, *supra* note 27, at 125.
49. This is not to suggest that other alternative business forms would not have been able to achieve such goals: *see* HARRIS, *supra* note 39, at 291.
50. For example, it has been said that limited liability "clearly encouraged the flow of capital into new enterprise": *see* HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW: 1836-1937, at 54 (1991).
51. JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA 53–54 (2003).
52. LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 176–77 (1973).

a strong and growing prejudice in favour of equality opposed the English tradition that corporate powers be granted only in rare instances. This led almost immediately to the enactment of general incorporation acts for ecclesiastical, educational, and literary corporations. It was also easier to obtain corporate charters from the new state legislatures than it was in England, leading to a considerable extension of corporate enterprise in the field of business before the end of the eighteenth century.[53] The United States was 30 years ahead of English practice, as charters were granted fairly frequently between 1800 and 1830, albeit with conditions and restraints placed on the corporate bodies.[54] Special chartering, however, smacked of privilege and set off a reform movement that sought to bring about equal access to corporate chartering. States also began to compete for corporate charters in order to increase taxes paid by corporations.[55]

In 1811, the State of New York became the first to pass a general incorporation statute for businesses, although it originally only applied to companies seeking to manufacture particular items, such as anchors and linen goods.[56] Soon, the types of businesses eligible to incorporate included all forms of transportation and nearly all forms of manufacturing and financial services as well. Other states followed the New York approach. The combined result of a more liberal approach to charters and general incorporation statutes caused the corporation to become crucial to the American economy by the last third of the nineteenth century.[57] It provided an efficient and trouble free device to aggregate capital and manage it in business, with limited liability and transferable shares.[58] The adoption of limited liability was an important development. It arose because of the pressure on the growing corporations (of the first half of the nineteenth century) to raise the capital required to take advantage of the emerging technology of the times. It was also a matter of protracted political struggle."[59]

Taking two examples in Continental Europe, in 1848, Sweden issued a governmental decree that recognised the legal position of the joint stock company. The coming of the railroad with its necessity for a large accumulation of capital was the initial catalyst.[60] In a number of German states, the pressure to

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53. JOSEPH STANCLIFFE DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 7–8 (1917).

54. COOKE, *supra* note 12, at 134. *See also* JOHN STEELE GORDON, AN EMPIRE OF WEALTH – THE EPIC HISTORY OF AMERICAN ECONOMIC POWER 229 (2004) (observing that between 1800 and 1860, the state of Pennsylvania alone incorporated more than 2000 companies).

55. WILLIAM A. KLEIN ET AL, BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 114 (2010).

56. FRIEDMAN, *supra* note 52, at 172; BAINBRIDGE & HENDERSON, *supra* note 14 at 37–38.

57. GORDON, *supra* note 54, at 228–29; FRIEDMAN, *supra* note 52, at 177 (suggesting that the triumph of the corporation as a business form over other business forms was due to almost random factors).

58. FRIEDMAN, *supra* note 52, at 178 (quotations omitted).

59. Phillip I. Blumberg, *Accountability of Multinational Corporations: The Barriers Presented by Concepts of the Corporate Juridical Entity*, 24 HASTINGS INT'L & COMP. L. REV. 297, 301 (2001) (quotations omitted).

60. CHARLES P. KINDLEBERGER, A FINANCIAL HISTORY OF WESTERN EUROPE 204 (2006).

move towards a system of free incorporation became progressively irresistible in the 19th century as the country faced the question of how to raise and regulate large capital sums needed for major industrial and infrastructure projects. As with many other countries, the coming of the railways was an important spur for this.[61]

Moving to Asia, the first company law in China was enacted by the Qing Dynasty in 1904. It established four types of companies, one of which was the company limited by shares. To qualify as juridical persons with limited liability, all companies had to register with the Ministry of Commerce with registration fees assessed as a percentage of capitalization.[62] Prior to 1904, there was little formal law associated with business enterprises. In part this was because engaging in commerce did not attract high social prestige. Farmers and artisans enjoyed higher social prestige, the former reflecting the importance of agricultural pursuits for much of Chinese history. Business, on the other hand, was regarded as parasitic without creating anything of value.[63] Given the lack of formal law, many Chinese businesses were family affairs, and people often entered transactions based on trust. Private ordering rather than law played a more important role.[64] The objectives of the 1904 law were to promote China's industrial development; to attain perceived Western standards of law so as to justify demands for the abolition of the system of extraterritoriality that had been imposed on China since the 1840s; and the strengthening of the power of the central government. These broad aims informed revisions of Chinese Company Law over the next eight decades.[65]

After the People's Republic of China was established in 1949, company law was abolished. A process of collectivisation and nationalisation took place that only began to be reversed after the death of Mao Zedong and the era of Deng Xiaoping. This eventually led to the promulgation of the 1993 Company Law, which took effect on July 1, 1994. Article 1 of that Act stated that it was intended to meet *inter alia* the needs of establishing a modern enterprise system, to maintain the socio-economic order, and to promote the development of the socialist market economy.[66] These stated objects illustrate the instrumentalist nature of corporate law in China.

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61. Peter Muchlinski, *The Development of German Corporate Law Until 1990: An Historical Appraisal*, 14 GERMAN L.J. 339, 345–46 (2013) (citations omitted).

62. William C. Kirby, China Unincorporated: Company Law and Business Enterprise in Twentieth-Century China, 54 J. ASIAN STUD. 43, 48 (1995).

63. FREDERICK W. MOTE, IMPERIAL CHINA: 900–1800, at 390–91 (1999).

64. *See generally* Kirby, *supra* note 62, at 44–46; Tan Cheng-Han, *Private Ordering and the Chinese in Nineteenth Century Straits Settlements*, 11 ASIAN J. COMP. L. 27, 44–47 (2016).

65. Kirby, *supra* note 62, at 43–44.

66. WANG JIANGYU, COMPANY LAW IN CHINA – REGULATION OF BUSINESS ORGANIZATIONS IN A SOCIALIST MARKET ECONOMY 5–7 (2014).

In fact, the process in Asia of creating a commercial law comparable to that found in Western countries began earlier in Japan. The impetus was similar to China's. Japan wanted to end the legal extraterritoriality granted to foreign residents that had been imposed by the "unequal treaties" that forced the opening of the country to foreign trade. In addition, the Meiji government felt that a modern commercial and corporate law system was necessary for the evolution of modern corporations which were regarded as indispensable for nursing strong economic growth. In turn, this would allow the country to create a strong military to assure her safety and independence.[67]

It will be clear from the foregoing that the development of corporate law in China (and Japan) was driven significantly by socio-political objectives. As both countries adopted the German civil law model, their corporate laws were at one time heavily modelled after German corporate law, although American law has since become increasingly influential. In many other parts of Asia that were colonized such as Singapore, colonial governments introduced Western corporate law and naturally mirrored the law in the colonizing country.[68]

VEIL PIERCING – A THEORETICAL ANALYSIS

The brief historical analysis outlined above reminds us that even though we currently take separate personality and limited liability for granted, neither came about naturally or easily. They were accepted ultimately because of a hard-nosed assessment that their benefits outweighed the risks, the latter of which was clear to most. Corporate legislation implicitly tolerates these risks for the greater good.

Statements such as the following have been made in numerous US cases[69] and is true for many other jurisdictions as well:

> The doctrine that a corporation is a legal entity existing separate and apart from the persons composing it is a legal theory introduced for purposes of convenience and to subserve the ends of justice….It is clear that a corporation is in fact a collection of individuals, and that the idea of a corporation as a legal entity or person apart from its members is a mere fiction of the law introduced for convenience in conducting the business in this privileged way.

This is the norm today; however, corporate legislation will often contain express exceptions to separate personality or limited liability,[70] and it is not

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67. Harald Baum & Eiji Takahashi, *Commercial and Corporate Law in Japan: Legal and Economic Developments After 1868*, in HISTORY OF LAW IN JAPAN SINCE 1868, at 336–37 (Wilhelm Röhl ed. 2005).

68. For example, Singapore's Companies Ordinance, 1940 (Act No. 49/1940) (Sing.) was based on England's Companies Act, 1929, 19 & 20 Geo. 5, c.23 (Eng.).

69. *See e.g., William H Sanders v. Roselawn Memorial Gardens, Inc.*, 159 S.E.2d 784, 800 (W. Va. 1968) (hereinafter "Sanders"); *TLIG Maintenance Services, Inc. v. Deann Fialkowski*, 218 So. 3d 1271, 1282 (Ala. Civ. App. 2016) (hereinafter "TLIG Maintenance Services").

70. *See e.g.,* Companies Act (Cap. 50, Rev. Ed. 2006) (Sing.), § 340(1) (imposing personal liability on a person who was knowingly a party to a company carrying on business with the intent to defraud creditors of the company, or of any other person, or for any fraudulent purpose).

unusual for other legislation to express exceptions as well in specific circumstances.[71] Such exceptions arise because of a policy choice that the benefits of incorporation ought not to be fully available in such instances.

Given the existence of specific legislative carve outs, and the apparently unqualified nature of limited liability in most jurisdictions,[72] it is conceivable that any limits to corporate personality or limited liability should be determined within such limited parameters. This has not been the case. The courts have gone beyond exceptions found in legislation to ignore corporate personality and extend liability to shareholders or directors of companies. When corporate personality is ignored or liability is extended, it is often said that the courts are piercing or lifting the corporate veil, thereby allowing the courts to take legal notice of the persons behind the company, usually the shareholders, to whom personal liability may then be attached for obligations that prima facie ought to be attributed only to the company.

What justifies such judicial intervention? In common law countries, statutory interpretation allows a court to determine the scope of a legislative provision, not only from the express language used, but also from what may be fairly implied from the express terms of the legislation and its purpose. As an English judge, Willes J, put it, the legal meaning to be ascribed to a legislative provision is "whatever the language used necessarily or even naturally implies."[73]

In the well-known case, *Salomon v. A. Salomon & Co. Ltd.*, it was established, beyond doubt in England, that the company was to be treated as a person separate and distinct from its shareholders, including the principal shareholder and director. Lord Watson observed:[74]

> In a Court of Law or Equity, what the Legislature intended to be done or not to be done can only be legitimately ascertained from that which it has chosen to enact, either in express words or by reasonable and necessary implication.

Accordingly, separate personality cannot be extended to a point beyond its reason and policy, and will be disregarded when this occurs.[75] Separate corporate identity is conferred "to further important underlying policies, such as the promotion of commerce and industrial growth" and as such "may not be asserted

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71. *See e.g.,* Residential Property Act (Cap. 249, Rev. Ed. 2009) (Sing.), § 2, defining a "Singapore company" as generally one which is incorporated in Singapore, and additionally all its directors and members must be Singapore citizens. Thus for the purpose of this legislation, the nationalities of non-Singaporean directors and members are attributed to the company. This in turn determines whether the company falls within or outside the legislative prohibitions.

72. China, which has a more general and open legislative exception which is found in Article 20 of the PRC Company Law promulgated by the National People's Congress, is an outlier, as we discuss in the part on the People's Republic of China *infra*.

73. *Chorlton v. Lings* (1868) L.R. 4 C.P. 374 (Ct. Common Pleas) 387. *See also Russian and English Bank v. Baring Brothers*, [1936] 1 A.C. 405 (H.L.) 427 (the House of Lords held that it was a necessary implication of the relevant winding up provisions in the Companies Act that the dissolved foreign company was to be wound up as if it had not been dissolved but had continued in existence).

74. *Salomon v. A. Salomon & Co. Ltd*., [1897] A.C. 22 (H.L.) 38.

75. *Sanders* 159 S.E.2d at 784; *TLIG Maintenance Services*, 218 So. 3d at 1271.

for a purpose which does not further these objectives in order to override other significant public interests which the state seeks to protect through legislation or regulation."[76] In other words, at common law the courts, in construing corporate legislation as giving rise to entities with separate personality and shareholders with limited liability, have concluded that there are implicit limits to this separateness.[77] These limits are ascertained by reference to what the court construes as the legislative intent behind such legislation, namely to bring about positive social and economic outcomes through an organizational framework that facilitates business transactions.[78]

Using Germany as a civil law comparator, Germany shares similarities with the English common law approach insofar as courts are showing growing reluctance to pierce the corporate veil. In Germany, when limited liability is disregarded, it is referred to as "*Durchgriffshaftung*" and relates to situations not governed "expressly by statutory or other legal rules in which an entity's existence is disregarded and the owner is held individually liable for the obligations of the company."[79] Under the modern approach, courts limit veil piercing to the scenario of commingled assets and otherwise rely on the law of torts to deal with instances in which shareholders intentionally lead companies into insolvency.

Given the importance of legislative policy to determine when piercing the corporate veil takes place, it is unsurprising that generally, in the jurisdictions discussed above, the courts disregard the corporate personality very sparingly and there are few real instances of piercing taking place.[80] This is consistent with the fact that limited liability was eventually settled upon by legislatures after decades of debate that fleshed out its advantages and disadvantages. The separation of power between judiciaries and legislatures necessitates that due respect be given to the policy choice made. In addition, the advantages of limited liability are regarded as crucial to the development of mature market economies. These advantages have been discussed widely elsewhere and will not be repeated here.[81] Also, courts tend to be sensitive to the need for certainty in matters of

76. *Glazer v. Comm'n on Ethics for Public Employees*, 431 So. 2d 752, 754 (La. 1983) (hereinafter "Glazer").

77. Tan Cheng-Han, *Veil Piercing: A Fresh Start*, J. BUS. L. 20, 29 (2015).

78. *See e.g., First National City Bank v. Banco Para El Commercio Exterior de Cuba*, 462 U.S. 611 (1983).

79. Overall outdated because of recent judicial changes, but still correct in this respect. *See* Carsten Alting, *Piercing the Corporate Veil in American and German Law – Liability of Individuals and Entities: A Comparative View*, 2 TULSA J. COMP. & INT'L L 187, 190, 197 (1994) (citations omitted).

80. *See e.g., Prest v. Petrodel Resources Ltd* [2013] UKSC 34; [2013] 3 WLR 1 (Eng.) (hereinafter "*Prest*"); Alting, *supra* note 79, at 191. Although US courts affirm the exceptional nature of veil piercing, the courts there appear more willing to pierce the corporate veil, and courts in China appear even more willing to do so. This is discussed in the part on the People's Republic of China *infra*.

81. *See e.g.,* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 93–107 (1985); Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 95, 99–107 (1991); BAINBRIDGE & HENDERSON, *supra* note 14, Chapter 3.

business. The importance attributed to certainty is part of the explanation as to why courts do not generally draw a distinction between voluntary creditors who choose to contract with a company and involuntary creditors such as tort victims.

Considering that veil piercing occurs only in exceptional circumstances where the use of the corporate vehicle is inconsistent with the legislative purpose behind corporate personality and limited liability, the courts in the jurisdictions surveyed above express a remarkably similar rationale underlying veil piercing. In the United Kingdom (UK), Lord Sumption, who delivered the leading judgment in *Prest v. Petrodel Resources Ltd.*, opined 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."[82] According to his Lordship, the considerations found in the English cases reflect the broader principle that the corporate veil may be pierced only to prevent the abuse of corporate legal personality.[83] Arguably, this approach by the UK Supreme Court is to be welcomed as it: (1) moves the focus away from metaphors such as "sham" and "façade" to justify veil piercing and which provide virtually no guidance to future courts, and (2) provides an approach that is based on policy.[84]

A court in Singapore, another common law jurisdiction, has framed the approach in similar terms:[85]

> Courts will, in exceptional cases, be willing to pierce the corporate veil to impose personal liability on the company's controllers. While there is as yet no single test to determine whether the corporate veil should be pierced in any particular case, there are, in general, two justifications for doing so at common law — first, where the evidence shows that the company is not in fact a separate entity; and second, where the corporate form has been abused to further an improper purpose.

Courts in the US have also invoked abuse as the underlying principle justifying disregard of the corporate personality. Under *Glazer v. Commission on Ethics for Public Employees*, a court may, "pierce the corporate veil when the established norm of corporateness has been so abused in conducting a business

82. *Prest* [2013] 3 WLR 1 [27].

83. *Id.* at [34]. *See also VTB Capital Plc v Nutritek International Corp* [2012] EWCA (Civ) 808, [2012] 2 C.L.C. 431, 460 (where the Court of Appeal of England and Wales stated that the "relevant wrongdoing [for veil piercing purposes] must be in the nature of an independent wrong that involves the fraudulent or dishonest misuse of the corporate personality of the company for the purpose of concealing the true facts"); *Faiza Ben Hashem v. Abdulhadi Ali Shayif* [2008] EWHC 2380 (Fam), [2009] 1 F.L.R. 115 [163] ("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.").

84. Tan, *supra* note 77, at 20–21. *See also* Tan Cheng-Han, *Piercing the Separate Personality of the Company: A Matter of Policy?*, 1999 SING. J. LEG. STUD. 531, 537–43 (1999) (foreshadowing *Prest v Petrodel*). Admittedly, Lord Sumption saw the application of the doctrine in very narrow terms but in this regard he was not in the majority. While all the Justices on the panel agreed that veil piercing was exceptional, they were not prepared to foreclose possible situations where veil piercing may take place beyond the category of "evasion" cases that Lord Sumption felt was the only true category where the corporate veil is lifted.

85. *Tjong Very Sumito v. Chan Sing En* [2012] SGHC 125 (Sing.) [67]; *see also Simgood Pte Ltd v. MLC Shipbuilding Sdn Bhd* [2016] 1 Sing. L. Rep. 1129 [195]–[204].

that the venture's status as a separate entity has not been preserved."[86] Corporate personality will be respected unless the "legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime,"[87] acts that speak to abusive conduct. Although under the Federal system in the US courts are not bound by a uniform position on veil piercing, generally there must be an element of wrongdoing to justify disregarding corporate personality.[88]

The importance of wrongdoing towards establishing abuse of the corporate form is another reason piercing is an exceptional remedy. Controllers of companies who in such capacity engage in wrongdoing will often find themselves incurring liability to their companies. While such liability may be academic where the entities are operating under the control of such persons, the issue of veil piercing often arises where the companies are insolvent and incapable of meeting their obligations or liabilities to third parties. In such instances, insolvency regimes usually impose a collective framework within which creditors of companies have their claims adjudicated. Insolvency laws typically frown on creditors who obtain preferential treatment when the corporation is already insolvent.[89] This is economically efficient as it facilitates an orderly and fair distribution of an insolvent entity's assets to all creditors. When piercing takes place, there is a danger that it may undermine the collective insolvency process and place the claimant in a superior position compared to other creditors of the insolvent corporation. Any successful claim against a corporate controller will diminish the controller's assets and increase the probability that the company will not be able to obtain the full measure of any loss caused to it by the controller's wrongful act. This in turn diminishes the pool of assets available for distribution to creditors as a whole and places those creditors who are able to act more quickly, usually those that are more sophisticated and with greater financial resources, in a superior position. The more liberal the approach to veil piercing, the greater the risk of undermining the insolvency process.

Another perspective favoring a narrow approach to veil piercing is its potential overlap with other legal doctrines. In *Prest v. Petrodel*, Lord Sumption opined that the veil piercing "principle is a limited one because in almost every case where the test is satisfied, the facts will in practice disclose a legal relationship between the company and its controller which will make it

86. *Glazer*, 431 So.2d at 757 (citations omitted).

87. *United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (E.D.Wis. 1905).

88. This is discussed below.

89. *See generally*, ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY 235-237 (4th Ed. 2011); Secured creditors are a significant exception to this as security arrangements are generally regarded as falling outside the general insolvency process. In common law jurisdictions such as England and Singapore, this is because a secured creditor is regarded as having a proprietary interest in property taken as security, allowing such secured creditor the right vis-à-vis such security to stand outside the liquidation process. *See* IAN FLETCHER, THE LAW OF INSOLVENCY 747- 749 (5th Ed. 2017).

unnecessary to pierce the veil." Where this was not necessary, it would not be appropriate to do so because there would be no public policy imperative to justify such a course.[90] Another member of the panel, Lord Neuberger, expressed the view that a number of cases that involved veil piercing could and should have been decided on other grounds.[91] Such a view of veil piercing confines the doctrine to a residual category. Nevertheless, this is consistent with the doctrine operating in exceptional circumstances. While a set of facts can raise overlapping legal rules, the exceptional nature of veil piercing justifies its application to situations of abuse that do not potentially fall within other areas of the law. Thus, where the situation overlaps with another area of law, the underlying policies and principles of that area, rather than veil piercing, should set the boundaries for personal liability. Veil piercing in such circumstances gives rise to a risk that corporate law may overreach. The difficulty lies in determining whether individual cases fall into gaps that corporate law should fill or if the lack of any other more obvious remedy reflects the inherent inappropriateness of the claim.

An example of potential overreach may be found in cases where directors (or senior management) were found liable for a tort committed by, for instance, an employee of the company on the basis that the tortious act had been procured, facilitated or directed by the said directors. In many common law countries, this raises a difficult question of policy. On the one hand, directors do not act personally in the discharge of their directorial responsibilities. There are good reasons for this, including the need for the benefits of corporate personality to extend to corporate officers lest it gives rise to disincentives to manage companies. Yet, this view conflicts with the principle that a person should answer for their own tortious acts.[92] In Australia, judicial statements have been made that this "is a complex and burgeoning field of law"[93] and has led to "a confusing picture on an issue that has persistently vexed the common law."[94]

In Canada and Singapore, there is authority to support the proposition that corporate personality is disregarded where a director is found liable for procuring a tortious act by another person. Canadian courts have made it clear that a particular mental state is required before authorization, direction or procurement sufficient for secondary tortious liability is made out. In *Mentmore Manufacturing Co v. National Merchandise Manufacturing Co*, Le Dain J expressed the view:

> But in my opinion there must be circumstances from which it is reasonable to conclude that the purpose of the director or officer was not the direction of the

90. *Prest* [2013] 3 WLR 1 [35].

91. *Prest* [2013] 3 WLR 1 [64].

92. *Mentmore Manufacturing Co v. National Merchandise Manufacturing Co* (1978) 89 DLR (3d) 195 para. 23 (hereinafter "Mentmore Manufacturing").

93. *G M (North Melbourne) Holdings Pty Ltd v. Young Kelly Pty Ltd* [1986] FCA 164 para. 58 (Austl.).

94. *Root Quality Pty Ltd v. Root Control Pty Ltd* [2000] FCA 980 para. 115 (Austl.).

> manufacturing and selling activity of the company in the ordinary course of his relationship to it but the deliberate, wilful and knowing pursuit of a course of conduct that was likely to constitute infringement or reflected an indifference to the risk of it. [95]

This approach has been accepted in a number of other Canadian decisions.[96] In *Halford v. Seed Hawk Inc.*,[97] Pelletier J said the principle underlying the approach in *Mentmore Manufacturing* was that the courts would not allow a corporation to be used as an instrument of fraud. Personal liability attaches to a director where such behavior is tortious, or when the corporation is used as a cloak for the personal activities of the director.[98] This is the language of veil piercing.

Under Canadian law, the courts will disregard the separate legal personality of a company where it is dominated and controlled, and being used as a shield for fraudulent or improper conduct. Thus, the conduct in question must be akin to fraud to warrant veil piercing.[99] Indeed, the similarity between secondary liability for procuring a tort and veil piercing under Canadian law can be seen from the following statement:[100]

> The question of whether the appellant, as an officer and director of ACPI and ACL, could be found to be personally responsible for the tort committed by the corporations — had this question been raised on the pleadings — would require evidence to support a finding that the appellant exercised clear domination and control over the corporations in directing the wrongful things to be done, and that the conduct he engaged in was akin to fraud, deceit, dishonesty or want of authority and constituted a tort in itself.

The above statement was made in the context of piercing the corporate veil but the reference to "directing" wrongful acts is similar to the imposition of secondary liability as a joint tortfeasor.

In Singapore, the link between veil piercing and secondary liability in tort has been more explicit. In *TV Media Pte Ltd v. De Cruz Andrea Heidi*,[101] Singapore's apex court, the Court of Appeal, held that where a statement of claim alleged that the defendant had authorized, directed and/or procured acts that amounted to corporate negligence, this was essentially a submission to lift the

95. *Mentmore Manufacturing*, (1978) 89 DLR (3d) 195 para. 28.

96. *See e.g., Steinhart v. Moledina*, (2005) 37 C.P.R. 4th 443 (Can. Ont. Sup. Ct. J.) para. 23; *Dimplex North America Ltd v. Globaltec Distributors Ltd*, 2005 FC 298 (2005), 137 A.C.W.S. 3d 716 (Can. Fed. Ct.) para. 13; *Cinar Corp v. Robinson* 2013 SCC 73, [2013] 3 S.C.R. 1168 (Can. Sup. Ct.) para. 60; *XY, LLC v. Canadian Topsires Selection Inc*., 2016 BCSC 1095 (Can. B.C. S.C.) para. 231.

97. *Halford v. Seed Hawk Inc*. 2004 FC 455, (2004) 31 C.P.R. 4th 434 (Can. Fed. Ct.).

98. *Id.* [330] – [331].

99. *See e.g.*, *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* (1996) 28 O.R. 3d 423 (Can. Ont. Gen. Div) [22]–[23]; *A-C-H International Inc v. Royal Bank of Canada* (2005) 254 D.L.R. 4th 327 (Can. Ont. Sup. Ct. J.) [29]; *Burke Estate v. Royal Sun Alliance Insurance Co of Canada*, 2011 NBCA 98, 381 N.B.R. 2d 81 (Can. N.B. C.A.) para. 60.

100. *A-C-H International Inc* (2005) 254 D.L.R. 4th 327 para. 29.

101. *TV Media Pte Ltd v. De Cruz Andrea Heidi*, [2004] SGCA 29, [2004] 3 Sing. L. Rep. (R.) 543 ("*TV Media*") [118].

corporate veil. The court also agreed with the trial judge that the veil should be pierced as the defendant director had authorized, directed or procured acts of negligence.[102] In particular, the court said:

> After all, a court can only find a director personally liable for authorizing, directing or procuring the company's tort if it has first lifted the company's corporate veil which otherwise protects a director from being found liable.[103]

While such an approach seems to provide a basis to impose personal liability, the issue may be better resolved within the framework of tort law, so that it can consider the relevant policies that should underpin the imposition of secondary tortious liability, an issue that goes beyond corporate entities. In English tort law, where a person "authorizes, procures or instigates the commission of a tort" by another, the former becomes a joint tortfeasor who is equally liable with the primary tortfeasor.[104] This is not to suggest that the understanding of what amounts to authorization or procurement in the corporate and non-corporate context should necessarily be the same. Rather tort law, which constantly must balance and assess the appropriate measures to regulate civil wrongdoings, may be more suited to determining this issue than corporate law. The contours of liability for civil wrongs are the essence of tort law. Accordingly, the law of torts, not the doctrine of veil piercing, may provide a superior framework to determine the circumstances under which a corporate officer should be responsible for the tortious act of a subordinate.

Similarly, where a director has caused a company to commit a tort and this leads to the insolvency of the corporation and therefore inadequate compensation for the tort victims who are involuntary creditors, there should not be recourse to veil piercing. The real question is whether the circumstances justify imposing a duty on the director to the tort victims, or if the director has breached a duty of care to the company that entitles the liquidator to bring a claim on behalf of the corporation against the director. These are policy issues at the heart of tort law, while corporate law lacks the analytical tools to address them. Engaging in veil piercing creates a messy and uncertain shortcut.

VEIL PIERCING – A COMPARATIVE ANALYSIS

Having outlined the conceptual framework behind veil piercing, we now analyze from a comparative perspective the judicial reasoning in veil piercing cases and the specific factors that courts take into consideration when such issue arises. The jurisdictions considered are England, Singapore, the United States, Germany and China.

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102. *TV Media* 3 Sing. L. Rep. at [132]–[140] The more traditional view is that both are separate doctrines and the court's approach in the earlier case of *Gabriel Peter & Partners v. Wee Chong Jin*, [1997] SGCA 53, [1997] 3 Sing. L. Rep. (R.) 649 [31]-[35] is consistent with this.

103. *TV Media* 3 Sing. L. Rep. at [119].

104. DAVID HOWARTH ET AL., HEPPLE AND MATTHEWS' TORT LAW 1121 (7th ed. 2015).

England and Singapore

Both England and Singapore have broadly similar approaches. Their courts have increasingly recognized that the main issue in dispute in these corporate liability cases revolves around whether corporate officers have abused or misused the corporate form. Accordingly, England and Singapore have begun to move away from the use of metaphors such as sham and façade as the basis to disregard corporate personality.

One significant uncertainty in England relates to the scope of the veil piercing doctrine. While it is an exceptional doctrine, Lord Sumption would limit it only to a category of "evasion" cases,[105] namely those where a company has been interposed to frustrate the enforcement of an independent legal right that exists against the controller of the company.[106] The majority of the judges in *Prest v. Petrodel* left the matter open, and it is suggested that in principle it is difficult to see why other instances of veil piercing should be foreclosed if the underlying basis is abuse of the corporate form[107] Human ingenuity suggests that we should be wary of bright-line rules.

Although Lord Sumption also spoke of a second category of "concealment" cases, he did not consider this to involve veil piercing. This was because the interposition of a company to conceal the identity of the real actors will not stop a court from identifying who the real parties to the transaction or act are if identification is relevant. Here, there is no lifting of the corporate veil, as the court is merely looking behind the corporate structure to see what it is concealing.[108] This is a well-known principle that goes beyond veil piercing. According to Diplock LJ in *Snook v. London and West Riding Investments Ltd,* parties carry out sham transactions when they execute documents or perform other acts that are intended to give the appearance of legal rights and obligations being created that are different from what they intend.[109] A company may be used to create the appearance that it is a party to a transaction so as to mask who the real parties are.[110] Although this may not involve true veil piercing, the effect is very similar and it is also unclear to what extent the other judges agreed with this view. Traditionally, it has been considered an aspect of veil piercing and

105. *Prest* [2013] 3 WLR 1 [28], [33].

106. An example of which can be found in *Gilford Motor Co Ltd v. Horne*, [1933] Ch 935 (Eng. C.A.) (hereinafter "*Gilford Motor*) (*see Prest* [2013] 3 WLR 1 [29]). *See also Winland Enterprises Group Inc v. WEX Pharmaceuticals Inc*, CACV 154/2011 (C.A. Mar. 29, 2012), [2012] HKCA 155, [2012] 5 H.K.C. 494 [50]–[51].

107. Tan, *supra* note 77, at 31–32.

108. *Prest* [2013] 3 WLR 1 [28].

109. *Snook v. London and West Riding Investments Ltd* [1967] 2 QB 786, 802 (Eng. C.A.).

110. As in *Adams v. Cape Industries Plc* [1990] 2 WLR 657 (HL) in relation to AMC which the court held was a mere corporate name and had no real role in the transactions.

there are jurisdictions that treat it as such.[111] Concealment cases will therefore be discussed in this paper.

Although the Singapore courts have generally endorsed the approach in *Prest v. Petrodel,* that abuse of corporate personality is what underlies veil piercing,[112] the Singapore Court of Appeal had previously also accepted an "alter ego" ground as a distinct basis to lift the corporate veil. This ground is premised on the company carrying on the business of its controller.[113] This may arise because the company was the agent or nominee of the controller.[114] The former basis is clearly incorrect. If a company is an agent for another person, such other person will generally be personally liable because of the law of agency and not because of any disregard of corporate personality. Indeed, for an agent to bind its principal, the agent must be a distinct person in the agent's own right.

Leaving aside cases where there is an agency relationship, in the case of *Alwie Handoyo v. Tjong Very Sumito*,[115] the Court of Appeal accepted that the appellant, Alwie, was the alter ego of a company known as OAFL. Accordingly, the court reasoned that OAFL's corporate veil should be pierced. Alwie beneficially received payments from OAFL's bank account and Alwie admitted that he used the account as his personal bank account, which is an example of commingling. In Alwie's view, he was authorized and entitled to receive money paid to this bank account.[116] In addition, Alwie also actively procured a payment due to OAFL into his personal bank account.[117]

Given the facts, Lord Sumption would have regarded this as a concealment case. The real actor was Alwie and OAFL was merely a convenient vehicle for him to structure a transaction to which he was the true protagonist. Other cases provide additional examples. In *Re FG Films Ltd*,[118] the court found that the film in question, which was the subject of an application to receive a British film classification, could not be classified as such for the purposes of the Cinematograph Films Act 1938. The applicant company had a share capital of only £100 and it could not be said that this "insignificant company" undertook the making of the film in any real sense, which had cost at least £80,000. On this basis, the court held that the applicant company was merely the nominee or agent of the American company that had financed the making of the film. Although the

111. For example, see the discussion below of cases involving commingling.

112. *Manuchar Steel Hong Kong Ltd v. Star Pacific Line Pte Ltd* [2014] SGHC 181, [2014] 4 Sing. L. Rep. 832 [95]-[96]; S*imgood* [2016] 1 Sing. L. Rep. 1129 [198]-[199]; *Max Master Holdings Ltd v. Taufik Surya Dharma* [2016] SGHC 147 [136]; *Goh Chan Peng v. Beyonics Technology Ltd* [2017] 2 Sing. L. Rep. 592 [75]. *See also Tjong* [2012] SGHC 125 [67], which was decided before *Prest v Petrodel*.

113. *Alwie Handoyo v. Tjong Very Sumito* [2013] SGCA 44, [2013] 4 Sing. L. Rep. 308 [96]; *NEC Asia Pte Ltd. v. Picket & Rail Asia Pacific Pte Ltd.* [2010] SGHC 359, [2011] 2 Sing L. Rep. 565 [31].

114. *NEC Asia Pte Ltd* [2011] 2 Sing L. Rep. 565 [31].

115. *Alwie* [2013] 4 Sing. L. Rep. 308 [96] – [100].

116. *Tjong* [2012] SGHC 125 [70]; *Alwie* [2013] 4 Sing. L. Rep. 308 [98].

117. *Alwie* [2013] 4 Sing. L. Rep. 308 [99].

118. *Re FG Films Ltd* [1953] 1 WLR 483 (Eng. Ch. Div.).

decision was based on agency, it could also have been justified on the concealment principle as the learned judge considered that the applicant company's involvement was "purely colourable."[119] Another example is *Gencor ACP v. Dalby*,[120] where a company had no sales force, technical team or other employees capable of carrying on any business. Its only function was to make and receive payments. On this basis, the court found that the controller of the company was the alter ego of that company.

United States

Generally, in the United States, a plaintiff seeking to pierce the corporate veil must establish "(a) the 'unity' of the shareholder and the corporation and (b) an unjust or inequitable outcome if the shareholder is not held liable."[121] In establishing the unity part of the test, courts will look at factors such as "a failure to observe corporate formalities, a commingling of individual and corporate assets, the absence of separate offices, and treatment of the corporation as a mere shell without employees or assets." The unjust outcome aspect is more difficult to specify but one common example would be a shareholder stripping essential assets from the corporation by dividends, or excessive salaries or other payments for services. A more uncertain basis involves companies that were undercapitalized at the outset so that it could not pay its foreseeable debts.[122]

Although corporate law in the US is based primarily on state law, virtually all state jurisdictions in the US subscribe to one of the two traditional formulations of veil piercing jurisprudence. These are the three factor "instrumentality doctrine" and the "alter ego" doctrine.[123]

The instrumentality doctrine was outlined in *Lowendahl v. Baltimore & O. R. Co*.[124] First, it requires more than control of the corporate entity. Liability must depend on "complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own."[125] Second, the defendant must have used such control "to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of the plaintiff's legal rights." Finally,

119. *Id.* at 486.

120. *Gencor ACP v. Dalby* [2000] EWHC 1560 (Ch), [2000] All Eng. Rep. (D) 1067.

121. KLEIN ET AL., *supra* note 55, at 148.

122. *Id.* (quotation omitted).

123. Blumberg, *supra* note 59, at 304, n. 17; *see also* BAINBRIDGE & HENDERSON, *supra* note 14, at 86–102.

124. *Lowendahl v. Baltimore & O. R. Co*., 287 N.Y.S. 62, 76 (N.Y. App. Div.), *aff'd* 6 N.E.2d 56 (N.Y. 1936).

125. *Id.*

the control and breach of duty must have caused the injury or loss complained of.

In *RRX Indus, Inc. v. Lab-Con, Inc*,[126] the court stated that the alter ego doctrine applies where "(1) such a unity of interest and ownership exists that the personalities of the corporation and individual are no longer separate, and (2) an inequitable result will follow if the acts are treated as those of the corporation alone." Although these appear to be separate tests, it is difficult to see any real difference between them. At their essence, they both require some form of wrongdoing as a result of the control of another person or persons, the extent of which meant that the corporation was unable to function as an entity in its own right. The domination was used to support a corporate fiction and the entity was organized for fraudulent or illegal purposes.[127]

Indeed, in *Wm. Passalacqua Builders, Inc v. Resnick Developers South, Inc*,[128] the court was of the view that the instrumentality and alter ego doctrines are "indistinguishable, do not lead to different results, and should be treated as interchangeable."

As mentioned earlier, of the jurisdictions considered in this paper the US (apart from perhaps China) seems to have a more liberal approach in practice to veil piercing. Although courts often say that the corporate form will be disregarded reluctantly or exceptionally, the cases in the United States appear to take into consideration a wider range of matters than other common law courts in England, Singapore, Australia, Hong Kong or New Zealand.

One reason for this may be that the approach in the United States is more explicitly policy-based. Thus, in *Wm. Passalacqua Builders, Inc v. Resnick Developers South, Inc*, the court remarked that ultimately it had to be decided whether "the policy behind the presumption of corporate independence and limited shareholder liability—encouragement of business development—is outweighed by the policy justifying disregarding the corporate form—the need to protect those who deal with the corporation."[129] US courts appear to place more emphasis on the need for persons dealing with corporations to be protected while the emphasis on *caveat emptor* in many other common law jurisdictions seems to be stronger.

A second reason may be the importance of domination and control in the American jurisprudence. While many cases say that it is insufficient in itself, it is a central element of veil piercing in US cases,[130] but has relatively little weight

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126. *RRX Indus, Inc. v. Lab-Con, Inc*, 772 F.2d 543, 545 (9th Cir. 1985).

127. *Sabine Towing & Transportation Co, Inc v. Merit Ventures, Inc*, 575 F.Supp. 1442, 1446 (E.D. Tex. 1983).

128. *Wm. Passalacqua Builders, Inc v. Resnick Developers South, Inc*., 933 F.2d 131, 138 (2d Cir. 1991) ("*Wm. Passalacqua Builders Case*").

129. *Id.* at 139.

130. In *Craig v. Lake Asbestos of Quebec, Ltd*., 843 F.2d 145, 150 (3d Cir. 1988) the court opined that only after there has been a finding of dominance does one reach the fraud or injustice issue. In *Morris*

in the other common law jurisdictions mentioned previously. Considering the two elements of wrongdoing and control/dominance, one could take the view that the presence of wrongdoing is significantly more important from a practical standpoint; where a corporation has been used to achieve a purpose that is regarded as abusive, it is hard to see a court finding that this has not been brought about in circumstances where the corporation has been so dominated as to justify veil piercing. In jurisdictions such as England and Singapore, the issue of wrongdoing (and therefore what constitutes sufficient wrongdoing) is the focus. Where the relevant abuse has been established, the inquiry then turns to the person or persons responsible for bringing about the abusive conduct in order to determine the liable party. The American approach, on the other hand, places significant weight on formalistic requirements as indicators of control and dominance.

In accordance with control and dominance occupying a central place in the United States to determine whether it is appropriate to ignore corporate personality, the courts have set out a list of factors that would tend to show that the defendant was a dominated corporation, such as:

> (1) the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, i.e., issuance of stock, election of directors, keeping of corporate records and the like, (2) inadequate capitalization, (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes, (4) overlap in ownership, officers, directors, and personnel, (5) common office space, address and telephone numbers of corporate entities, (6) the amount of business discretion displayed by the allegedly dominated corporation, (7) whether the related corporations deal with the dominated corporation at arms length, (8) whether the corporations are treated as independent profit centers, (9) the payment or guarantee of debts of the dominated corporation by other corporations in the group, and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own.[131]

The centrality of dominance and control inclines courts in the United States to see these as being undesirable in themselves and, it is suggested, predisposes them to have a more expansive view of wrongdoing compared to courts from other common law jurisdictions.[132] There almost seems some inevitability in imposing liability when the initial conclusion is that a shareholder/parent has utterly dominated the subsidiary. This is demonstrated by the "identity" doctrine which is discussed in the next paragraph. Taken as a whole, there is a danger of

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v. New York State Department of Taxation and Finance, 623 N.E.2d 1157, 1161 (N.Y. 1993), it was said that "complete domination of the corporation is the key to piercing the corporate veil" though establishing a wrongful or unjust act towards the plaintiff was also necessary. *See also* BAINBRIDGE & HENDERSON, *supra* note 14, at 91–93.

131. *Wm. Passalacqua Builders Case*, 933 F.2d at 139. *See also* PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS – TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 137–40 (1987).

132. *See also* KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL: A TRANSNATIONAL APPROACH 81 (2007) (finding that some courts "have been quite liberal in defining the 'wrong' required" for the instrumentality doctrine).

the doctrine being over and under inclusive. In relation to the latter, as the elements for veil piercing are conjunctive, scrupulous adherence to formality will go a long way towards reducing the risk of veil piercing.[133] Conversely, relatively unsophisticated shareholders or businesses that have not been properly advised are at greater risk of being subject to the doctrine.

Third, aside from the "instrumentality" and "alter ego" doctrines, reference is also sometimes made to "agency,"[134] or to a person using "control of the corporation to further his own rather than the corporation's business," with the consequence that the corporation was only a "dummy"[135] or "shell."[136] Where piercing takes place in these circumstances, the existence of wrongdoing does not appear to be crucial as this category seems to be distinct from the two earlier doctrines, even if at times it is conflated with them.[137] It is perhaps best described as the "identity" doctrine which has been criticized as being "such a diffuse and relatively useless approach that it does not deserve extended discussion."[138] Certainly agency, properly speaking, ought to be distinct from veil piercing.[139] Where the law finds that an agency relationship has arisen, it means that the agent is a distinct person from the principal. Although the principal is bound by the agent's acts, this is because the principal has authorized the agent to act in a certain manner and the agent has done so in accordance with the principal's instructions.[140] Aside from agency, where a corporation is merely a "dummy" or "shell," this could include situations similar to the concealment principle that has been recognized in England where the real party to a transaction is not the corporation but some other person.[141] The understanding in the United States

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133. At least in theory. As a practical matter, where a court is of the view that the corporate vehicle has been used in an abusive manner, it would in all likelihood strive to find the necessary dominance and control, which begs the question of whether control and dominance should occupy such a central place in the judicial reasoning. Certainly the conjunctive nature of the elements is unusual by the standards of the other jurisdictions discussed in this paper as it suggests that control or wrongdoing simpliciter cannot as a matter of principle ever give rise to piercing.

134. *Walkovszky v. Carlton*, 223 N.E.2d 6, 7–8 (N.Y. 1966).

135. *Id.* at 8. The concept of agency has also been invoked in this context, *see e.g., Berkey v. Third Ave Ry. Co*., 155 N.E. 58, 61 (N.Y. 1926); *Port Chester Elec. Constr. Corp. v. Atlas*, 40 N.Y.2d 652, 657 (1976).

136. *Wm. Passalacqua Builders Case*, 933 F.2d at 138.

137. *See e.g., Wm. Passalacqua Builders Case*, 933 F.2d 131, 138; *Fletcher v. Atex, Inc*, 68 F.3d 1451, 1458 (2d Cir. 1995).

138. BLUMBERG, *supra* note 131, at 122.

139. *See e.g., Lowendahl*, 287 N.Y.S. at 74–75, which also noted that "agency" in this context was not being used in its technical legal sense.

140. RESTATEMENT OF THE LAW (THIRD) OF AGENCY §1.01 (AM. LAW INST. 2006).

141. Given the vague nature of this doctrine, some cases have regarded it as interchangeable with the other veil piercing theories. *See e.g., Wm. Passalacqua Builders Case*, 933 F.2d 131, 138 (the corporate veil may be pierced "either when there is fraud or when the corporation has been used as an alter ego"); *Fletcher*, 68 F.3d 1451 (finding that fraud was not necessary under the "alter ego" doctrine though there must be an overall element of injustice or unfairness which are somewhat vague concepts; *contra Walton Construction Co, LLC v. Corus Bank*, N.D.Fla., July 21, 2011, at *3 (stating that "fraud, or a similar injustice or wrongdoing" must be demonstrated); *Wausau Business Insurance Co. v. Turner Construction Co.,* 141 F.Supp.2d 412 (S.D.N.Y. 2001) (adopting the approach from *Wm. Passalacqua Builders Case*,

goes beyond this, as some courts simply ask if the company is merely a conduit for the shareholder/parent, or exists simply as a mere tool, front or personal instrumentality.[142]

Fourth, some cases of veil piercing have arrived at the right conclusion in terms of liability, but the reasoning may have been better justified on some basis other than veil piercing. Where, for example, an appropriate officer of the parent company has made representations assuring the plaintiff that the parent company will be the responsible party, and the plaintiff reasonably placed reliance on this, either an estoppel against the parent would arise, or a contract may have come into existence between the parent and the plaintiff on the objective theory of contract formation. In such cases, there is no need to resort to veil piercing.[143] As mentioned earlier in a different context, engaging in veil piercing risks creating a messy and uncertain shortcut. Indeed, *McFerren v. Universal Coatings, Inc* utilized an alternative approach.[144]

Where proof of wrongdoing is unnecessary for veil piercing (wrongly, it is submitted), or where an expansive notion of wrongdoing is applied because the level of control or identification is regarded as excessive, it is difficult to resist the notion that the doctrines are a proxy for what is really taking place, namely that the real basis for veil piercing in such cases is what courts regard as extremely poor corporate governance. The courts have pierced the corporate veil because of the failure to sufficiently distinguish the company's activities from its parent/owner. Some examples will illustrate this. In *Gorill v. Icelandair/Flugleider*,[145] the corporate veil was pierced on the "instrumentality" theory. The court was of the view that the element of domination and control was made out. In addition, the subsidiary's wrongful termination of employment was a sufficient "wrong" for the doctrine to be made out.[146] With respect, this seems to go too far. Wrongful termination of employment is a breach of contract. Unless there is something special about employment contracts, to find that a breach of contract is a sufficient wrong that can lead to veil piercing suggests that a wide

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933 F.2d 131); In *re MBM Entertainment, LLC*, 531 B.R. 363 (S.D.N.Y. Br. 2015) (also following *Wm. Passalacqua Builders Case*, 933 F.2d 131). Although some cases that apply the "instrumentality" and "alter ego" doctrines do so in the absence of proof of inequitable conduct, many cases do not, *see* BLUMBERG, *supra* note 131, at 117–24. It is suggested that proof of wrongdoing should be a critical element. In countries such as England and Singapore where small companies predominate, even what is referred to as "one-man" companies, over-reliance on concepts of dominance and control will likely lead to corporate personality being potentially ignored in a very large number of companies. English and Singapore courts have therefore reiterated that control and dominance are in themselves unimportant, *see e.g., Adams* [1990] 2 WLR 657; *Public Prosecutor v. Lew Syn Pau* [2006] SGHC 146, [2006] 4 Sing. L. Rep. (R) 210.

142. *Harris v. Wagshal*, 343 A.2d 283, 287 (D.C. Ct. App. 1975); *International Union v. Cardwell Manufacturing Co, Inc.*, 416 F.Supp 1267, 1286 (D. Kan. 1976); *Miles v. American Telephone & Telegraph Co.*, 703 F.2d 193, 195 (5th Cir. 1983); *Vuitch v. Furr*, 482 A.2d 811, 817 (D.C. Ct. App. 1984).

143. *See e.g., Morgan Bros, Inc. v. Haskell Corp.*, 604 P.2d. 1294 (Wash. Ct. App. 1979).

144. *McFerren v. Universal Coatings, Inc.*, 430 So. 2d 350, 353 (La. 1983).

145. *Gorill v. Icelandair/Flugleider*, 761 F.2d 847, 853 (2d Cir. 1985).

146. *Id.* at 853.

variety of legal wrongs are in themselves sufficient for such purpose. Given that a successful claim against a corporate defendant is a pre-requisite for veil piercing, it is difficult to see when this element will not be satisfied. On such a liberal view of "wrong," any real limit on veil piercing will amount to little more than the element of domination/control.

Carte Blanche (Singapore) Pte Ltd v. Diners Club International, Inc[147] provides another example of a liberal approach to the understanding of wrongdoing in veil piercing. A subsidiary entered into a franchise agreement with the plaintiff company. As a result of a corporate reorganization, the subsidiary transferred its operations to its parent such that by the end of 1983, it had no separate offices, officers, books, or bank accounts. The plaintiff's franchise was serviced solely by employees of the parent company. Subsequently, a dispute arose over certain provisions of the franchise agreement and the chairman of the subsidiary, who was also chairman of the parent, gave notice of default to the plaintiff. The notice indicated the chairman's title as chairman of the parent company and not the subsidiary. The parties proceeded to arbitration and it was found that the subsidiary was in breach of the franchise agreement when it withheld services from the plaintiff. As the plaintiff was unable to collect damages from the subsidiary, it attempted to do so from the parent.

The court held that this was an appropriate case for the corporate veil to be pierced. The court accepted that the subsidiary acted as a separate corporation from its organization from 1972 until mid-1981. The question was whether it did so in 1984 when the franchise agreement was breached. This depended on whether its parent dominated or controlled its actions. It was noted that at the time of the breach in 1984: (1) the subsidiary had observed no corporate formalities for at least two years; (2) it kept no corporate records or minutes and had no officers or directors elected in accordance with its by-laws; (3) it had no assets, and its initial capitalization of $10,000 was insignificant when compared to the more than $7,000,000 in loans that it received from group companies to finance its business activity; (4) it had no separate offices or letterhead; (5) it had no paid employees or a functioning board of directors; (6) all of its revenues were put directly into the parent's bank account, which paid all of its bills; (7) services provided to the plaintiff from 1983 came from full-time employees of the parent; (8) its revenues and marketing reports were not recorded independently, but were treated as part of the parent's revenues and statistics; and (9) the chairman was the only person who functioned on behalf of the subsidiary and he was also chairman of the parent's board. He was paid no salary by the subsidiary and occasionally acted not in the name of the subsidiary but in the name of the parent.

147. *Carte Blanche (Singapore) Pte Ltd. v. Diners Club International, Inc.*, 2 F.3d 24 (2d Cir. 1993) (hereinafter "Carte Blanche Case").

While the preceding facts indicate a failure to properly segregate the activities of group companies, it is difficult to see any wrongdoing aside from the breach of the franchise agreement.[148] The risk of breaches of contract are inherent in any contractual relationship and should be the subject of a specific bargain if a contracting party wishes to extract greater security from a parent company or other shareholder. In addition, as American law recognizes the tort of inducing a breach of contract, it might seem more appropriate for such wrongs to be determined within this framework, which is shaped by policies relevant to such liability. From a policy perspective, the decision is also difficult to justify as providing an optimal measure of protection for those who deal with corporations. It would seem from the judgment that if the breach had taken place before mid-1981, no veil piercing should take place. Was the plaintiff in any way materially prejudiced after such date?[149] It is difficult to see how it was. The subsidiary's financial position did not appear to be any worse after this date. While its capitalization was low, there is nothing wrong with financing a business from loans, and a substantial sum was advanced to it for its business. Prima facie, it would appear that such loan was unrecoverable with the consequence that the parent company also made a substantial loss. The other factors listed by the court are failures relating to proper formalities reflecting poor governance but are of marginal relevance upon closer scrutiny.[150] The business of the subsidiary was almost moribund given the existence of only one remaining franchisee, the plaintiff. For the subsidiary to have continued operations on this basis might have led to a greater drain on its remaining financial resources (if any). This could have led to its winding up and consequently brought the franchise agreement to an end. *Carte Blanche* is a good example of the potentially distorting effects when the element of control/dominance sits at the heart of the test for veil

148. It is possible that because the court expressed the test for veil piercing using the disjunctive "or" for the elements of control and wrongdoing, rather than the conjunctive "and" which New York courts have since endorsed (*see Cary Oil Co, Inc v. MG Refining & Marketing, Inc.*, 230 F.Supp.2d 439, 488 (2002)), the court in *Carte Blanche* may have arrived at its decision purely on the basis of control.

149. In *Abraham v. Lake Forest, Inc*, 377 So.2d 465, 469 (La. Ct. App. 1980) the subsidiary was undercapitalized, there was commingling of funds, and almost all the business of the subsidiary was accomplished by unanimous consent of the shareholders. Nevertheless, no piercing took place as the plaintiff was a sophisticated real estate entrepreneur who exercised business judgment when contracting with the subsidiary and was not relying on the credit of the parent corporation.

150. It would have been possible to structure the relationship between the parent and subsidiary more formally to minimize the danger of veil piercing. For example, there could have been an agreement between both companies under which employees of the parent would provide services to the subsidiary in consideration for which the parent would be allowed to collect the subsidiary's revenues and apply them towards such costs with any excess held for the benefit of the subsidiary. This would have addressed some of the criticisms of the parent's conduct. Once again, this illustrates the sub-optimal nature of rules that may trip up small and relatively unsophisticated businesspeople or entities even though in this case the parent was not such a person. A similar point is made by BAINBRIDGE & HENDERSON, *supra* note 14, at 108–09.

piercing. It gives rise to the danger that it can be applied in a formulaic manner without regard to the proper context of the case.[151]

Nevertheless, the outcome itself may have been correct as the subsidiary's operations and assets had been absorbed into the parent company.[152] This meant that when the parent's employees and its chairman dealt with the plaintiff, they did so on behalf of the parent which had stepped into the shoes of the subsidiary. In other words, the conduct of the parties brought about a novation of the contract from the subsidiary to the parent. Veil piercing would not be necessary in these circumstances. The parent was liable to the plaintiff under the contract that the parent and plaintiff became parties to.

Similarly, in *Sabine Towing & Transp. Co., Inc. v. Merit Venture, Inc.*,[153] the court apparently relied on a breach of contract as one aspect of wrongdoing. However, given that the wrongdoing included acts that were designed to keep creditors from reaching the subsidiary's remaining assets, one wonders if reliance on laws designed to prevent fraudulent conveyances would have been more appropriate and sufficient.[154] And in *Vuitch v. Furr*, the court opined that insolvency or undercapitalization is often an important factor evidencing injustice.[155] No elaboration was given and it is suggested that in and of themselves such situations should not be equated with injustice.

Parker v. Bell Asbestos Mines, Ltd provides a further example illustrating a broader understanding of wrongdoing in the United States.[156] The issue related to the extent to which a parent could be insulated by its subsidiary from tort liability for asbestos related harm. In England, where there was similar litigation, the issue was resolved in favour of the parent with the court taking the view that the purpose of incorporation was to allow a person to limit potential future liabilities.[157] In *Parker v Bell Asbestos Mines, Ltd*, the court came to the opposite conclusion from that in England by drawing a distinction between:[158]

151. On the other hand, in *Penick v. Frank E. Basil, Inc.*, 579 F.Supp. 160, 166 (D.C. Cir. 1984), no piercing took place because the plaintiff failed to establish "that the employees of either failed to observe proper corporate formalities." In any event, the claim was for breach of a contract of employment with the subsidiary which should generally not be a sufficient act of wrongdoing to justify piercing. In *Amsted Industries, Inc v. Pollak Industries, Inc*, 382 N.E.2d 393 (Ill. App. Ct. 1978), the court held that while there may have been some failures to adhere to formalities within the corporations, the veil would not be pierced as against the individual shareholder as there were other indicators that the separation between the corporations existed. The companies had separate employees that were paid by the company which employed them; the companies had separate meetings of directors and kept separate minute books; they had separate bank accounts; they never advertised together; and they never circulated a joint financial statement. In other words, there was at least a threshold observance of corporate formalities.

152. *Carte Blanche Case*, 2 F.3d at 28.

153. S*abine Towing & Transportation Co*, 575 F.Supp. at 1448.

154. See *Lowell Staats Mining Co, Inc v. Pioneer Uravan, Inc.*, 878 F.2d 1259 (10th Cir. 1989).

155. *Vuitch v. Furr*, 482 A.2d at 819 (D.C. 1984).

156. *Parker v. Bell Asbestos Mines, Ltd*, 607 F. Supp. 1397 (E.D. Pa. 1985).

157. *Adams* [1990] 2 WLR 657. Such an approach is also the position in Singapore, see *Simgood* [2016] 1 Sing. L. Rep. 1129 [195].

158. *Bell Asbestos Mines, Ltd.*, 607 F. Supp. at 1403.

> (1) carrying out the everyday affairs of corporate business (e.g., the mining and sale of asbestos)—the sort of activity which traditionally merits the privilege of limitation of liability bestowed by the protective corporate form; and (2) carrying out legal maneuvers aimed at maximizing the limitation of liability to a point of near invulnerability to responsibility for injury to the public. In our view, the latter, which may well be the situation here, constitutes an abuse of privilege, which in an equitable analysis of competing public policy considerations must surely fail.

On the face of it such a distinction is difficult to justify. Business activities inevitably give rise to the possibility of tortious acts, and it is hard to see why a corporate structure that is intended to maximize the limitation of liability for such acts is an abuse of privilege. It may be if the activity in question will inevitably give rise to a tort, and in such an instance the directors of the company may also be personally liable for procuring the company to engage in a tortious act. As a general and unqualified statement of the law, however, *Parker* with respect probably goes too far.[159]

In England, the effect of separate personality in the context of the tort of negligence can be limited by finding that a parent company has assumed responsibility towards the employees of a subsidiary so as to give rise to a duty of care towards such employees. Arguably, this is the real issue, namely what are the circumstances where a parent ought to incur tortious liability to employees of a subsidiary. For this to arise in England, it is not necessary that the parent should have absolute control over the subsidiary. Tortious liability was found where "(1) the businesses of the parent and subsidiary are in a relevant respect the same; (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary's system of work is unsafe as the parent company knew, or ought to have known; and (4) the parent knew or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employees' protection….A court may find that element (4) is established where the evidence shows that the parent has a practice of intervening in the trading operations of the subsidiary, for example production and funding issues."[160]

It is worth pausing at this stage to make a broader point. It is arguable that in a tort or contract case, where negotiation is not plausible (for example where contracts are in a standard form), if a corporation has an amount of capital that is unreasonably low given the nature of its business and the risks it faces, from an *ex ante* perspective, veil piercing may be justifiable. On the other hand, veil piercing should not take place where creditors can protect themselves *ex ante*.[161] Having a company operate in a way that puts third parties at risk of uncompensated harm where such risks would reasonably be expected to occur, or that similarly puts the other contracting party at risk of contract breach because

159. *See also Lake Asbestos of Quebec, Ltd.*, 843 F.2d at 145.
160. *Chandler v. Cape plc* [2012] EWCA (Civ) 525, [2012] 1 WLR 3111, 3131.
161. BAINBRIDGE AND HENDERSON, *supra* note 14, at 110.

it is clear that the other contracting party has to deliver the goods or products ordered to another person, would be unjust and an abuse of corporate personality as required by veil piercing doctrine. Limited liability in such circumstances provides incentives to invest recklessly.[162]

As powerful as this view may be, veil piercing may not be the best solution. Should veil piercing in such situations take place, the courts are really holding the shareholders and/or directors of such a corporation accountable for the loss suffered by the tort victim or unfortunate counterparty to the contract. The broader (and real) policy issue therefore is whether the circumstances are such as to impose a direct duty of care on the said shareholders or directors to such persons. Again, tort law may provide a superior framework for analysis and, depending on the facts, other areas of tort may be applicable.

It is worth noting that many of the US cases discussed above involved parent-subsidiary relationships.[163] It may be that a more liberal approach to veil piercing in the US is explicable on this basis. It has been argued that, in the context of a corporate group, the theoretical analysis behind limited liability largely becomes irrelevant. For instance, any veil lifting within a corporate group does not affect the ultimate investors of the enterprise as the piercing is generally not extended beyond the corporate parent.[164] Such an approach reflects the perceived reason and policy behind limited liability and hence its limits. An alternative approach that is more accommodative of group enterprises may reflect a view that, given the right circumstances, large firm size can bring about efficiencies (e.g. through risk spreading, economies of scale and scope, access to capital markets, more favourable borrowing terms) which as a whole benefit society. A mix of large and small firms may also provide the most optimal environment for innovation to take place.[165] Part of the reason for this is because some innovation takes place in start-up companies founded by former employees of large enterprises.[166] This also applies to large firms that decide to spin off divisions or lines of businesses into subsidiaries. It is therefore optimal to treat corporate shareholders no differently from individual investors. This will avoid disincentivizing enterprises from growing without endangering the entire enterprise given the greater

162. Henry Hansmann and Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 Yale Law Journal 1879, 1882–83 (1991).

163. For example, *see Walkovszky v. Carlton*, *supra* note 134; and *see also Mangan v. Terminal Transportation System*, *Inc.,* 247 A.D. 853 (1936).

164. BLUMBERG, *supra* note 131, at 93–97; *see also* BAINBRIDGE & HENDERSON, *supra* note 14, at 293–301 which argues that veil piercing should be abolished with respect to individual shareholders.

165. Ajay K. Agrawal et al., *Why Are Some Regions More Innovative than Others? The Role of Firm Size Diversity* (NBER Working Paper No. 17793, 2012), available at http://www.nber.org/papers/w17793.pdf.

166. Paul Gompers et al., *Entrepreneurial Spawning: Public Corporations and the Genesis of New Ventures*, *1986 to 1999*, 60 J. FIN. 577 (2005); Aaron K. Chatterji, *Spawned with a Silver Spoon? Entrepreneurial Performance and Innovation in the Medical Device Industry*, 30 STRATEGIC MGN'T J. 185 (2009).

complexity and therefore risk inherent in larger enterprises. Such a viewpoint probably underpins the approach in England and Singapore where arguments relating to group enterprise liability have not been met with much success.[167]

On the whole, the body of cases relating to veil piercing in the US is somewhat confused. It is difficult to disagree with the following comment:[168]

> In light of the diversity of judicial approaches, the use of expansive rhetoric, and the sheer volume of legal opinions, veil-piercing jurisprudence in the US lacks the degree of certainty and predictability that the modern business requires. The veil-piercing common law of torts and contracts remains highly discretionary and problematic for the business planner.[169]

Germany

Veil piercing by courts is rare in Germany.[170] The courts restrict direct claims of harmed creditors against shareholders to situations in which assets have been commingled. In all other instances, the principles established and applied by German courts have recently changed.[171] Shareholders that strip a company of its assets to the disadvantage of creditors may be liable, but for tort and not on the basis of veil piercing. Courts avoid veil-piercing because the liability of the shareholders is to the company, not to its creditors since the latter's losses are of a reflective nature.

Shareholders are also never personally liable in situations of undercapitalization or for abuse of the corporate form, and a dominant influence exercised on a company is by itself no basis for such liability either. Earlier judgments that applied the principles relating to corporate groups[172] to instances where shareholders exercised a dominant influence over a company in the group

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167. *See e.g.*, *Adams* [1990] 2 WLR 657; *Win Line (UK) Ltd v. Masterpart* (Singapore) Pte Ltd [1999] 2 SLR(R) 24; *Manuchar Steel* [2014] SGHC 181.

168. Sandra K. Miller, *Piercing the Corporate Veil among Affiliated Companies in the European Community and in the US: A Comparative Piercing Approaches Analysis of US, German and U.K. Veil Piercing Approache*s, 36 AM. BUS. L.J. 73, 94 (1998). *see also* BAINBRIDGE & HENDERSON, *supra* note 14, at 129–131.

169. It has been suggested, however, that although many aspects of veil piercing doctrine from judicial decisions make little sense, if the actual outcomes of cases are analyzed, piercing cases can be explained as judicial efforts to remedy one of three problems, namely to ensure behavior that conforms to a statutory scheme, to preserve the objectives of insolvency law, and to remedy what appears to be fraudulent conduct, *see* Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99 (2014). There is no difficulty with the first two categories but in the third it is clear that fraudulent conduct is construed broadly so the difficulty of construing what conduct crosses the line remains.

170. For a similar conclusion, *see* COMPARATIVE COMPANY LAW – A CASE-BASED APPROACH 219 (Mathias Siems & David Cabrelli eds. 2nd ed. 2018).

171. As such, observations such as those made in *Am. Lecithin Co. v. Rebmann*, 12-CV-929 (VSB) (S.D.N.Y. Sep. 20, 2017) as to the similarity between the German law on veil piercing and New Jersey or Delaware law are no longer correct.

172. Aktiengesetz [AktG] [Stock Corporations Act], Sept. 6. 1965, BGBL I at 1089, last amended by Gesetz [G], July 17, 2017 BGBL I at 2446, art. 9 (Ger.), available at https://www.gesetze-im-internet.de/aktg/AktG.pdf, §§ 291-318.

to its financial detriment are obsolete.[173] They have been absorbed by newly established principles that apply when the existence of the company is threatened by shareholders. The term used in the relevant German rulings ("*existenzvernichtender Eingriff*") translates literally into "existence annihilating interference." We have chosen to refer to it as "annihilating interference."

For a better understanding of the policy reasons underpinning the German position, the discussion of the principles of veil piercing is preceded by some introductory remarks about relevant aspects of German company law.

Veil-piercing in the context of the smaller German company type, the GmbH

Whereas English law, and the jurisdictions that have derived their corporate laws from it, typically subject the private limited company to essentially the same rules and requirements as the public limited company,[174] German law has created two substantially different forms of corporations. One form is the *Gesellschaft mit beschränkter Haftung* ("GmbH"), which is the company of choice of small- and medium-sized businesses and therefore frequently closely held.[175] Its typical structure explains why veil-piercing or a functional equivalent is a relevant issue for the GmbH.[176] In closely-held companies, shareholders can exercise a dominant influence and attempt to enrich themselves to the disadvantage of the company and its creditors. German law also grants the shareholder meeting a dominant influence over the GmbH. In contrast to other jurisdictions where directors may generally manage companies independently of directions from shareholders,[177] the German GmbH requires directors to adhere to shareholder resolutions decided in meetings.[178]

173. GÜNTER H. ROTH & PETER KINDLER, THE SPIRIT OF CORPORATE LAW – CORE PRINCIPLES OF CORPORATE LAW IN CONTINENTAL EUROPE 68 (2013).

174. Even the UK follows this rule although its public limited company is subject to EU legislation and therefore while there are some differences between the two corporate forms, the overall conceptual approaches are similar and accordingly substantially different from the German concept. Some US states offer a separate regime for closely-held corporations, particularly Delaware, that shareholders can opt into. In other states, the courts apply special principles to closely held corporations that serve the interests of minority shareholders. However, the deviations from the general rules are rather insignificant compared to the existence of fundamentally different regimes for different types of companies in jurisdictions that follow the German and French approaches.

175. For these elementary principles of German company law, *see generally* Gregor Bachmann, *Introductory Editorial: Renovating the German Private Limited Company - Special Issue on the Reform of the GmbH*, 9 GERMAN L.J. 1064 (2008).

176. As GÖTZ HUECK & CHRISTINE WINDBICHLER, GESELLSCHAFTSRECHT § 24 Rdn 27 (21st ed. 2008) correctly emphasize, the issues of limited liability and veil piercing are not limited to the GmbH, but factually-speaking of little relevance for the stock corporation. It could be added that this is so because the particular liability-triggering scenarios are very rare for larger, widely-held corporations with a strict structure of corporate governance that reduces the influence of shareholders to a minimum.

177. An example is in Singapore, where this principle is firmly expressed in §157A of the Singapore Companies Act, subject to any provisions in the Act itself or the corporate constitution.

178. This principle is derived from section 37(1) GmbHG that provides that the powers of the directors are limited by the resolutions of the shareholders in meeting.

The GmbH is not simply a smaller version of the stock corporation (*Aktiengesellschaft* or "AG"), which relies on a detailed regime underpinned by largely mandatory statutory law. The corporate governance structure of the AG vests the decision-making powers in its two-tier board and not in the shareholders.[179] It is therefore generally considered a company form that is, conceptually speaking, entirely different from the GmbH.[180]

German legislation created the GmbH in 1892,[181] and the GmbH Act (GmbHG)[182] became the model law for similar forms of limited liability companies in civil law jurisdictions throughout the world. This seems, in particular, interesting and relevant from an Asian perspective. In the late 19th and early 20th centuries, German law had a significant influence over East Asian jurisdictions.[183] Although German company law remains important in the region, a wave of legal transplantation of US corporate law has dramatically reduced the impact it once had. This decline in influence is most obvious in Japan where the legislature in its 2006 company law reform abolished its GmbH-equivalent, the yūgen kaisha, and reduced Japanese company law to one type of corporation, the kabushiki kaisha with no minimum capital requirement, and adopted a US-style LLC called the gōdō kaisha.[184]

Cases of undercapitalization and liability for "annihilating interference"

Whether undercapitalization of the GmbH may justify a piercing of the corporate veil was controversially discussed in German literature until the Federal High Court firmly decided against it in a 2007 ruling.[185] This discussion about a potential liability for undercapitalized companies is best understood with

179. For details about the AG from a comparative corporate governance perspective, *see* Theodor Baums & Kenneth Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM J. COMP. L. 31 (2005); Paul Davies & Klaus Hopt, *Corporate Boards in Europe: Accountability and Convergence*, 61 AM J. COMP. L. 301 (2013); Klaus Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM J. COMP. L. 1 (2011).

180. *See e.g.,* Michael Beurskens & Ulrich Noack, *The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century?*, 9 GERMAN L. J. 1069, at 1070 (2008).

181. ROTH & KINDLER, *supra* note 173, at 16.

182. Gesetz betreffend die Gesellschaften mit beschränkter Haftung [GmbHG] [Limited Liability Companies Act], Apr. 20, 1892, RGBl. at 477, last amended by Gesetz [G], Jul. 17, 2017 BGBl I at 2446, art. 10 (Ger.), https://www.gesetze-im-internet.de/gmbhg/.

183. For Japan, *see e.g.,* KONRAD ZWEIGERT & HEIN KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW 298 (Tony Weir trans., 3d ed. 1998); MATHIAS SIEMS, COMPARATIVE LAW 211–12 (2014); CARL F. GOODMAN, THE RULE OF LAW IN JAPAN: A COMPARATIVE ANALYSIS 20 (4th ed. 2017).

184. *See* Beurskens & Noack, *supra* note 180, at 1071.

185. On the discussion of the literature prior to the ruling, *see* Rüdiger Veil, *Gesellschafterhaftung wegen existenzvernichtenden Eingriffs und materieller Unterkapitalisierung* [Liability of Members under Annihilating Interference and Substantial Undercapitalization], 2008 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 3264, 3265.

some insight in the basics of German principles of minimum capitalization and capital maintenance.[186]

Principles of German law of capital maintenance

The minimum initial legal capital of the stock corporation (AG) must amount to EUR 50,000.[187] This is double the amount required by the EU second directive that pursues a minimum harmonization approach and applies in all EU member states. It permits the member states to implement higher, but excludes lower, minimum capital requirements.[188] The United Kingdom is another prominent member state of the EU that goes well beyond the minimum required by EU legislation and sets the minimum capitalization of its public companies at GBP 50,000.[189]

The registration of the GmbH requires a minimum legal capital of EUR 25,000.[190] German law therefore requires a substantial amount of initial capital for the incorporation of any company because even the so-called 'Entrepreneurial Company' (*Unternehmergesellschaft*), created by a 2008 reform of the GmbHG and sometimes referred to as "GmbH-lite,"[191] is ultimately a GmbH with a minimum capital of EUR 25,000. Although it can be established without any legal capital, it remains an imperfect company with inconvenient restrictions until capital up to the amount of EUR 25,000 has been contributed, at which time it converts into a GmbH.[192]

In this respect, Germany contrasts with the UK. The minimum capital requirements stemming from EU legislation[193] only apply to the public limited and its civil-law equivalents (i.e., the German stock corporation AG), rendering the decision whether to require a minimum capital for smaller company forms a national matter. While the United Kingdom has exercised its legislative discretion in a way typical of common law-countries and abstained from minimum capital requirements for its private limited companies, Germany still

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186. For more detail on the principles of capital maintenance in German company law, *see* ROTH & KINDLER, *supra* note 173, at 54–66.

187. AktG, § 7.

188. Directive 2017/1132/EU of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification), 2017 O.J. EU (L 169) 46 [hereinafter Codification Directive], art. 45.

189. Companies Act 2006 (c. 46) (UK), § 763(1). For further examples of EU countries going beyond the required minimum, *see* ROTH & KINDLER, *supra* note 173, at 33.

190. Section 5(1) GmbHG. For a comparative look at different European jurisdictions, *see* ROTH & KINDLER, *supra* note 173, at 33.

191. On the reform, *see* Bachmann, *supra* note 175, at 1063–68; Beurskens & Noack, *supra* note 180, at 1069–1073.

192. *See* GmbHG, § 5a, especially paragraph 5 for the transformation into a "proper" GmbH and paragraph 4 for the restrictions until its legal capital reaches EUR 25,000, especially the requirement that one-fourth of its annual profit must be allocated to its legal capital. On this aspect, *see* Beurskens & Noack, *supra* note 180, at 1084.

193. Art 45(1) Codification Directive, *supra* note 188.

pursues what was once the typical fashion of civil law jurisdictions and requires a substantial legal capital as a precondition for the incorporation of a GmbH.[194]

In addition, principles of capital maintenance are strict in German company law. The traditional German approach to capital and its maintenance for purposes of creditor protection strongly influenced the rules of EU law, which have forced the United Kingdom to deviate from general common law principles that apply to the distribution of profits to shareholders in the case of public companies.[195] Profits, and more generally assets necessary to maintain the legal capital are not to be distributed to shareholders,[196] and shareholders who receive payments contrary to this principle must make repayment. If such repayment falls short of the amount owed, all other shareholders are jointly and severally liable for the remaining sum.[197] In addition, a solvency test applies and holds the directors of the GmbH liable for any asset transfers to shareholders (including those in fulfilment of contractual obligations such as repayment of loans to a shareholder or payment for goods purchased from a shareholder) if such transfers have led to the illiquidity or balance-sheet insolvency of the company.[198]

We emphasize these principles of German law here because we believe that they help to explain the decisions of the German courts that will be discussed below, especially the Federal High Court's reluctance to pierce the corporate veil in instances where undercapitalization of a GmbH is suggested, i.e., where its legal capital looks inadequate in light of its business purpose and/or obligations. When requirements for initial capitalization and maintenance of capital are strict, calls for penalties for undercapitalization in a material sense are less appealing.

As emphasized in the German legal literature, minimum capital requirements bear no indication of the correct or appropriate amounts of capitalization for companies. The minimal capital requirements aim to establish integrity of the business that the founding members commit to, and they seek to prevent insolvencies at an early stage of a company's life. The underlying theory

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194. Many other civil-law jurisdictions have abolished such minimum capital requirements. On the French s.à.r.l., *see* CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L223-2 (Fr.). On Japan, *see* Beurskens & Noack, *supra* note 180, at 1071, and *see also* the discussion on the People's Republic of China at *infra* .

195. Section 830 of the UK Companies Act 2006 represents the general company law approach to the distribution of profits to shareholders and applies to the private limited company. In contrast, section 831, in relation to public companies, implements the principles of capital maintenance stemming from the Codification Directive, *supra* note 188, and correspond to the stricter principles that have traditionally been pursued in Germany. For an analysis of the drastic change in common law principles that took place in the early 20th century, *see* Basil S. Yamey, *Aspects of the Law Relating to Company Dividends*, 4 MOD. L. REV. 273 (1941). On Germany's influence on the directive Stefan Grundmann, *European Company Law* (Intersentia 2012) 205.

196. GmbHG, §30(1). *See* CARSTEN JUNGMANN & DAVID SANTORO, *German GmbH Law – Das deutsche GmbH-Recht* 39 (2011).

197. GmbHG, §§31(1) and (3). For exemptions from this rule, *see* JUNGMANN & SANTORO, *supra* note 196, at 42.

198. GmbHG, § 64. *See also* JUNGMANN AND SANTORO, *supra* note 196, at 44.

provides that shareholders, and often shareholder-directors in small companies, whose own equity is at stake are prudent decision-makers, rely on sounder business plans and try to stay clear of exorbitant risk. By contrast, minimum capital requirements do not seek to provide a guarantee as to whether the amount of legal capital to which the shareholders commit in the corporate constitution is adequate for the pursuit of the planned business endeavours. Neither the registration authorities that incorporate a company, nor the shareholders that commit to the corporate constitution, provide any implicit statement of this kind. Similar to all the jurisdictions discussed in this paper, creditors need to be aware that German company law expects them to exercise their own due diligence and business judgment.[199]

The Trihotel judgment of the Federal High Court (BGH)

As early as the 1920s, German courts recognized that shareholders could be held personally liable when companies became insolvent as a result of their conduct.[200] The requirements for such personal liability have changed over time, and from the 1980s to early 2000s courts tended to look unfavorably at dominant shareholders in GmbHs that went into insolvency and left creditors unpaid. Such tendencies ignited hopes in disgruntled creditors who demanded that shareholders be held personally liable for the company's debts on the basis that they had insufficiently capitalized it. Several recent judgments of the BGH (*Bundesgerichtshof*, literally Federal Court of Justice, but more commonly translated as Federal High Court or Supreme Court) have crushed such expectations and led to important clarifications that have strengthened the principle of limited liability. The majority of academic commentators has welcomed this new series of judgments.[201]

In its 2007 *Trihotel* judgment,[202] the BGH reaffirmed older judgments and held that shareholders could be found personally liable for wrongful conduct in cases where they improperly handled assets intended to be reserved preferentially for creditors, and thereby triggered or aggravated the company's

199. *See also* ROTH & KINDLER, *supra* note 173, at 36 (with references to literature in German); JUNGMANN & SANTORO, *supra* note 196, at 27; Detlev Kleindiek, *Materielle Unterkapitalisierung, Existenzvernichtung und Deliktshaftung – GAMMA* [Substantial Undercapitalization, Existence-Annihilation and Tort Liability – GAMMA], 2008 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 687.

200. For an overview of the developments, *see* Holger Altmeppen, *Abschied vom "Durchgriff" im Kapitalgesellschaftsrecht* [Farewell to Veil-Piercing in Capital-based Companies], 2007 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 2657.

201. *See e.g.,* Altmeppen, *supra* note 200, at 2659. Christian Glöger et al., *Die neue Rechtsprechung zur Existenzvernichtungshaftung mit Ausblick in das englische Recht (Teil I)* [The New Jurisprudence on Liability for Existence-Annihilating Interference, with an English Law Perspective (Part 1)], 2008 DEUTSCHES STEUERRECHT [DStR] 1141. For a critical view, *see* Marcus Lutter & Walter Bayer, GMBH-GESETZ §13 Rdn 46 (Marcus Lutter & Peter Hommelhoff eds., 18th ed. 2012).

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

insolvency.[203] However, the court made the requirements for such liability more onerous. It explicitly reversed its previous holdings that had created a subgroup of veil-piercing based not on torts, but on abuse of the corporate form as an exception to the principle of limited liability.[204] This had resulted in shareholders being held directly liable vis-à-vis the company's creditors[205] in situations where recourse under the statutory provisions protecting the maintenance of the GmbH's capital[206] was insufficient to fully compensate them.[207] Liability was imposed on shareholders where they openly or secretly depleted the company of assets that were needed to satisfy creditors.[208]

Based on the civil law understanding that courts do not establish but simply apply the law, German courts are not held to the principle of *stare decisis* and are therefore not bound by their previous rulings or those of other courts.[209] However, in the interests of legal certainty, it is understood that courts should not arbitrarily change past decisions and ought to explain their reasons when they do so. The cases regarding veil-piercing form no exception to this rule. The BGH explained that it considered its former rulings questionable from a doctrinal perspective because they had resulted in shareholders being held directly liable to creditors although no duties owed to creditors were breached. The duties that were breached were owed to the company and only resulted in losses to the company. The BGH considered it flawed to assume that any loss of corporate assets immediately affected the creditors.[210] Instead, the losses were of a purely reflective nature, and reflective losses generally did not give creditors any remedies.[211] The previous decisions created contradictory outcomes because "annihilating interference" (a concept explained immediately below) resulted in direct external liability of shareholders, whereas the statutory provisions for the

203. *Id.* ¶ 16.

204. *Id.* ¶ 22. The overruled principles were developed and applied in BGH II ZR 178/99, Sep. 17, 2001 (*Bremer Vulkan*), 2002 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 38; BGH II ZR 196/00, Feb. 25, 2002, 2002 NZG 520; BGH II ZR 300/00, Jun. 24, 2002 (*KBV*), 2002 NZG 914; BGH II ZR 206/02, Dec. 13, 2004 (*Autovertragshändler*), 2005 NZG 177; BGH II ZR 256/02, Dec. 13, 2004 (*Handelsvertreter*), 2005 NZG 214.

205. BGH *Trihotel*, 2007 NJW 2689 ¶ 17.

206. GmbHG, §§ 30 & 31.

207. BGH *Trihotel*, 2007 NJW 2689 ¶ 18.

208. *Id.* ¶ 21.

209. For an introduction to basic differences between court rulings in common and civil law countries, *see* Joseph Dainow, *The Civil Law and the Common Law: Some Points of Comparison,* 15 AM. J. COMP L. 419, 426–27 (1967); Ewould Hondius, *Precedent in East and West*, 23 PENN ST. INT'L L. REV. 521, 525 (2005) (with references to the Kingdom of Prussia, one of the legal predecessors of today's Germany). The situation has since changed as courts discuss their and other court's former rulings, but they are still not legally bound by them.

210. BGH *Trihotel*, 2007 NJW 2689 ¶ 23.

211. *Id.* ¶ 26.

maintenance of capital (§§30 and 31 GmbHG) only led to shareholders' internal liability.[212]

The Court emphasized that veil-piercing had to be applied cautiously because it could undermine the principle of limited liability. It was evidently worried that supporting widely-worded categories of veil piercing would create a mechanism that courts could use too lightly. It emphasized that the loss of the privilege of limited liability would threaten the very existence of the GmbH as a popular and useful type of business entity and thereby go against the intentions of the legislature. Thus, the court concluded that shareholders could not be liable for "abuse of the corporate form" as set out in its previous decisions.[213]

However, shareholders continued to be personally liable in cases of "annihilating interference," but no longer based on the considerations previously applied.[214] The Court held that "annihilating interference" was henceforth to be understood as tortious liability for improperly and self-servingly tampering with corporate assets. These corporate assets are subject to strict rules of capital maintenance in the interest of creditors. Tampering with these assets results in tortious liability when it causes or aggravates corporate insolvencies.[215] Damages are owed to the company alone and not to its creditors because their losses are of a purely reflective nature.[216] In practice, this means that administrators in insolvency proceedings enforce these claims on behalf of the company.[217] Outside of insolvency, creditors must obtain an enforceable title against the company and then request to be assigned the company's claims against its shareholders.[218]

To be held liable for "annihilating interference" under tort law, the shareholders' conduct must conform to the strict requirements of section 826 of the German Civil Code ("BGB") which provides: "A person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable

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212. *Id.* ¶ 32. In addition, the Court stated at paragraph 20 that the previous principles had proved difficult to apply for practitioners and lower courts alike.

213. *Id.* ¶ 27.

214. As explained above, "annihilating interference" is the loose translation chosen here for the German expression *existenzvernichtender Eingriff*. Other authors speak of "endangering the existence of the company", *see* ROTH & KINDLER, *supra* note 173, at 68, but the wording chosen here reflects the drastic language used by the courts in German.

215. BGH *Trihotel*, 2007 NJW 2689 ¶ 28.

216. *Id.* ¶ 17. The Court held at paragraphs 19 and 24 that liability for "annihilating interference" was still needed because a lacuna of legal consequences was left by the statutory provisions in cases where shareholders drain companies of their assets without crossing the line set out in sections 30 and 31 GmbHG, i.e. without touching the subscribed capital of the company. As the Court said at paragraph 25, corporate assets require protection even beyond the lines drawn by the capital requirements if this is necessary to meet the obligations owed to creditors. On this need for principles protecting the assets of the company below the threshold of subscribed capital, *see also* ROTH & KINDLER, *supra* note 173, at 68.

217. BGH *Trihotel*, 2007 NJW 2689 ¶ 34.

218. *Id.* ¶ 34 and confirming BGH II ZR 129/04, Oct. 24, 2005, 2006 NZG 64.

to the other person to make compensation for the damage."[219] This requires a shareholder to harm the company intentionally and in bad faith.[220] The provision's premise 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 not necessarily that he understands that the law holds his acts to be contrary to public policy, nor that he intends to harm the creditors. It suffices to know and accept that the company's ability to pay its obligations is permanently impaired as a result of his actions, a state of mind referred to as *dolus eventualis*.[221] As a result, a shareholder can, factually speaking, only be held liable when the risk of insolvency is very real and obvious to the shareholder.[222] Importantly, not only the shareholders of the disadvantaged company, but also the shareholders of a second company that itself holds shares in the company can be liable. The BGH has confirmed this rule where such shareholders in effect dominate the disadvantaged company. The supporting argument is that no shareholder should be allowed to hide behind formalities, i.e., the fact that he is not a shareholder himself is of no defense when effectively the harm done is the same as if he were.[223]

The GAMMA judgment of the BGH

The BGH confirmed these new principles shortly afterwards in its *GAMMA* ruling. This ruling of the BGH was preceded by the judgment of a state court of appeal that held the shareholders of a GmbH personally liable for using the company as a so-called "Cinderella company". The term is commonly used in German cases and legal writing for companies in which shareholders exercise their influence in ways that ultimately prove detrimental to creditors.[224] These shareholders had burdened the company that subsequently became insolvent with obligations originally owed by other companies in the same group although

219. BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], § 826, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p3497 (Ger.).

220. ROTH & KINDLER, *supra* note 173, at 68.

221. BGH *Trihotel*, 2007 NJW 2689 ¶ 30; BGH II ZR 292/07, Feb. 9, 2009 (*Sanitary*), 2009 NZG 545 (547).

222. *See* Lutter & Bayer, *supra* note 201, at Rdn 40.

223. BGH *Trihotel*, 2007 NJW 2689 ¶ 44 referring to BGH *Autovertragshändler*, 2005 NZG 177. From a comparative perspective there are similarities to some of the common law rules relating to directors in whom the power of management is usually vested. Where directors are aware or ought reasonably to be aware that their acts will cause the company to become insolvent, they owe duties to creditors of the company*, see Liquidators of Progen Engineering Pte Ltd. v. Progen Holdings Ltd.* [2010] SGCA 31, [2010] 4 Sing. L. Rep. 1089 [48]; *Chip Thye Enterprises Pte Ltd. v. Phay Gi Mo* [2003] SGHC 307, [2004] 1 Sing. L. Rep.(R.) 434; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722 (Court of Appeal)(NSW). In addition, persons who act as de facto directors are deemed to be directors even if they were never appointed to such office, *see Primlake Ltd v Matthews Associates* [2006] EWHC 1227 (Ch), [2007] 1 B.C.L.C. 666.

224. On the terminology, *see* BGH II ZR 264/06, Apr. 28, 2008 (*GAMMA*), 2008 NJW 2437 ¶ 13; Lorenz Fastrich, GMBHG § 13 Rdn 51 (Adolf Baumbach & Alfred Hueck eds., 21st ed. 2017).

it had been clear, as the court put it, that the subsequently insolvent company was inadequately capitalized in view of the obligations transferred to it. They also convinced a number of workers employed by other companies in the group to move to this subsequently insolvent company, a further fact that became relevant for the BGH's decision.

The BGH overruled the appellate court's judgment and reaffirmed its former ruling in *Trihotel* that shareholders whose actions endanger the company's existence cannot be held directly liable to creditors.[225] It went on to clarify further points. It emphasized that instances of mere undercapitalization in a material sense, i.e., instances that do not involve a breach of the principles of capital maintenance, do not meet the requirements of an "annihilating interference."[226] The BGH emphasized that such undercapitalization alone could not lead to shareholder liability and explicitly rejected academic writing to the contrary.[227] It emphasized that shareholders are responsible for providing the required legal capital of the GmbH, but are under no obligation to furnish it with the financial means necessary to meet all its legal obligations; such a duty would be incompatible with the company's nature as an entity of limited liability.[228] Shareholders are under no obligation to assess and provide adequate financing to the company. They are only required to abstain from depriving the company of its assets in any manner incompatible with the rules of capital maintenance.[229] Such acts can take place when they channel corporate assets to a sister company, themselves or other shareholders or parties related to shareholders.[230]

In the case at hand, the court held that an annihilating interference of the shareholders could not be based on their failure to adequately finance the company to enable it to pay off its debt. The company was formally fully capitalized as required by the law and the shareholders did nothing to deprive the creditors of their right of legal access to all of the company's assets when it was a going concern.[231] However, in an interesting twist, the court ultimately held the shareholders liable for compensation payable to the company's employees because they had failed to disclose the precarious financial situation when these employees agreed to move from their former employer to this company. The BGH based this liability also on section 826 of the BGB. As a result, the employees had a direct claim against the shareholders because of a tortious act committed against them, not against the company.

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225. BGH *GAMMA*, 2008 NJW 2437, overruling Oberlandesgericht [OLG] Düsseldorf [Düsseldorf Higher Regional Court] 6 U 248/05, Oct. 26, 2006, 2007 NZG 388, confirming BGH *Trihotel*, 2007 NJW 2689.

226. BGH *GAMMA*, 2008 NJW 2437 ¶ 13.

227. *Id.* ¶¶ 16–22.

228. *Id.* ¶ 23. The principle of limited liability follows from section 13(2) GmbHG.

229. BGH *GAMMA*, 2008 NJW 2437 ¶ 23.

230. Lutter & Bayer, *supra* note 201, at Rdn 35.

231. BGH *GAMMA*, 2008 NJW 2437 ¶ 12.

A direct claim against shareholders may therefore exist, but only when a tortious wrong was directly committed to the creditors of the company. This ruling in *GAMMA* is therefore in line with *Trihotel* because it does not contradict the latter's holding that purely reflective wrongs and losses cannot be claimed by creditors. Further judgments have since confirmed the holdings of *Trihotel* and *GAMMA*.[232] In one of them, the BGH ruled that it could amount to "annihilating interference" and hence shareholder liability (under section 826 of the BGB) to the company when a shareholder prevented the company from pursuing its legitimate claims against him.[233] Here again, the court confirmed that shareholders might be personally liable for their actions, but generally not to creditors of the company, but to the company itself.

Veil-piercing for commingling of corporate and private assets

Legal writing almost uniformly supports veil-piercing in cases where shareholders commingle the company's assets with their own. By doing so, shareholders disregard the company's separate legal identity in financial matters. In terms of the exact requirements that justify such an exception to the principle of limited liability, however, academic commentators have not been able to reach an agreement.

The BGH has repeatedly supported this category of corporate veil-piercing and helped to shape its contours. In a 2005 ruling, the BGH defined the requirements for personal liability resulting from comingling of corporate and personal assets in disregard of principles of capital maintenance. It held that payment transactions among the company, its shareholder(s) and third parties must lack transparency to the extent that it becomes impossible to attribute them to the company and that, consequently, the corporate assets become indistinguishable from the shareholder's personal assets.[234] It thereby confirmed previous judgments that had arrived at the same conclusions.[235] Any personal liability resulting from such conduct may only affect the shareholder(s) responsible for the situation, and no other shareholders who simply happen to be members of the company during the time when such commingling occurs. This type of veil piercing therefore most commonly applies to sole or majority shareholders.[236]

As a result, German courts pierced the veil in cases in which shareholders commingled corporate and private assets. Commingling presently represents the

232. BGH II ZR 252/10, Apr. 23, 2012 (*Wirtschafts-Akademie*), 2012 NZG 667.

233. *Sanitary*, 2009 NZG 545.

234. BGH II ZR 178/03, Nov. 14, 2005, 2006 NZG 350 ¶ 15. On these judgments, *see also* ROTH & KINDLER, *supra* note 173, at 67.

235. BGH II ZR 16/93, Apr. 13, 1994, 1994 NJW 1801; BGH II ZR 275/84, Sep. 16, 1985 (*Autokran*), 1986 NJW 188.

236. BGH Nov. 14, 2005, 2006 NZG 350 ¶ 17.

only situation in which German courts still rely on the principles of veil-piercing to hold shareholders directly liable to the creditors of a company. Notwithstanding the principle that civil law judges do not make law, veil-piercing in these commingling cases is a judge-made legal rule that fills a gap left by statutory law. Its doctrinal basis is abuse of the corporate form[237] that results in the loss of the privilege of limited liability and instead leads to the application of section 128 of the Commercial Code (*Handelsgesetzbuch*) that holds all general partners of commercial partnerships personally liable.[238] It is strictly separate from all other scenarios in which shareholders' actions result in losses for the company. These other cases are at present resolved by application of general principles of law, be it the statutory provisions of liability for tortious acts (as discussed above) or principles of contract law (as explained below). As emphasized repeatedly, such application of general principles of the law may result in shareholders' internal liability, i.e., damages owed to the company, not in any direct liability owed to the company's creditors.

To distinguish these two scenarios, i.e., veil piercing with consequential personal liability to the company's creditors on the one hand and breaches of the law resulting in shareholders' liability vis-à-vis the company on the other, the BGH emphasized that improper accounting is not a sufficient basis for veil-piercing. While it certainly amounts to a breach of the law which may therefore give rise to damages by the company against the directors, this does not justify an exception to the principle of limited liability.[239]

It should be added that embezzlement of corporate assets results in shareholder liability under sections 30 and 31 of the GmbHG, and may also amount to "annihilating interference" but is not a basis for veil-piercing under the commingling exemption.[240] As explained above, shareholders are liable for repayment to the company under sections 30 and 31 of the GmbHG when they receive payments when the company's legal capital is not intact. A transfer of assets outside a formalized distribution process such as distribution of dividends, capital reduction or share buybacks is subject to an arm's length test. If a diligent director would not have agreed to the conditions granted to the shareholder in a transaction with an unaffiliated third party, then the transaction with the shareholder is deemed a "hidden allotment of corporate assets" (*verdeckte Vermögenszuwendungen*) and constitutes a breach of the duty of good faith generally owed by shareholders to the company under German law. Such a

237. Called *Objektiver Rechtsmissbrauch*, *see* HUECK & WINDBICHLER, *supra* note 176, at §24 Rdn 30.

238. HANDELSGESETZBUCH [HGB] [COMMERCIAL CODE], § 128. The courts apply this section of the commercial code 'by analogy' when they pierce the corporate veil, *see* BGH Nov. 14, 2005, 2006 NZG 350 ¶ 10.

239. BGH Nov. 14, 2005, 2006 NZG 350 ¶ 15.

240. Fastrich, *supra* note 224, § 13 Rdn 45.

breach can result in claims by the company for restitution and damages.[241] In addition, the shareholders may also be liable for "annihilating interference" under section 826 of the BGB as discussed earlier.

It is not the element of intent that distinguishes commingling from these other situations that give rise to claims against shareholders because sections 30 and 31 of the GmbHG and "hidden allotment of corporate assets" do not require the company or creditors to experience any intentionally committed harm. For the remedy of restitution that results in the return of assets to the company, no subjective mental element is necessary. Only when the company additionally claims damages do these subjective elements such as knowledge play a role. Instead, commingling is an exceptional situation where the financial situation of the company is so muddled that applying the principles of depletion of assets and the consequential claims for their return to the company is of no use. The drastic situation that corporate assets are indistinguishable from shareholders' personal assets justifies the harsh consequence that the shareholders responsible for commingling are personally and directly liable to the company's creditors.

These principles of commingling have not been rendered obsolete by the (slightly later) decisions on personal liability to the company resulting from "annihilating interference." The BGH emphasized in its judgment of November 14, 2005 that the newly-contoured cases on liability for "annihilating interference" leave the principles of veil-piercing under the commingling exception intact,[242] although this statement was made at a time when the BGH still recognized that a shareholder's direct liability could result from such "annihilating interference." Such direct liability has since been ruled out. Regardless of this immense swing in doctrinal analysis, the BGH clarified in *Trihotel* that the principles applied in situations of commingling remain applicable.[243]

A different type of commingling must be distinguished from the one just discussed. Under the term *Sphärenvermischung*, academic commentators have discussed whether a shareholder should be held personally liable when he commingles his own affairs with those of the company, i.e., commingles the two separate spheres. Such an issue occurs when the shareholder conceals from third parties that the company and himself are different legal persons, e.g., by using similar names, the same premises and employees. In an old case, where the sole shareholder-director of a GmbH negotiated with creditors and did so as a director of the company in some instances and as a private person in others, the BGH

241. CHRISTIAN HOFMANN, DER MINDERHEITSSCHUTZ IM GESELLSCHAFTSRECHT 315–17 (2011) (on the principles of "hidden allotment of corporate assets"); *id.* at 25–67 (providing a comparative analysis of the principle of good faith in German company law and the role of fiduciary duty in US company law). On good faith in German company law, *see also* BGH II ZR 205/94, Mar. 20, 1995 (*Girmes*), 1995 NJW 1739.

242. BGH Nov. 14, 2005, 2006 NZG 350 ¶ 14.

243. BGH *Trihotel*, 2007 NJW 2689 ¶ 27.

held this shareholder personally liable and applied the principle of good faith in section 242 of the BGB. The court reasoned that the shareholder had acted as one and the same person in all instances, which justified not distinguishing between his position as a legal representative of the company and an independent sole proprietor, so as to hold him personally liable for all obligations under the legal relationship with the third party.[244]

The case has remained an outlier, and the BGH abstained from using any terminology that is commonly related to veil piercing. Instead, it relied on the principle of good faith, which supports the argument that it was not a case of veil-piercing. The BGH disapproved in more general terms of the shareholder's conduct and relied on the general principle of good faith to reach a result that seemed fair in the circumstances.[245] These findings blend in with some of the earlier suggestions made in the discussion of the US position. At common law, it may on occasion be more fruitful to rely on concepts such as estoppel or misrepresentation rather than veil piercing.

Further scenarios that may be regarded as veil-piercing in other jurisdictions

The above discussion reflects the cases decided by German courts. As demonstrated, veil-piercing in Germany only applies in one scenario, the commingling of assets, while the courts analyzed a number of other situations on the basis of tort law, the principles of good faith, or by relying on provisions in the GmbHG. However, what about all other scenarios well-known from case law in the common law jurisdictions? American, English and Singaporean case law covers a wider range of situations, and the question arises of how German law would deal with them.

The answer reads: all other instances in which third parties have rights against shareholders are not considered exceptions to the principle of limited liability. Instead, the principles of the law of obligations as well as teleological interpretations of statutory provisions and widely-understood contractual terms apply and protect third party interests. In all these instances, the shareholder is held liable for what he did or promised to the third party, but not because of his role in the company. The role of the company in such scenarios is that of a silent bystander.

The following provides a few illustrative examples. If a company is used as a scheme to trick third parties into contracting because they would never contract

244. BGH VII ZR 9/57, Jan. 8, 1958, 1958 WERTPAPIER-MITTEILUNGEN: ZEITSCHRIFT FÜR WIRTSCHAFTS- UND BANKRECHT [WM] 463 ¶ 22.

245. Commentators that are generally supportive of veil-piercing categorize this case as one of commingling of spheres, *see* Lutter & Bayer, *supra* note 201, at ¶ 24, while others who are less supportive of this doctrine do not include it in the list of decisions dealing with veil-piercing, *see* Fastrich, *supra* note 224, § 13 Rdn 46.

with the shareholders of the company, e.g., because they are convicted bankrupts or fraudsters, German law applies general principles of private law to free the third parties from any obligations they entered into. It may also grant them damages against the shareholders, not because the corporate veil was pierced, but because of a wrong they directly committed to such third parties.

The fact that the shareholders incorporated and used the company as part of their fraudulent scheme represents the very wrong for which they are held liable. Section 123 BGB[246] entitles third parties to avoid the contract, rendering it void *ab initio*. The other party to the contract is the company and not the shareholder, but in cases when the shareholder commits deceit, the company must accept that the deceived party can avoid its declaration of consent to the contractual agreement if the company knew or should have known of the deceit. Since in such scenarios the fraudster shareholders are inevitably also the directors of the company, their knowledge is attributed to the company based on section 166 BGB. The knowledge of the directors is the knowledge of the company, and their mistakes are the mistakes of the company.[247] In addition, the shareholders are liable to the deceived parties under tortious principles, particularly in the application of sections 826 and 823(2) BGB read with section 263 StGB, the provision of the Criminal Code that sanctions fraud. In addition, a shareholder may be liable if he breaches duties of care and diligence in his role as the legal representative of the company and as part of a fraudulent scheme. Such liability requires that the shareholder enjoys a high degree of trust from the deceived party and substantially influences the pre-contractual negotiations between that party and the company.[248] Under these preconditions, a so-called "legal relationship without primary obligations" exists between the shareholder and the third party and may lead to the shareholder's liability for breaches of the duties of care and diligence under sections 311(2), 241(2), 280(1) BGB.[249]

A second example involves a shareholder who is bound by a non-competition clause with his former employer that states that the employee is prevented from

246. BGB, § 123 reads:

(1) A person who has been induced to make a declaration of intent by deceit or unlawfully by duress may avoid his declaration.

(2) If a third party committed this deceit, a declaration that had to be made to another may be avoided only if the latter knew of the deceit or ought to have known it. If a person other than the person to whom the declaration was to be made acquired a right as a direct result of the declaration, the declaration made to him may be avoided if he knew or ought to have known of the deceit.

247. On these generally accepted principles of attribution, *see* Wolfgang Zöllner & Ulrich Noack, GMBHG § 35 Rdn 146 (Adolf Baumbach & Alfred Hueck eds. 20th ed. 2013); HUECK & WINDBICHLER, *supra* note 176, § 9 Rdn 3.

248. These are requirements under the BGB: BGB, § 311 para. 3.

249. Such legal relationships are very common in German law and have no direct equivalent in French or common law. In the context of this article, they result from the situation where a third party involved in contractual negotiations dominates the negotiations or enjoys a high level of trust by the parties, a situation typical of agents and organs of a company.

running a business in the same district where the employer is based. In order to avoid liability under the clause, he incorporates a company which becomes the owner of a business that competes with the shareholder's former employer.[250] German courts or scholars would never consider this a case of veil-piercing. If a party to a contract is held to a valid non-competition clause,[251] this party is prevented from engaging in any activity that falls under the respective clause. Sections 133 and 157 BGB require contracts to be interpreted as required by good faith, taking customary practice into consideration, and to ascertain the true intention rather than adhering to the literal meaning of the declaration. The courts have always applied an objective test that interprets declarations of parties to a contract in the way that a prudent third person would have understood it.[252]

These principles of interpretation would lead to the understanding of the non-competition clause in a broad way. The prudent third party would have understood that the former employer can operate free from any disadvantage that might result from the former employee using his professional knowledge and experience in the employer's district, be it by running his own business, i.e., as a sole proprietor, or by forming any type of business entity that engages in such a business and which the former employee supports with his expertise. The scenario of a company whose director-shareholder the former employee becomes would clearly be covered by the non-competition clause, and since the employee himself is found in breach of his contractual agreement with the former employer, the employer could successfully seek a prohibitory injunction under sections 823(1) and 1004(1) BGB. The same would apply if the former employee only had a contract of employment with another company that placed him in a position of some materiality, such as being a director or having some other management position. On the other hand, there would be no breach if the shareholder was merely a passive investor in a business, even if that business was in competition with his former employer.

These two examples show that the principles of veil-piercing are not needed in Germany to deal with scenarios in which a shareholder tries to hide behind the principle of limited liability and which are commonly discussed as veil-piercing cases in other jurisdictions. It has been shown that the courts disregard the principle of limited liability and allow creditors of the company to pursue claims directly against shareholders in one narrow situation only: when shareholders commingle the company's assets with their own. The climate in Germany is increasingly becoming hostile against any attempts to pierce the corporate veil.

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250. As in *Gilford* [1933] Ch 935 where the corporate veil was pierced.

251. Such clauses are sometimes considered invalid as contrary to public policy when they disproportionately limit a person's occupational freedom as guaranteed by the constitution: BGB, § 138 paras. 1–2; GRUNDGESETZ [GG] [BASIC LAW], art. 12 para. 1, *translation at* https://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0071.

252. Sections 133 and 157 BGB as generally interpreted by the courts, *see e.g.*, BGH X ZR 37/12, Oct. 16, 2012, 2013 NJW 598 (599 at ¶ 17).

Many commentators argue that the concept should be abandoned altogether,[253] and the BGH's change of heart in the "annihilating interference" cases shows that it might well be moving in that direction.[254]

As explained, German company law relies heavily on principles of initial capitalization and strict capital maintenance rules. It follows that the question whether the principle of limited liability should be disregarded in instances where shareholders adhere to capital maintenance rules but seek to take advantage of the corporate veil in other ways should be answered in the negative. Not corporate law, but general principles of the law as found in tort law and the law of obligations stand ready to deal with these situations. Consequently, it is submitted here that even in the situation involving commingled assets the Court could apply principles of tort law and hold the shareholders liable when they overstep the line drawn by section 826 BGB. It is not evident why the law should look less favorably at a shareholder who may be disorganized or unsophisticated and has therefore indistinguishably commingled his and the company's assets than another who systemically strips the company of its assets.

People's Republic of China

As mentioned earlier, China (unusually) has a specific legislative provision that provides an exception to separate personality and limited liability. Article 20 of the 2005 Company Law,[255] after restating the general principle that the shareholders of a company should not abuse shareholders' rights, the company's legal person status, or shareholders' limited liability, provides in the third paragraph:

> "Any of the shareholders of a company who abuses the independent legal person status of the company and the limited liability of the shareholders to evade the payment of the company's debts, thus seriously damaging the interests of the company's creditors, shall bear joint liabilities for the debts of the company."[256]

Article 20 establishes a four-pronged legal test, or a standard comprising four elements, for judicial application of the doctrine.[257] First, it must be proven that

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253. *See e.g.,* Fastrich, *supra* note 224, § 13 Rdn 44.

254. Lord Neuberger of the UK Supreme Court was sympathetic to such a view, *see Prest* [2013] 3 WLR 1 [79].

255. There was a revision to the legislation in 2013. All references to China's Company Law are to the 2013 revised legislation unless otherwise stated.

256. Hui Huang, *Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading?*, 60 AM. J. COMP. L. 743, 744 (2012) (describing this as "a bold move" to codify "a common law doctrine renowned for its complexity and amorphousness.").

257. The standard has been articulated in different ways by judges of China's Supreme People's Court in their scholarly writing. *See* Judges XI XIAOMING （奚晓明）and JIN JIANFENG（金剑锋）, GONGSI SUSONG DE LILUN YU SHIWU WENTI YANJIU 公司诉讼的理论与实务问题研究 (CORPORATE LITIGATION: THEORIES AND PRACTICES) [Beijing: People's Court Press, 2008], pp. 562-564; Judge JIANG BIXIN (江必新) et al, ZUIGAO RENMIN FAYUAN ZHIDAOXING ANLI CAIPAN GUIZE LIJIE YU SHIYONG (GONGSI JUAN) 最高人民法院指导性案例裁判规则理解与适用（公司卷）[THE UNDERSTANDING AND APPLICATION OF JUDGING RULES IN

the shareholder concerned has abused the company's legal person status and the shareholder's limited liability. The abuse of the company's legal personality and that of shareholder limited liability are not separate acts, but rather understood as two sides of the same coin.[258]

Second, the purpose of the aforesaid abuse must be to "evade" the payment of debts to the company's creditors. This has been interpreted by some judges of China's Supreme People's Court ("SPC") as the use of corporate personality to "avoid" contractual or legal obligations.[259] Another SPC judge, Yu Zhengping, maintained that the wording of Article 20 "undoubtedly requires the existence of a subjective intent" to evade debts.[260]

Third, the interests of the creditors must be damaged "seriously" (*yanzhong*). Needless to say, Company Law does not define "seriously," and courts will interpret its meaning on a case by case basis. Zhou suggests that the court should consider three factors when determining whether the damage is serious enough to activate veil piercing: (1) the actual damage to the creditors; (2) the debt-paying ability of the company; and (3) the subjective intent of the shareholder concerned.[261]

Fourth, there must be a causal link between the shareholder's abusive behavior and the damage/losses suffered by the creditors.[262]

Since 2006, when the new Company Law took effect, Chinese courts have decided hundreds of veil piercing cases, and researchers within and outside China are producing a growing body of academic literature.[263] Thus far, the

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GUIDANCE CASES OF THE SUPREME PEOPLE'S COURT (VOLUME OF CORPORATION LAW), Beijing: China Legal Publishing House (2012), p. 87.

258. Liu Junhai (刘俊海), Xiandai Gongsifa (现代公司法) [MODERN CORPORATIONS LAW] 665 (2015).

259. *See* Li Guoguang (李国光) & Wang Chuang (王闯), Shenli Gongsi Susong Anjian de Ruogan Wenti – Guanche Shishi Xiudinghou Gongsifa de Sifa Sikao (审理公司诉讼案件的若干问题 – 贯彻实施修订后公司法的司法思考) [*Several Questions on Corporate Litigation: Judicial Thoughts on Implementing the Revised Company Law*] reprinted in Zuigao Renmin Fayuan Sifa Guandian Jicheng (最高人民法院司法观点集成) [THE COLLECTION OF THE SUPREME PEOPLE'S COURTS' JUDICIAL VIEWS] 286 (2005).

260. Yu Zhengping (虞政平), Zhongguo Gongsifa Anli Jingdu (中国公司法案例精读) [RESEARCH INTERPRETATIONS ON SELECTED CHINESE CORPORATE LAW CASES] 146 (2016).

261. Zhou Yousu (周友苏), Xin Gongsi Fa Lun (新公司法论) [NEW SURVEY ON CORPORATIONS LAW] 105 (2006).

262. *See* Xi and Jin, *supra* note 257, at 564; Jiang, *supra* note 257, at 87.

263. *See e.g.,* Mark Wu, *Piercing China's Corporate Veil: Open Questions from the New Company Law*, 117 YALE L.J. 329 (2007); Ge Weijun (葛伟军), Lun Zuidi Ziben yu Jiekai Gongsi Miansha (论最低资本与揭开公司面纱) [*On Minimum Registered Capital and Piercing Corporate Veil*], 13 上海财经大学学报（哲学社会科学版）[JOURNAL OF SHANGHAI UNIVERSITY OF FINANCE AND ECONOMICS] 34 (2011); Huang, *supra* note 256; Shuangge Wen, *The Ideals and Reality of a Legal Transplant – The Veil Piercing Doctrine in China*, 50 STAN. J. INT'L L. 319 (2014); Kimberly Bin Yu & Richard Krever, *The High Frequency of Veil Piercing in China*, 23 ASIA-PAC. L. REV. 63 (2015); Colin Hawes et al, *Lifting the Corporate Veil in China: Statutory Vagueness, Shareholder Ignorance and Case Precedents in a Civil Law System*, 15 J. CORP. L. STUD. 341 (2015); and Hu Gairong (胡改蓉), Ziben Xianzhu Buzu Qingxingxia Gongsifa Renge Fouren Zhidu de Shiyong (资本显著不足情形下公司法人格否认制度的

literature, including both empirical studies and doctrinal analyses, seems to overwhelmingly suggest that Chinese courts have been enthusiastic in piercing the corporate veil, or, at least, "Chinese judges are clearly much more willing to pierce a company veil and shift liability to its owners on the basis of statutory authority than their common law counterparts relying on judicial doctrines."[264] The literature also suggests that Chinese courts practiced "judicial activism" in veil piercing cases.[265]

The evolution of the veil piercing doctrine in China

To fully understand veil piercing in Chinese law, it is necessary to appreciate the position prior to the 2005 Company Law, as veil piercing was not officially recognized in Chinese law prior to this. There was, however, a loosely crafted legal framework to allow veil piercing under limited circumstances. This ambiguous and confusing framework was established through "judicial practice," or *sifa shijian*, which refers to the practice of the judiciary to develop jurisprudence and legal doctrines, mainly through the SPC's issuance of judicial interpretations and selected case reports, as well as the legal enactments of the State Council, China's Central Government.[266] It has been stated: "[a]lthough the 1993 Company Law did not include veil-piercing doctrine, the Chinese judiciary cautiously applied it even without a clear statutory basis before its codification in 2005."[267]

The introduction of the veil piercing doctrine started with a regulation issued by the State Council on 12 December 1990, titled Guanyu Qingli Zhengdun Gongsi zhong Bei Chebing Gongsi Zhaiquan Zhaiwu Qingli Wenti de Tongzhi (*Circular on Questions relating to the Claims and Debts of Companies Dissolved or Merged with Others in the Campaign for Sorting Out and Consolidating Companies*) [关于清理整顿公司中被撤并公司债权债务清理问题的通知]. Some people believe that the 1990 Circular is the first law to offer an exception to the doctrine of limited liability, which was well established in China through various regulations but not codified yet into a national company law. It provided that investors or incorporators of the company should directly assume the debts of the company but that such liability was limited to the extent that the

适用) [*Disregarding Corporate Personality in Cases of Undercapitalization*], Faxue Pinglun (法学评论) [LAW REVIEW] 163 (2015).

264. Yu & Krever, *supra* note 263, at 81.

265. Hawes et al, *supra* note 263, at 363–68.

266. On the roles and functions of the various legal institutions in China (including their legislative functions), *see generally* Jiangyu Wang, *Legal Reform in an Emerging Socialist Market Economy*, in LAW AND LEGAL INSTITUTIONS OF ASIA: TRADITIONS, ADAPTATIONS, AND INNOVATIONS 24–61 (E. Ann Black & Gary F. Bell eds. 2011).

267. WANG, *supra* note 66, at 80.

investors/incorporators benefited from the company's operations or misappropriated the company's assets.[268]

The first judicial interpretation on veil piercing by the SPC is believed to have taken place in 1994 in a reply to a question submitted by the Higher People's Court of Guangdong Province (Zuigao Renmin Fayuan Guanyu Qiye Kaiban de Qiye bei Chexiao huo Xieye hou Minshi Zeren Chengdan Wenti de Pifu (最高人民法院关于企业开办的企业被撤销或歇业后民事责任承担问题的批复) [Reply of the Supreme People's Court on the Civil Liability of Enterprises Whose Subsidiaries were Revoked or Shut Down]). This judicial interpretation made an effort to strengthen the traditional mandate of limited liability, as it first required the investing enterprise to undertake civil liability to the extent of the unpaid capital contributions in the subsidiary's registered capital, and "if no capital was actually contributed to the terminated company, or the amount was not sufficient according to the law, then the company will be determined not to be a legal person and its full civil liability will be assumed by the enterprise that established the company."[269]

The SPC issued two judicial interpretations in 2001 and 2003 to further develop the piercing doctrine. The 2001 judicial interpretation, captioned Guanyu Shenli Jundui, Wujing Budui, Zhengfa Jiguan Yijiao, Chexiao Qiye he yu Dangzheng Jiguan Tuogou Qiye Xiangguan Jiufen Anjian Ruogan Wenti de Guiding (关于审理军队、武警部队、政法机关移交、撤销企业和与党政机关脱钩企业相关纠纷案件若干问题的规定) [*Provisions of the Supreme People's Court on Several Issues on the Trial of Cases concerning Enterprises transferred by the Army, Armed Police Force and Judicial Bodies, Enterprises Whose Licenses have been Revoked, and Enterprises Which Have been Disconnected from Party and Government Agencies*], mainly addressed legal issues relating to business enterprises owned by the army, armed police force, and judicial bodies, and provided that a shareholder/investor was no longer liable if it made its legal or contractual obligations with respect to capital contributions. It is important to note that this interpretation was aimed to clarify a confusion caused by the 1994 Reply which had encouraged many lower courts to impose unlimited liability improperly on shareholders.[270]

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268. See Jin Jianfeng (金剑锋), Gongsi Faren Fouren Lilun Jiqi zai Woguo de Shijian (公司法人否认理论及其在我国的实践) [*The Doctrine of Disregarding Corporate Personality and Its Adoption in China*], 2005 Zhongguo Faxue (中国法学) [CHINA LEGAL SCIENCE] 117–25 (2005).

269. David M. Albert, *Addressing Abuse of the Corporate Entity in the People's Republic of China: New Thoughts on China's Need for a Defined Veil Piercing Doctrine*, 23 U. PA. J. INT'L ECON. L. 873, 883 (2002). A historical analogy may be drawn with the pre-incorporation joint stock companies that were not legal entities but partnerships and therefore the "shareholders" were ultimately liable for any shortfall in the assets of the joint stock company. Given that Chinese law did recognize the doctrine of limited liability, this is a somewhat strange judicial interpretation.

270. *See* Jin, *supra* note 268, at 123 (noting that, after the 1994 Reply, some courts asked the investing shareholders to repeated "making up for the differences" in their capital contribution because of the lack of a definition about capital in the 1994 Reply).

The 2003 judicial interpretation, titled Guanyu Shenli yu Qiye Gaizhi Xiangguan de Minshi Jiufen Anjian Ruogan Wenti de Guiding (关于审理与企业改制相关的民事纠纷案件若干问题的规定) [*Provisions of the Supreme People's Court on Several Issues concerning the Trial of Cases of Civil Disputes Related to Enterprise Restructuring*], offered a relatively more precise legal test for veil piercing in the context of a merger and acquisition transaction. Article 35 provided that the holding or parent enterprise shall be responsible for the debts of the subsidiary where the subsidiary's inability to pay off its debts was caused by the holding enterprise's own acts to withdraw capital from the subsidiary to evade its debts, if the holding enterprise achieved its controlling stake through a merger and acquisition.[271]

The veil piercing rule eventually codified into the 2005 Company Law was certainly built upon the aforesaid judicial interpretations, but it differs from the SPC's interpretations in at least two ways. First, the consequence for the court's application of the veil piercing rule merely means that the effects of corporate personality are not applicable to the extent determined judicially. The shareholders concerned will be held liable for the debts in the case in question, but the company will still be a going concern and keep its legal personality with limited liability. In contrast, the judicial interpretations issued before 2005 aimed to hold the shareholders and investors liable in the course of a company's liquidation, which would lead to the company's termination. The rationale was that the business license was issued by the national or local Administration for Industry and Commerce and hence an administrative act. While the court would normally respect such acts, the court is not bound by it if it discovers that the conditions provided for in the national laws or administrative regulations were not met. In comparison, under Article 20 of the Company Law the court orders veil piercing as an isolated case to ask the shareholder to bear joint and several liability for the debts owned by the company to the creditor(s) who brought the veil piercing lawsuit. It requests the responsible shareholders to pay for company debts but will not terminate the company by any means.

Second, prior to the Company Law, the extent of the liability of the shareholders or investors was confined to their unpaid capital contributions to, or undeserved benefits received from, the company; in other words, liability was confined to what was due to the company or benefits improperly obtained from the company. For example, an investor or shareholder would be responsible for the debts of the company to the extent it received money or other assets, without proper consideration, from the company. Likewise, it was responsible to the extent of the money and assets it had illegally withdrawn from or transferred out of the company or hidden from outsiders.[272] Such liability to make compensation

271. Wang, *supra* note 66, at 80.
272. Jin, *supra note* 268, at 124.

was fault-based. However, in the case of veil piercing under the Company Law, fault is not necessarily an element for applying Article 20.[273]

The broader historical background of the above-mentioned judicial interpretations is also of notable importance. As clearly suggested by the stated purpose and explicit language in those judicial rules, the rudimentary veil piercing framework then was largely developed to address the abuse of power by shareholders or investors, especially state investors, in the subsidiaries established by them.[274] The intention of the SPC was to strike a balance between the rights of shareholders and creditors. As noted, the application of the judicial interpretations would lead to the termination of the subsidiary enterprises concerned. In this process, they would hold accountable not only the shareholders or investors, but also government agencies which approved the establishment of the enterprises.[275] This is further indication that the main targets of the judicial interpretations were abusive state-owned enterprises. On the other hand, the veil piercing doctrine seems thus far to have been rarely invoked against state owned enterprises since it was adopted in the 2005 Company Law.

Grounds for veil piercing in judicial practice

While Article 20 of the Company Law sets out a general principle, scholarly writing has suggested the following circumstances that are capable of giving rise to sufficient abuse to warrant veil piercing.[276]

The first is undercapitalization, where either the shareholder did not make adequate contributions to the company's registered capital or that such capital, including corporate cash and assets, was improperly withdrawn from the company by the shareholder. The second is where the company has been used as a device to evade contractual obligations. This occurs when the shareholder, who has to refrain from doing something under a non-competition agreement or

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273. Fault or even negligence is especially not considered in veil piercing cases concerning comingling of assets of corporate affairs. *See* Jiang Bixin et al, *supra* note 257. In a veil piercing case adopted by the PRC Supreme Court as a Guiding Case with binding force on lower courts, it was ruled by the Jiangsu High People's Court veil piercing should be ordered simply because the three defendants had commingled personalities in terms of "commingled personnel", "commingled business" and "commingled finances". *See* Xugong Jituan Gongcheng Jixie Gufen Youxian Gongsi Su Chengdu Chanjiao Gongmao Youxian Zeren Gongsi Deng Maimai Hetong Jiufen An (徐工集团工程机械股份有限公司诉成都川交工贸有限责任公司等买卖合同纠纷案) [XCMG Construction Machinery Co, Ltd. v. Chengdu Chuanjiao Industry and Trade Co., Ltd. et al., A Sale and Purchase Contract Dispute], (2011), adopted as the Supreme People's Court Guiding Case No. 15 on 31 January 2013, available at http://www.court.gov.cn/fabu-xiangqing-13321.html. English information about this case is available at Stanford Law School's China Guiding Case Project at https://cgc.law.stanford.edu/guiding-cases/guiding-case-15/.

274. *See generally* Wen, *supra* note 263.

275. Jin, *supra* note 268, at 124.

276. Wang, *supra* note 66, at 81–82; *See also* Liu, *supra* note 258, at 668–71; Xi and Jin, *supra* note 257, at 560–62.

confidentiality agreement, incorporates a company to evade his obligations.[277] Another example is when a shareholder uses the company to defraud creditors. A third situation arises in circumstances where the company is a device to evade statutory restrictions and involves illegal activities such as tax evasion or money laundering. Finally, it has been suggested that veil piercing can take place where there has been a lack of formality or confusion of affairs. In such cases, the shareholder himself disregards the separate legal personality of the company and makes the company an alter ego of the shareholder. This could include the control of the company so that the decision-making of the company is entirely dominated by the shareholder, or there is confusion or intermingling of the assets, business, affairs, and even management personnel of the company and the shareholder. It is clear that these instances where veil piercing may take place have parallels in other jurisdictions discussed previously.

Although it would appear that there are many instances of veil piercing in China, the exceptional nature of the doctrine has also been articulated. For example, two former prominent judges of the SPC have noted:[278]

> The fact that the doctrine of piercing corporate veil only serves to complement [the principle of separate legal personality of the company law] determines that the application of the doctrine must be exceptional . . . . Our country's Company Law has to establish the system of corporate veil piercing because of practical needs. However, it must be emphasized that the courts must be firmly cautious when applying this system and always be mindful of any abuse of it. Cautious application of the doctrine means, whenever a problem can be solved by the normal rules in the civil law, the piercing corporate veil rule must be avoided so as to protect the principles of independent legal personality and limited liability of modern corporate law. The application of the veil piercing doctrine must be the last resort, not a regular tool for the court.

This cautionary statement should be contrasted with the sometimes made assumption that undercapitalization is the most important ground for piercing in China.[279] Xi and Jin, on the other hand, express that undercapitalization should not be the only reason to pierce the corporate veil, stating that "only in the case where the company's capital was extremely inadequate should the court disregard corporate personality on the ground of undercapitalization."[280] One empirical study has found that undercapitalization was the least important reason for veil piercing. Huang examined court decisions in a five-year period from 2006 to 2010 and found ninety-nine cases on veil piercing. Chinese courts ordered piercing in sixty-three cases, leading to a high frequency of 63.64%.[281] It was further found, of the 118 requested grounds for veil piercing, seventy-four

277. This seems similar to the cases in England on evasion, see *Gilford* [1933] Ch 935.

278. *See* Xi & Jin, *supra* note 257, at 559. Again there are parallels with judicial statements elsewhere.

279. For example, *see* Liu, *supra* note 258, at 667–670.

280. Xi & Jin, *supra* note 257, at 560.

281. Huang, *supra* note 256, at 748–49.

involved commingling or confusion of assets, business or personnel; thirty-two concerned fraud or other improper conduct; eleven were about undue control; while only one case was based on undercapitalization. Even in that single case, the court rejected the request and refused to lift the veil on the ground of undercapitalization.[282]

The case of *China Orient Asset Management Co Ltd v. The Xi'an High-Tech Area Branch of China Construction Bank*[283] may illuminate the approach towards the ground of undercapitalization. In this case, China Construction Bank made a loan to a company named Jinling Co. Jinling, however, failed to repay the China Construction Bank. The debt was eventually transferred by the bank to the plaintiff, China Orient Asset Management Co Ltd. (COAMC). COAMC brought a lawsuit against several shareholders of Jinling, asking them to be jointly liable for the debt, because four of the shareholders made false capital contributions and one shareholder withdrew RMB2 million from Jinling. At first instance, the Xi'an Intermediate People's Court upheld the plaintiff's allegation. It said:[284]

> According to paragraph 3 of Article 20 of the Company Law of the People's Republic of China, shareholders of a company who have abused the company's independent legal person status and shareholders' limited liability, evade the payment of the company's debt so as to harm the interests of the company's creditors, should be jointly liable for the company's debt. On this basis, the request of COAMC to ask the shareholders to be jointly liable to the extent of their false capital contributions should be upheld.

However, the appellate court – in this case the Shan'xi Higher People's Court, disagreed with such legal reasoning. The appellate court ruled that the application of the veil piercing doctrine was wrong. On this point, the Higher Court opined:[285]

> Undercapitalization as a ground for piercing the corporate veil does not mean that a court can simply make such determination by comparing the company's existing capital to the minimum registered legal capital prescribed in the Company Law. Instead, it means the company's actual capital is excessively lower than the risks that are generated by the business nature of the company. Thus, in this case, the court cannot apply the piercing corporate veil rule simply on the grounds that the shareholders had made false capital contribution or withdrawn capital from the company.

In the end, the appellate court still ordered the shareholders to compensate the plaintiff for the same amounts, but it was fashioned on a different legal basis,

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282. *Id.* at 760–61.

283. Zhongguo Dongfang Zichan Guanli Gongsi Xi'an Banshichu Deng yu Zhongguo Jianshe Yinhang Gufen Youxian Gongsi Xi'an Gaoxin Jishu Chanye Kaifaqu Zhihang Jiekuan Jiufen Zaishen'an (中国东方资产管理公司西安办事处等与中国建设银行股份有限公司西安高新技术产业开发区支行借款纠纷再审案) [Retrial of Loan Dispute between China Orient Asset Management Co Ltd et al and the Xi'an High-Tech Area Branch of China Construction Bank], （2010）Shan Min Zai Zi Di 00013 Hao,Shaan'xi Higher People's Ct. Apr. 7, 2011, *available at* www.pkulaw.cn.

284. *Id.*

285. *Id.*

namely that the shareholders were held to have the liability of *buchong peichang*, or complementary liability.[286]

The difference between the Chinese and German positions is notable. At one time, both countries adopted a similar approach.[287] However, as discussed above, Germany now no longer considers undercapitalization that does not involve a breach of the capital maintenance requirements as capable of leading to shareholder liability to third party creditors. The BGH considers such an approach to be inconsistent with limited liability. Interestingly, both the aforementioned first instance and appellate courts in China ordered the shareholders to compensate COAMC to the extent of the false capital contributions and wrongful withdrawal of capital. It is suggested respectfully that care should be exercised in fashioning such a remedy, as the court must be reasonably satisfied that there are no other creditors of the company which appeared to be effectively insolvent. Payment by the shareholders of the capital they should have injected or not withdrawn ought to be a complete discharge of their obligations which would leave other creditors of the company without a remedy. This seems particularly unfair if the capital should have belonged to the company in the first place and therefore distributed to creditors on a *pari passu* basis. The application of a 'proper plaintiff' rule in this context seems apposite.

Based on the opinion of the Shan'xi High People's Court, veil piercing based on undercapitalization in China need not be limited to the statutory minimum required by law. Where payment is ordered to be made directly to some creditors where there are other possible creditors, the risk is that, from a practical standpoint, the latter may not be able to recover meaningfully if the shareholders' assets are depleted from earlier judgments. It places well-resourced and better-informed creditors in a superior position. This note of caution applies not only to China. Where undercapitalization gives rise to a remedy and has also led to insolvency, it may be more optimal to explore means to facilitate a corporate claim—the success of which will benefit the creditors collectively —rather than to allow veil piercing actions by individual creditors.

Leaving aside undercapitalization, the other three grounds of commingling, undue control, and fraud or other improper conduct, mentioned by Huang as grounds for veil piercing, are matters that would support veil piercing in some other jurisdictions as well. It would appear, nevertheless, that a success rate of 63.64% of veil piercing cases over a five-year study period seems significantly

286. Wen, *supra* note 263, at 344 states that under Article 23(2) of the Company Law, a required precondition of incorporation is having capital contributions of shareholders reach the statutory minimum amount of capital. If shareholder's capital contributions fail to meet the minimum legal threshold, the company will never be duly incorporated and thus will not have separate personality in the first place. Such cases should not be regarded as veil piercing cases but some courts have mistakenly relied on Article 20.

287. Alting, *supra* note 79, at 210.

higher than that found in major common law jurisdictions.[288] Another survey of published cases from 2006 to the end of 2012 found that the court lifted the veil in 75.27% of cases.[289] Yet Huang rightly states that caution should be exercised in drawing conclusions, as the numbers may be affected by several contextual factors such as the stage of economic development and the number of firms in each jurisdiction.[290] Some indication of the former may be seen by the fact that a substantial percentage of piercing cases were brought in economically less developed regions of China, and cases from such regions were more likely to have high rates of veil piercing. Abuse of the corporate form is possibly more prevalent in economically less developed regions due to lesser knowledge of corporate law and thus a higher level of corporate irregularities.[291] If Huang's finding is true, it also raises the question of whether judges in such regions have the same appreciation of corporate law as their brethren in more economically sophisticated regions do.[292]

One reason for the higher rate of piercing in China may be that judges in some cases have been overly enthusiastic in their approach towards veil piercing. This can be seen by analyzing some of the commingling cases which constitute the largest number of cases brought and where veil piercing occurred.[293] Commingling has certain aspects and is distinguished from misappropriation. Where shareholders (or the corporate parent) do not properly distinguish between corporate assets and their assets, it raises the issue of whether the shareholders treated the corporation as a mere extension of themselves. By not recognizing the integrity of the corporate entity as a matter of fact, the court may infer that the real parties to the apparent corporate transactions were the shareholders and not the corporation itself. Using the language of Lord Sumption in *Prest v. Petrodel*,[294] the shareholders were merely concealing their true involvement. Another aspect of commingling is that the financial affairs of the company and that of another person, usually a shareholder, are such a "mess" that it is impossible to distinguish which person is the owner of the assets in question. Whatever the approach, the essence of commingling is that no distinction is made or can be made between the assets of the company and that of its shareholders. They are therefore to be treated as one and the same for this purpose. If this is the correct conclusion, no part of the commingled assets should be regarded as

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288. Huang, *supra* note 256, at 748. However, the system of law reporting in China is by no means as comprehensive as that found in major common law jurisdictions and therefore there is a danger of reading too much into this statistic.

289. Hawes et al, *supra* note 263, at 350.

290. Huang, *supra* note 256, at 748.

291. *Id*. at 751.

292. *Contra* Hawes et al, *supra* note 263, at 351–52 which found no significant distinction between economically developed and less-developed regions, or between lower-level and higher-level courts.

293. Huang, *supra* note 256, at 760.

294. *Prest* [2013] 3 WLR 1 [28].

having ever properly been owned by the company, given that the company's involvement is merely illusory,[295] or it is impossible to make any distinction between corporate and personal assets. In some instances, the court may even conclude that the company simply held the assets on trust for the shareholders.[296] There is a subtle but real difference between commingling and the misappropriation of corporate assets by the company's shareholders. In the latter, the shareholders recognize that the assets belong to a separate entity but improperly/dishonestly withdraw such assets. The corporation may therefore maintain a claim for the recovery of its assets. Misappropriation is a form of theft that can also give rise to criminal prosecution and, in this context, requires a particular mental state involving some element of dishonesty.[297]

In *Wuhan Vegetables Co. v. Wuan Jiutian Trade Development Co.*,[298] the plaintiff transferred its equity interest in Baishazhou LLC to Tianjiu Co. Tianjiu never fully paid the plaintiff for this transfer. Tianjiu later transferred part of this equity interest to Mrs. Wang Xiuqun, making her a shareholder with a 70% interest in Baishazhou. Two subsequent transfers then occurred. First, Mrs. Wang transferred her equity interest in Baishazhou to China Velocity Group Limited, and subsequently she transferred her equity interest of 96% in Tianjiu to two individuals, Huang Yi and Tao Xin. The court allowed the corporate veil to be pierced against Mrs. Wang. In the court's view, the aforementioned acts of Mrs. Wang, the majority shareholder who had absolute control of Tianjiu, coupled with the fact that she did not have evidence to prove that consideration was duly paid to the plaintiff for the transfer of its equity interest, indicated that Mrs. Wang had successfully "escaped" from Tianjiu by transferring her equity ownership in Tianjiu to others. The court concluded that she had negatively affected the realization of the debt claims of the plaintiff as a creditor of Tianjiu. Accordingly, Mrs Wang was jointly liable for Tianjiu's debts under Article 20(3) of the Company Law. One way of analyzing this case is that it is an example of a shareholder abusing the corporate form to defraud creditors. Another explanation is that the defendant, Mrs Wang, had misappropriated the assets the company had purchased from the plaintiff. This single act of misappropriation was held to constitute evidence of commingling of assets, thus justifying veil piercing.[299] If this is the correct explanation of the case, in addition to the point

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295. *See also* Tan, *supra* note 77, at 23–26.

296. *See e.g., Asteroid Maritime Co Ltd v The owners of the ship or vessel "Saudi al Jubail"* [1987] SGHC 71; *Gencor ACP v Dalby* [2000] All ER (D) 1067.

297. *See e.g.,* section 403 of the Singapore Penal Code (Cap. 224) and section 1 of the UK Theft Act 1968.

298. Wuhan Shi Shucai Jituan Youxian Gongsi Su Wuhan Tianjiu Gongmao Fazhan Youxian Gongsi deng Guquan Zhuanrang Hetong Jiufen An (武汉市蔬菜集团有限公司诉武汉天九工贸发展有限公司等股权转让合同纠纷案) [Wuhan Vegetables Co v Wuan Jiutian Trade Development Co], (2009) Wu Min Shang Chu Zi No. 66, Wuhan Interm. People's Ct., December 25, 2009, original judgment available at www.pkulaw.cn.

299. Huang, *supra* note 256, at 765.

made earlier regarding the distinction between commingling and misappropriation, it is difficult to see how a single act such as this could have amounted to commingling. Commingling usually requires a pattern of activity that demonstrates unequivocally that the separate personality of the corporation was not respected.

Another decision where the same criticism can be made is *Yueyang Shenyu Grease Trading Ltd. v Lin and Others*,[300] a decision of the Yueyang Municipality Intermediate Court. In this case, the defendant company had two shareholders, Mr. Liu and Mr. Hu. The company hired Mr. Xu as the CEO and Mr. Peng as the finance manager. It was orally agreed that Messrs Liu, Xu and Peng would be the shareholders of the company holding 40%, 40% and 20% respectively. Notwithstanding this agreement, Mr. Liu and Mr. Hu remained the only shareholders on record, although Messrs. Liu, Xu and Peng were regarded within the company as the actual shareholders and controllers. The plaintiff made a number of payments to the company for purchases of cotton. The finance manager deposited these payments into his personal bank account to minimize the company's income for tax purposes. When the cotton that the plaintiff ordered was not delivered, the plaintiff brought a claim against the company and joined its shareholders as defendants, as the company did not have sufficient assets.

At first instance, the court ruled that the three shareholders who were regarded as actual shareholders, namely Messrs Liu, Xu and Peng, had abused the company's independent legal personality by commingling personal assets with corporate property. They were therefore held jointly liable for the company's debts. Mr. Hu, on the other hand, was not liable. The appellate court revised the first instance decision. It ruled that Mr. Liu, as the company's legal representative and a registered shareholder, had indeed abused the company's separate personality and harmed the interests of creditors. The corporate veil was therefore correctly lifted in relation to him. As Mr. Hu was also a shareholder, he too was liable for the company's debts. The finance manager, on the other hand, was not a shareholder and therefore veil piercing was inapplicable. The court did not consider Mr. Xu's case as he had accepted the first instance decision.

If the purpose for placing the monies in the finance manager's bank account was tax evasion, the characterization of the case as one involving commingling may not be correct. Rather, it is a case of shareholders recognizing that they were removing corporate assets with a view to under-declaring the company's income. The proper remedy would appear to lie with the company for the recovery of its

300. Yueyang Shenyu Youzhi Maoyi Youxian Gongsi deng yu Lin XX deng Zhaiquanren Liyi Zeren Jiufen Shangsu An (岳阳神禹油脂贸易有限公司等与林XX等债权人利益责任纠纷上诉案). (2010) Yue Zhong Min San Zhong Zi Di 276 Hao, Yueyang Interme. Peple's Court, September 30, 2011, available at www.pkulaw.cn.

assets against the finance manager and possibly other persons engaged in the scheme as co-conspirators or joint tortfeasors.[301] The finding of liability against Mr. Hu seems particularly harsh given that he was not an active shareholder, presumably because it was intended that at some point there would be a transfer of his shares. It is difficult to see how in this context he could be regarded as a shareholder who had abused the independent legal status of the company.[302] It would seem over-inclusive and contrary to the public policy underlying incorporation to impose liability on shareholders who are merely passive investors and therefore not involved in any abusive conduct.

The position regarding commingling in the Chinese context is also unusual in the context of one-person companies. The burden of proof in the case of such companies is that the shareholder must establish that the property of the company is independent of his own. If he cannot do so, he becomes personally liable for the debts of the company. This is set out in Article 64 of the Company Law:[303]

> Where the shareholder of a one-person company with limited liability cannot prove that the property of the company is independent of his own property, he shall assume the joint and several liability for the debts of the company.

It has been argued that it is extremely difficult for a defendant shareholder to discharge the burden.[304] If this is correct, it provides another explanation of why veil piercing takes place more frequently in China. Yu and Kraver go further and suggest that beyond single-shareholder companies the courts have appeared to shift the burden of proof from creditors to companies and their shareholders more than the legislative language implies and this is the most plausible explanation for the higher frequency of veil piercing in China. This shift of onus in veil piercing cases is allied to the absence in Chinese veil piercing cases of the responsibility of creditors to protect themselves.[305]

However, this argument lacks support from cases. The cited support for this broad proposition is not compelling. The case of *Shanghai Zhongbo Company (Appellant) v. Anhui Water Conservancy Construction Engineering Corporation*

301. For example, at common law joint tortfeasance may be established by showing that Messrs Liu and Xu procured or authorized the finance manager to commit the wrongful act, *see e.g.*, *Mentmore Manufacturing Co v National Merchandise Manufacturing Co* (1978) 89 DLR (3d) 195; *C Evans & Son Ltd v Spritebrand Ltd* [1985] 1 WLR 317; *Gabriel Peter & Partners v Wee Chong Jin* [1997] 3 SLR(R) 649.

302. Hawes et al, *supra* note 263, at 364 state that the finance manager had purchased the shares from the seller, presumably Mr Hu, but the share transfer had not been registered. This may not be entirely accurate. While the oral agreement contemplated that the finance manager would be made a shareholder, there was no sale of Mr Hu's shares to the finance manager.

303. Translation from http://www.npc.gov.cn/englishnpc/Law/2007-12/13/content_1384124.htm (accessed on September 6, 2017).

304. Huang, *supra* note 256, at 765–66, citing as an example the case of Zhao Yongying Su Quzhou Weini Huagong Shiye Youxian Gongsi deng Maimai Hetong Jiufen An (赵庸英诉衢州威尼化工实业有限公司等买卖合同纠纷案) [Zhao Yongying v Quzhou Weini Chemical Industrial Ltd Co], (2010) Qu Shang Chu Zi No. 1130, People's Court of Qujiang District of Quzhou City of Zhejiang Province, 2010. *See also* Yu & Krever, *supra* note 263, at 76, 80–81.

305. Yu & Krever, *supra* note 263, at 82–84.

and Others (Respondents)[306] is cited as a typical example of the tendency to shift the burden of proof away from creditors. The shareholders' argument was that debts could not be paid in the course of liquidation and the liquidation process was taking a lengthy period of time because of *inter alia* complications from partial ownership of assets and difficulties dealing with competing claims from other creditors. The appellate court did not require the plaintiffs to show abuse; rather, the court indicated that the defendants had failed to provide proof of the reasons offered for the delay and treated the non-payment for an extended period as abuse. It is said that in the same fact situation, a common law court might very well have come to a similar conclusion, but first, such a court would have required the creditor plaintiffs to prove abuse by showing there were no legitimate reasons for extending the liquidation period for such a long time.[307]

However, it is difficult to expect creditors in all instances to prove that there were no legitimate reasons for the length of the liquidation period. These may not be matters particularly within the knowledge of creditors. Given that the liquidation process had already been going on for five years, together with the defendant company's lack of cooperation during the process, a common law court might have concluded that there was some prima facie evidence of unreasonable delay such that the burden of proving that the delay was justifiable had shifted to the defendant. Issues relating to the burden of proof are not static[308] and can shift where, as in this case, the objective facts call for an explanation that only the defendant can reasonably provide. If the defendant cannot do so, it is not unreasonable for a court to only attribute the fault for delay to the defendant. Whether this should amount to abuse is a separate issue. There are at least two possibilities. First, it may be arguable that if a defendant company and its shareholders were intransigent in the liquidation process, the court could infer from the circumstances as a whole that the corporate structure had been used in an abusive manner. The decision, however, proceeded on the second possible mode of analysis, namely that responsibility for the failure to complete the liquidation process ought to be placed on the shareholders. The trial preferred the first possibility, while the appellate court preferred the second one. Relying on Article 20 of the Company Law, the court ruled that, based on the evidence available (including evidence provided by the parties which also comprised the repeated applications from the company to delay the first-instance trial), it was clear that the shareholders intended to abuse the independent corporate personality of the company and the shareholders' limited liability, with the

306. Shanghai Zhongbo Jingguan Luhua Yuanyi Youxian Gongsi yu Anhuisheng Shuili Jianzhu Gongcheng Zonggongsi deng yu Gongsi Youguan de Jiufen Shangsu An (上海仲伯景观绿化园艺有限公司与安徽省水利建筑工程总公司等与公司有关的纠纷上诉案), (2011) Wan Min Er Zhong Zi Di 00007 Hao, Higer People's Court of Anhui Province, March 28, 2011, available at www.pkulaw.cn（hereinafter the "*Shanghai Zhongbo case*"）

307. Yu & Krever, *supra* note 263, at 83.

308. *See also* Wen, *supra* note 263, at 352 on the dynamic nature of the burden of proof.

consequence that the company's veil should be lifted.[309] On either analysis, there is no basis to state that the courts have illegitimately shifted the onus of proof from creditors to shareholders.

Beyond whether Chinese judges have adopted an overly broad view of commingling, and if the burden of proof has been unfairly shifted from creditors to shareholders, it has also been suggested that loopholes regarding shareholder performance in corporate liquidation may have led judges to use veil piercing to play a gap-filling role. It is argued that, unlike many other jurisdictions that have rules to prevent the liquidation process from being unduly influenced by shareholders, many of these rules are scarce in China's company law context. Rather than independent liquidators who are insolvency professionals, Chinese company law allows shareholders of a limited liability company to form a liquidation group, the composition of which must be determined by the shareholders' meeting. This has led to courts using veil piercing to impose liability on shareholders where the liquidation process is not completed or does not proceed reasonably.[310]

If this is one of the reasons that have led to a more liberal approach towards veil piercing in China, it appears unjustified. Two points can be made. First, it is undoubtedly true that under the Company Law creditors do not have a general right to initiate a corporate winding up through the appointment of a liquidator or equivalent institution. Pursuant to Article 180 of the 2013 Company Law, a company is to be liquated if: (1) the circumstances for liquidation provided for in the articles of association of the company occur; (2) the shareholders' meeting passes a resolution to liquidate; (3) a corporate merger or division compels liquidation; (4) the company's license has been revoked or the company is ordered to close in accordance with the law; (5) shareholders who own at least 10% of the ownership of the company request it in cases involving a corporate deadlock.

Corporate creditors are relegated to a secondary role. For example, where a company is dissolved as a result of factors (1), (2), (4) and (5) in the preceding paragraph, the company shall, within 15 days from the date when the reasons for dissolution prevail, set up a liquidation team to begin the process. Where a company fails to do so, its creditors may apply to the court to designate relevant people to form a liquidation team.[311] Creditors may also petition the court to develop a liquidation team in other circumstances such as when a liquidation team has been developed but has deliberately delayed the liquidation, or when a wrongful liquidation may seriously damage the interests of the creditors or shareholders.[312]

309. *See Shanghai Zhongbo* case, *supra* note 306.
310. Wen, *supra* note 263, at 354–55.
311. PRC Company Law, art. 183.
312. SPC Company Law Interpretation (II), Article 7.

It is understandable that where shareholders are in control of the liquidation process, such control ought not to be unqualified as it can lead to prejudice to other stakeholders, in particular, creditors. Accordingly, in addition to creditors being allowed to file a petition to the court in certain circumstances, there are also instances where shareholders can be held directly liable to creditors. First, if a company does not form a liquidation team within the statutorily prescribed period of 15 days and this has caused the depreciation, loss, damage or disappearance of corporate assets, the creditors can ask the court to hold the responsible shareholders liable for compensation to the extent of the value of the said assets.[313] Second, if the failure in performing the aforesaid obligations has caused the loss of essential documents and accordingly made it impossible for the liquidation to proceed, the court, at the request of the creditors, can additionally hold the responsible shareholders jointly liable for the company's debts.[314] Third, creditors can ask the court to make the shareholders liable to provide compensation if the shareholders (and directors in joint stock limited companies) maliciously disposed of corporate assets and caused losses to the creditors after the company's dissolution, or if the shareholders wrongly caused the companies registration authority to deregister the company without it being lawfully liquidated.[315] Also, if the company does not have sufficient assets to satisfy the claims of the creditors at the time of its dissolution, the creditors can ask the court to hold the shareholders liable to the extent of their unpaid capital contributions.[316]

Members of the liquidation team, which may include shareholders, can also be liable to creditors when they do not discharge their obligations properly, such as when they fail to give notice to all known creditors of the company's liquidation; the liquidation team implements a liquidation scheme that is not confirmed by shareholders or the court as the case may be; or there has been violation of laws, administrative regulations, or the company's articles of association, thereby causing loss to creditors or the company.[317]

While the application of these rules may lead to shareholder liability, it is incorrect to regard them as veil piercing cases. Insofar as the shareholders are liable to creditors, the liability arises when the company is liquidated for dissolution and deregistration. The legal test of Article 20 of the Company Law does not apply in these circumstances. The shareholders will be held liable to provide compensation to creditors jointly and severally for the debts of the company if, in the course of and related to the liquidation process, they were directly or indirectly involved in acts that made the company unable to repay its

313. Company Law Interpretation (II), Article 18(2).
314. Company Law Interpretation (II), Article 18(3).
315. Company Law Interpretation (II), Articles 19 and 20.
316. Company Law Interpretation (II), Article 22.
317. Company Law Interpretation (II), Articles 11, 15 and 23.

debts, including non-payment of outstanding capital contributions. Liability is premised on the liquidation having been conducted improperly and is different from shareholders' abuse of the independent legal status of corporate personality and shareholders' limited liability as required by Article 20 of the Company Law. The relevant rules in the aforesaid judicial interpretations are not aimed at clarifying Article 20, and hence are not interpretations about the doctrine of veil piercing.

The second point is that there is another legislation that allows creditors to initiate the liquidation of a company. The PRC Enterprise Bankruptcy Law 2006 governs bankruptcy issues of all legal business persons including companies established under the Company Law. Under the law, where a company fails to repay its debts and its assets are not sufficient to pay all debts that are due, or the company is obviously incapable of paying its debts, its creditors can petition the court for revival (re-organization), compromise, or bankruptcy liquidation. [318] Even if the liquidation process under the Company Law has commenced, creditors are free to petition the court to initiate the bankruptcy procedure under the Enterprise Bankruptcy Law as long as it can be established that the conditions of Article 2 are met. These two forms of liquidation found in different Chinese legislation are not unusual and can be broadly equated with voluntary and creditor windings-up in Commonwealth jurisdictions such as the UK and Singapore. It is sensible for a liquidation regime to allow shareholders to liquidate a company in certain circumstances, for instance, where the objectives set out in the constitution have been fulfilled, or the requisite majority of shareholders pass such a resolution while allowing creditors to do so if the corporation becomes insolvent. This is because where a company is insolvent, its remaining assets effectively belong to creditors since they are the ones who are entitled to the residue in priority to shareholders. Therefore, creditors should have the right to commence liquidation to ensure an orderly distribution of corporate assets.

Given the above, if cases in the insolvency setting have contributed to the greater than average percentage of successful veil piercing cases, the number of such cases has been overstated by the inclusion of cases that ought not to involve piercing at all. In addition, if veil piercing has taken place because of a perceived gap in the insolvency framework, this is also not justified. One example of the former is *Hengsheng Co. Ltd v Xianglan Co. Ltd*.[319] Hengsheng had purchased RMB 2.2 million worth of electric cables from Xianglan from 2000 to 2003. Hengsheng failed to repay Xianglan. In March 2003, the parties reached a

318. PRC Enterprise Bankruptcy Law 2006, art. 2.

319. Hengsheng Gongsi yu Xianglan Gongsi Jiekuan Hetong Jiufen Zhixing An (恒生公司与橡缆公司借款合同纠纷执行案) [*Hengsheng Co. Ltd v Xianglan Co. Ltd* on Enforcing a Lending Contract], (2015) Yang Hui Zhi Zi Di 393 Hao (2015), Yanggu Basic People's Court, June 30, 2015, available at www.pkulaw.cn.

repayment agreement under which Hengsheng was obliged to make payment in full before 2007. Hengsheng's business license was revoked by the local Administration of Industry and Commerce on May 30, 2005 because it failed the government's annual inspection of business enterprises. According to Article 184 of the Company Law, the shareholders of Hengsheng, Mr. Zheng, Mr. Li and Mr. Zhang, should have initiated liquidation of the company within 15 days.

Hengsheng failed to make payment as had been agreed, and Xianglan brought legal action in 2011. An order was made in favour of Xianglan, and it applied to enforce the order. On June 30, 2015, the Court issued its enforcement decision, in which Article 20(3) of the Company Law and Article 18 of Company Law Interpretation (II), among others, were relied upon as the legal basis on which the court ordered that the aforementioned Messrs. Zheng, Li, and Zhang were persons against whom the agreement could be enforced. The court held that the corporate veil should be pierced against them, as their failure to liquidate the company constituted an abuse of corporate personality and limited liability. Although Article 18(2) of Company Law Interpretation (II) was also properly invoked, it is questionable if veil piercing should have been relied upon.

SOME CONCLUDING OBSERVATIONS

This paper goes beyond the traditional functional method in comparative law, which mainly looks at how different legal systems offer solutions to the same problems.[320] Undoubtedly, the doctrine of veil piercing has been adopted in all the jurisdictions under comparison in this paper, and there is also a striking similarity in the notion of abuse that is said to underlie the disregard of the corporate form to hold shareholders personally liable for corporate debts. In addition, the history of how corporate law came into existence is a factor that has influenced the shape of the doctrine. The law in Singapore for example demonstrates the effect of transplantation with strong similarities with the legal approach in England. China, on the other hand, appears to resemble the United States more closely. This is not surprising given the more recent influence of US corporate law in China and that it has a specific statutory provision that recognizes veil piercing, thereby implying a broader role for the doctrine.

By critically examining the relevant statutory provisions as well as judicial reasoning in veil piercing cases against the doctrine's underlying conceptual framework we can see how the doctrine is used, arguably misused, or even sidelined in the jurisdictions under comparison. In particular, we caution against the indiscriminate use of veil piercing where more appropriate legal tools are available. Veil piercing can be a blunt and simplistic instrument to achieve perceived justice without addressing the real policy issues that are at the heart of

320. ZWEIGERT & KÖTZ, *supra* note 183, at 34.

other areas of the law. We find, for example, that the doctrine has become largely unnecessary in Germany because of other remedies that provide more direct and effective solutions. In England (and perhaps Singapore if the courts adopt the approach advocated by Lord Sumption), veil piercing may follow the same route, given that before *Prest v. Petrodel* the approach towards veil piercing in both jurisdictions was in any event conservative. Lord Sumption's approach leaves very little room for the veil piercing doctrine to operate.[321] It is interesting to observe that both countries are highly mercantilist in outlook, which may (at least partially) explain the strong tendency not to disregard corporate personality as evidenced by the paucity of veil piercing cases. Judicial policy is inclined towards giving businesses certainty.

On the other hand, the United States, also a common law country, is significantly more liberal in piercing the veil even though its courts articulate that this should be done exceptionally. Similarly, the Chinese courts also adopt a more liberal approach towards veil piercing, and we believe that our analysis of the veil piercing doctrine in Chinese company law offers an original perspective of how this doctrine is misunderstood and applied by Chinese courts through judicial interpretations and judgments. The evolution of the doctrine in China to its final codification into the Company Law (and the approach taken by the other jurisdictions discussed) is one indication of the strong trend of convergence of corporate law across the world. Yet the doctrine's application by Chinese courts is also a demonstration of a material degree of divergence. Formal law which has converged in this area, and the law in practice, can be very different in China and elsewhere. Where China is concerned, divergence in practice is partly caused by the uniqueness of the business context which, because of its stage of economic development, is less attuned to developed notions of governance. We also argue that some of the interpretations by Chinese courts are doctrinally questionable, which partly explains the significantly higher number of successful veil piercing cases, though we disagree with some of the reasons advanced by others for this. As the doctrine is a relatively new transplant to China, it is understandable that it will take some time before the law "settles."

321. Indeed, Lord Neuberger in *Prest* [2013] 3 WLR 1 [79] was initially strongly attracted by the argument that the veil piercing doctrine "should be given its quietus".