Limited Liability and Justice: When Should We Pierce the Corporate Veil?

Andrea Sebastiani

Associate at Chiomenti Law Firm, Italy

Received: November 1, 2020

Revised: February 4, 2021

Accepted: February 20, 2021

Abstract

Over the years, it has become common practice for some shareholders to use the limited liability of companies in such a way in order to cheat in pursuit of their personal interests. Various theories have been developed to address this issue, several of which give indication as to when judges should disregard shareholder's limited liability - although recognized by law. These theories are known under the name of piercing the corporate veil.

The present article will analyze some among the most relevant of these theories, taking into consideration the solutions adopted in various legal systems. In particular, the German, Italian, Chinese, English and US legal systems were taken into consideration due to the innovative nature of the theories they introduced. Moreover, the great disparities between these systems, facilitate the comparison between the solutions offered in order to deal with the issue of veil piercing. Finally, a reworked of veil piercing and the policy implications are proposed.

Keywords : Corporate Veil, Shareholders, Limited Liability

1. INTRODUCTION

Nowadays in every legal system, some forms of corporations provide limited liability for shareholders. Thus, as the American Professor Stephen Bain Bridge critically observed[1], it could be claimed that the legislator devised limited liability with the side-effect of permitting shareholders to elude the debts of the company, providing them with a sort of immunity.

But why is limited liability so important?; the answer may be found in the assumption that limited liability guaranties that a corporate loss will not affect the personal assets of a shareholder. Therefore, it can limit the risk of investors and consequentially even their fairs, in this way boosting them to invest more, thus it permits business to raise large amounts of capital from dispersed shareholders all over the globe[2]. Indeed, who would wish to invest in a mutual fund with no limited liability? A hypothetical stock market where shareholders are unlimitedly liable is likely to halt economic and social development[3]. Therefore, there is no misunderstanding that limited liability is a

---

[1] Stephen Bainbridge professor of corporations and business law at The University of California, Los Angeles (UCLA).

[2] As the former president of the Columbia University, Professor Nicholas Murray Butler said during a speech in 1911 "*limited liability corporation is the greatest single discovery of modern times... Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it*", in "Politics and Economics" to the 143rd Annual Banquet of the Chamber of Commerce of the State of New York in 1911. However, there are even scholars which criticized limited liability. According to Professor Seth Oranburg, (Assistant Professor at Duquesne University School of Law), limited liability is a "*necessary evil*", so something that is not good for creditors, but essential for the society, Video lessons of Professor Seth C. Oranburg, https://www.youtube.com/channel/UCdLxnSUlcEHtrdOt5R51Q1g

[3] Video lessons of Professor Seth C. Oranburg, https://www.youtube.com/channel/UCdLxnSUlcEHtrdOt5R51Q1g

cornerstone for the economic and social development of a country, the reason why it should be recognized and implemented. However, limited liability has always raised heated scepticism. As early as 7th October 1893, an *operetta* called "*Utopia, Limited*" by A. Sullivan and W. S. Gilbert, humorously stated the distrust of the time towards limited liability companies. These latter were seen as a strange innovation the main purpose of which was to hide the illegal acts of shareholders[4]. Scholars have been investigating establishment whether shareholders may enjoy limited liability in case they abuse of their rights to cheat other subjects. Think about, for example, the acts to undercapitalized limited liability companies established to the sole purpose of avoiding paying rents, taxes, mortgages, and any other debts. Or again, about those shareholder's conducts by which the corporate assets are going to be used for private interests rather than for the interest of the corporation, thus increasing the risk of insolvency to the detriment of the rights of creditors[5]. In order to solve this issue, scholars have formulated the theories of the so-called *piercing the corporate veil*. Since the applicability of the law in a final instance should pass through legal proceedings, *piercing the corporate veil* is the practice applied and enforced by judges to disregard the rights of shareholders. In this case a limited liability shareholder would be considered unlimited liable for corporate debts, in case the latter have acted unlawfully, to the detriment of society and against any principle of fairness and justice. In this context a contrast between

[4] John Micklethwait, Adrian Wooldridge, *The Company: A Short History of a Revolutionary Idea* (New York City, Modern Library, 2005), 20.

[5] See Fan Jian (范健), Wang Jianwen (王建文), *Gongsi fa* (公司法) [*Company Law*], (Beijing, Falu chuban she, 2018), 188-221; Nadia Zorzi, "L'abuso della personalità giuridica: tecniche sanzionatorie a confront" (Padova, CEDAM, 2002), 119-136; Hui Huang, "Piercing the Corporate Veil in China: Where is it Now and Where is it Heading," *American Journal of Comparative Law* 60, No. 3 (Summer 2012), 743-774.

two fundamental interests might arises. Namely, a strict principle of limited liability ensuring the interest for a good country's social and economic development on one side, and the veil piercing practice which represent the interest to maintain any reasonable sense of fairness and justice on the other side. The present article examines how this issue has been addressed in vary legal systems which involve both civil and common law experiences. The final part reports a conclusive opinion by the author.

2. EMPIRICAL ANALYSIS OF VEIL PIERCING

Roughly speaking, veil piercing practice is not something that easy to be regulated by law. Indeed, in most countries it seems that are judges - through their judgements - or scholars who initially formulate veil piercing theories rather than the legislator. It must be said that the shortcoming of the legislator in regulating veil piercing is understandable. Indeed, no one can exactly predict in advance how a shareholder would abuse of his limited liability until the specific case raise. Therefore, while the law provides general provisions and principles, their interpretation is left to the judges case by case. The legal systems illustrated in the following paragraphs, namely the German, Italian, Chinese, English, and US, were selected by reason of the innovative nature of the theories on veil piercing they introduced. Moreover, the relevant variance in the doctrinal and jurisprudential solutions proposed between one country and the other facilitate the comparison.

2.1 Germany

One of the most interesting approach ever used to address the veil piercing enigma, is the one adopted by the German jurisprudence. As in every legal system even in Germany shareholder's limited liabilities is stated by law.

Article 13 (2) of the German Law on Limited Liability Company[6] states that shareholders are not held personally liable for the obligations of a GmbH (a German Limited liability company). Indeed, the German doctrine outlined the principle of "*Trennungsprinzip*", which translates to "*principle of separation*", intending to highlight an essential feature of the corporation, namely the separation of identities between the shareholder and the corporation. German judges found mainly two different ways to implement veil piercing (*haftungsdurchgriff*) in case of abuse.

A first theory is known as Commingled Assets theory (*vermögensvermischung)* according to which veil piercing should be implemented when the assets of the company and the shareholder are commingled together. A situation of commingled of assets is disguised by a lack of transparency or in any other way, as a result the assets can no longer be divided[7]. In this case, according to the German Federal Court of Justice (Bundesgerichtshof - BGH), *veil piercing* is justified since there may be evidence showing the shareholder intention to disregard a *principle of identity separation.* This principle is clearly laid down in § 13 Section 2 GmbHG and it took the name of "*trennungsprinzip"*[8].

When shareholders do not treat the company as a separate entity why should judges treat limited liability shareholders as such? According to this theory, the application of the privilege and right of limited liability is not reasonable anymore. Consequently, the entity can be considered like a partnership without limited liability and the § 128 of the German Trade Act -

---

[6] *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* (law on limited liability company).

[7] Tan Cheng, Han Wang, Jiangyu Christian Hofmann, "Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives," *NUS Law Working Paper*, No. 25 (Winter 2018), 39.

[8] BGH, Judgment of the 14th of November 2005, II ZR 178/03, (Recital 10).

which states the unlimited liability of the partners in a partnership - can be analogically applied. As a result, shareholders are recognized as liable for the debts of the corporation[9]. The implementation by analogy is basically a means by which is achieved a so-called theological reduction (*teleologische Reduktion*), the principle of jurisprudence that provides for certain laws to be disregarded by judges when their application would compromise their purpose, that is the purpose of the legislator.

A second relevant legal instrument is so-called "Existence Annihilating Interference" (*existenzvernichtender Eingriff*)[10] which enables veil piercing when the shareholders are intentionally in bad faith, tamper improperly and selfishly with corporate assets, causing or aggravating corporate insolvencies[11]. The doctrine views such a conduct as in contrast with a *principle of capital maintenance* that should characterised corporate capital. Therefore, in case shareholders intentionally damage the capital of the corporation for their own interest rather than the interest of the corporation, why should they still enjoy and be protected by limited liability? From a law perspective, the German Judges justification for implementing veil piercing, should be sought in the principles of tort law. In this situation, the applicable provision is Article 826 of the German Civil Code states how "*a person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable to the other person to make compensation for the damage".* Therefore, shareholders that tamper improperly and selfishly with corporate assets, might be qualified as acting in a manner contrary to public interest and would inflict a damage to creditors in case they cause or aggravate the insolvency of the corporation.

---

[9] Ibid.

[10] Cheng, *Piercing the Corporate Veil.*

[11] BGH, Judgment of the 16th of July 2007, II ZR 3/04.

2.2 Italy

The ways by which the problem of abuse of limited liability was addressed in Italy, have been developed in very interesting abstract theories which could offer interesting insights. Among the most interesting veil piercing theories, we might mention those of the manager shareholder (*socio gestore*) and the *de facto* partnership (*società di fatto*). Scholars derived the name manager shareholder by the interpretation of Article 2476 (7) from the Italian Civil Code. According to this provision, shareholders are jointly liable with directors in case they intentionally decide or authorize directors to accomplish harmful acts towards the company and also other shareholders or creditors[12]. Therefore, the Italian legislator and Judges concede the disregard of limited liability when a shareholder manipulates directors to pursue his own interest and at the same time improperly damage creditors' interests. In this case, shareholder's liability might be raised on the grounds of two pre-requirements, namely, the intention of deciding or authorizing acts of directors to accomplish

[12] A second noteworthy feature is that Article 2476 (7) does not actually clarify whether - in light of such abuse of the corporation - the manager shareholder liability towards creditors should be limited or unlimited. Roughly speaking, the legislation about limited liability company provides limited liability for shareholders (Article 2462, Civil Code), thus shareholders' liabilities in these types of corporation is normally limited. It is generally accepted that directors of a limited liability company are unlimitedly liable with all their present and future assets, pursuant to Article 2740 of the Civil Code. From these two contrasting types of liabilities (shareholders-directors), shareholders who exercise a control on directors to make them carry out harmful acts, should bear the same unlimited liability of directors, which adds to the limited liability they normally enjoy. In this case, the jurisprudence stated that the burden to prove the undue control of the shareholder on directors lies with those company's creditors who bring the action (plaintiff). Holzmiller, *Responsabilità del "socio gestore"*, 77-81; Sangiovanni, *La responsabilità del socio di s.r.l.,* 531-538.

harmful acts and the existence of a damage for creditors[13]. In practice, a manager shareholder is intended as enjoying vast managing powers and able to control directors in virtue of his decisions or authorizations[14]. In this regard, it should be specified that the Italian limited liability company legislation provide for the possibility of entrusting shareholders with extensive managing powers as to control the corporation.

Much more sophisticated is the theory of the so-called *de facto* partnership. Through relevant provisions (Article 147 (5), Italian Bankruptcy Law), the recent Italian jurisprudence developed the idea that, in order to disregard limited liability of those shareholders that abuse of their powers, Judges could recognize a third entity between the shareholders and the corporation[15]. This third entity is a *de facto* partnership where the company and each shareholder individually are recognized as unlimited liable partners. Hence, both the companies and the shareholders are held liable for the acts carried out by the partnership. This theory relies on the idea that, under certain circumstances the business is to be considered as carried out by a *de facto* partnership established between the limited liability company and the shareholders.

This might be the case when the shareholder's private assets are commingled with the assets of the company to confuse creditors. Indeed, the said commingling could be interpreted by judges as acts of asset contribution carried out by both shareholder and company to form a partnership. In this case, pursuant to Article 147 (5), the involved partners shall be declared

---

[13] Ibid.

[14] Ibid.

[15] Valerio Sangiovanni, "La responsabilità del socio di s.r.l.," *Le rassegne: Società* (Summer 2011), 531-538.

bankrupt in case of insolvency of their occult and *de facto* partnership[16]. Therefore, both company and shareholders as partners of a de facto partnership should bear unlimited liability[17].

2.3 China

The most common legal provision applied by Chinese Judges to disregard the veil of limited liability is article 20 (3) of the Company Law of the PRC. According to the third paragraph of this article, a shareholder shall bear several and joint liabilities for the debts of the company if he *"evades the payment of its debts by abusing the independent status of legal person or the shareholder's limited liabilities"* and, at the same time *"seriously injures the interests of any creditor".*

The empirical analysis carried out by Professor Huang Hui, observed that from 2006 to 2010, in China limited liability was disregarded in 63 cases out of the total 99 veil piercing cases (occurrence of 63.64%)[18]. Most important, among the 118 requested grounds to disregard limited liability, veil piercing occurred in four types of hypothesis: 74 concerning commingling or confusion

---

[16] In accordance with Article 147 (5) of the Italian Bankruptcy Law, there is the possibility - at request of creditors or the official receiver - to declared the unlimited liability for bankruptcy of a shareholder, if after the declaration of bankruptcy is going to be discovered that his enterprise is linked to another entity in which the bankrupt entrepreneur is and can be considered an unlimitedly liable shareholder.

[17] One of the most relevant judgement in this regard, is that one of the Italian Court of Cassation 2016 n. 12120. By this judgement, pursuant to Article 147 (4, 5) of Bankruptcy Law, the Court of Cassation admitted the application of unlimited liability for bankruptcy to an insolvent de facto partnership and its partners, even in the case of a natural person and a limited liability company.

[18] Hui Huang, "Piercing the Corporate Veil in China: Where is it Now and Where is it Heading," *American Journal of Comparative Law* 60, no. 3 (Summer 2012), 743-774.

of assets, business or personnel; 32 concerning fraud or other improper conduct; 11 concerning undue controls, and only 1 case referred to undercapitalization. However, Judge handled last case did not approve of the disregard of limited liability[19].

Commingling or confusion of asset business or personnel, represents the most common case of veil piercing in China. According to relevant jurisprudence[20], pursuant to Article 20 shareholders' limited liability should be disregarded when the personalities of two or more companies are confused so that only one company is indebted with the final objective to evade most debts. In this context, veil piercing is justified mainly by two factors, namely, the indistinguishable independent personality of the companies, and the debt evasion due to the misuse of the limited liability which seriously damaged creditors' interests.

In addition to the previous theory Chinese Judges have often disregarded limited liability simply by relying on the evidences showing that the corporation had been used to commit frauds and other illicit conducts. In this regard, the case of Wuhan Vegetables Co v. Wuan Jiutian Trade Development Co, occurred in 2009[21], may be taken into consideration. The trial exposed the mechanism that Mrs. Wang Xiuqun set in place to avoid her obligations towards the plaintiff, namely the creditor of her company. This was recognized as an abuse perpetrated against a corporation in order to defraud a creditor. According to the Chinese court's judgement, in compliance with Article 20 (3), two are the

---

[19] Ibid.

[20] Guiding Case No. 15: Xuzhou Construction Machinery Group Co., Ltd. v. Chengdu Chuanjiao Industry and Trade Co., Ltd., 2013 (Supreme People's Court of The People's Republic Of China).

[21] Tan Cheng, Han Wang, Jiangyu Christian Hofmann, "Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives," *NUS Law Working Paper*, No. 25 (Winter 2018), 53-54.

most important aspects someone should refer to implement veil piercing. One of these is the "*abuse of the independent status of the company*", which seems to have been committed through the undue control of Mrs. Wang Xiuqun over her company. Another one seems to be the fraudulent evasion of debts and the result of serious damage to the creditors of the company, namely the evasion of contractual obligations.

2.4 United Kingdom

In the United Kingdom, as a country of common law system, veil piercing doctrines have been mainly deducted through case law practice rather than from statutory provisions. However, unlike in the US, English courts did not develop a systematic approach since they relied on general and traditional common law principles to disregard limited liability in certain cases. According to some scholars, the reasons of this restricted approach may be found in the conservative view towards limited liability that contrasts with its disregard. Indeed, it is in the UK that one of the most important judgement for recognition and acceptance of limited liability occurred, namely the case of Salomon v. Salomon - which stated for the first time the principle for which the assets of companies belong to companies, and not to their shareholders.

The most relevant and recent doctrine of veil piercing in the UK was developed in 2013 as a result of the case Prest. V Petrodel Resources Ltd[22] where the famous Judge Lord Sumption made an interesting distinction between two principles, namely concealment and evasion. There is concealment when a subject interposes a company in an attempt to conceal his real identity[23],

[22] Prest v Petrodel Resources Ltd [2013] UKSC 34, [2013] 2 AC 415.

[23] In this case, although the courts can still identify the real actors going behind the corporation (that is a "*fecade*") in order to discover the facts, veil piercing cannot be carried out.

whereas evasion occurs when there is a legal right against a subject and the company is interposed in order to "defeat this right or frustrate its enforcement". According to Lord Sumption's provision, only in this latter case the court may hypothesize piercing the corporate veil[24]. Briefly quoting Sumption - for the principle of shareholders' limited liability "*there is a limited exception that is based on public policy. The exception applies where a person is under legal obligation or liability or subject to some legal restriction and he deliberately evades it or frustrates its enforcement by interposing a company under his control. In such a case, if there is no other way of giving effect to the liability for obligation or restriction in question, the court might disregard the separate legal personality of the company*". Furthermore, the said exception to limited liability, can be implemented *"only for the purpose of depriving the company or its controller of the advantage they would otherwise have obtained by interposing the company".* Therefore, in the light of Lord Sumption's statement, we should notice that in the UK there are currently few circumstances to disregard shareholders' limited liability. In particular, we should notice that veil piercing may be applied only when there is a legal obligation, liability or a legal restriction, also in the light of the public interest. This would appear to exclude veil piercing in those cases where the shareholders' abuse of limited liability to evade contractual obligations, that is the thing that use to happen in most of cases. This is a relevant difference with the other mentioned countries where veil piercing seems to be more widely accepted.

2.5 United States

The main reasons American Judges justify the disregard of limited liability can be expressed through the domination and control of the corporation perpetrated by the shareholder. In each State of the Federation, the jurisprudences

---

[24] Prest v Petrodel.

have outlined similar standards for veil piercing by the elaboration of two theories, namely the so-called *alter ego doctrine* and the *instrumentality doctrine*.

The Alter ego doctrine is the one upheld by important cases such as Walkovszky v. Carlton[25]. According to this doctrine, the main requirements for the applicability of piercing the corporate veil, are as follows: "*firstly, the corporation is dominated and controlled by the shareholder to the point where their interest and ownership can be considered the same, thus their personalities are no longer separate; and secondly, the aforementioned conduct is able to create an inequitable result in case the acts of the company are going to be considered as its acts alone*"[26].

Over the years, courts have rendered several indications that might confirm the aforementioned circumstances. These are for instance: the disregard of company law formalities such as the election of directors, corporate records etc.; undercapitalization; putting and withdrawing the funds of the company for private interest rather than for the corporation interests; same directors, personal, office, address among more than one entity[27]. The reasoning underlying this theory is that, in these cases the controlling shareholder and the corporation

---

[25] Walkovszky v. Carlton, 223 N.E.2d 6 (N.Y. 1966). In accordance with the Court's point of view, Carlton would have been considered liable if he carried out a control of the corporation only to pursue his personal benefit rather than the purpose of the company. In this case the company is treated as a dummy for the shareholder that do not really care about the benefit of the corporation.

[26] Walkovszky v. Carlton, 223 N.E.2d 6 (N.Y. 1966); RRX Industries, Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. 1985); Laya v. Erin Homes, Inc., 177 W.Va. 343 (1986).

[27] Cheng, *Piercing the Corporate Veil*, 22.

could be considered the same entity[28], therefore the shareholder should be considered liable for corporate's debts[29].

However, according to Professor Stephen M Bainbridge and M. Todd Henderson, the alter ego doctrine alone might be problematic. The source of this criticism relies on the fact that it is the law that empowers shareholders to control the corporation. This can be seen, for example, in the right of shareholders to appoint directors and the shareholders' rights to manage the corporation as they see fit, which is naturally made in accordance with their interests. The purpose of the law in granting limited liability is to limit risks for shareholders in the course of normal business operations. An indiscriminate use of the alter ego theory might conflict with this purpose.

Following the aforementioned issues, a further theory was developed by American Judges[30]. This is the so-called Instrumentality doctrine which represents the current approach to address the abuse of the limited liability[31]. This doctrine is an integration of the alter ego doctrine, adding one further requirement, viz, the fact that the observance of limited liability might "*sanction a fraud or*

---

[28] As far as the liability raised by this theory is concerned, some courts held that for the alter ego doctrine there is not a vicarious liability, rather is a direct liability. This means that the controlling shareholder and the corporation are considered the same entity, therefore the shareholder should be considered liable for corporate's debts.

[29] Board of Trustees, Sheet Metal Workers' National Pension Fund v. Elite Erectors, Inc., 212 F.3d 1031 (7th Cir.2000).

[30] Ibid.

[31] The Court of Appeal agreed with the aforementioned observations of the trial court, and supported the disregard of the separate corporate identities to held Sovereign of Illinois and Future corporations jointly and severally liable for debts toward Van Dorn Company.

promote injustice"[32]. Therefore, as highlighted by the Van Dorn Co. v. Future Chemical and Oil Corp (1985) trial[33], veil piercing can be implemented when two requirements are met. Firstly, it should be recognized that between the shareholders and the corporation *"there must be such unity of interest and ownership that the separate personalities of the corporation and the individual [or other corporation] no longer exist".* Secondly, the *"circumstances must be such that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice"*. However, the terminology of the second pre-requirement, "*sanctioning of a fraud or the promotion of an injustice"*[34], might slightly change depending on the jurisdiction. For instance, interesting is the case of Virginia judges that use to rely on the fact that the company was "*a device or sham used to disguise wrongs, obscure fraud, or*

[32] Van Dorn Co. v. Future Chemical and Oil Corp. 753 F.2d 565, 570 (7th Cir. 1985) in Bainbridge, *Limited liability*, 97.

[33] In the case Van Dorn Co. v. Future Chemical and Oil Corp., Mr. Edward Roth was the president of Future Chemical and Oil Corporation (Future) and Sovereign Oil Company (Sovereign of Illinois) involved in the business of blending, packaging and distributing motor oils and other automotive products.

[34] The main facts that was noted by the court of first instance were that Edward Roth was the president and the controlling shareholder of Future and Sovereign of Illinois while his sons Jeff and Steven were the other officers of the two companies. Sovereign of Illinois was the subsidiary of Future, and subsequently Mr. Roth made stocks transfers to let both corporations become the wholly-owned subsidiaries of Sovereign Chemical and Petroleum Corporation (Sovereign of Delaware) where Mr. Roth was still the president and controlling shareholder. Therefore, Mr. Roth controlled all corporations and used them for his benefits without regard to the interests of the legal entities. Although the cans were shipped to Sovereign of Illinois, Future corporation was billed, and it was not by chance that Future was not provided with enough assets unlike Sovereign of Illinois.

conceal crime"[35]. In this case, the commission of *wrongdoing* might create confusion, however, in accordance with most jurisprudence it might be intended as the *unjustified enrichment* of the shareholder where his limited liability is recognized[36]. Finally, the Judges have sometimes outlined a further precondition, which is the causal link between the shareholder excessive control and the creditor's injury[37].

3. REWORKING VEIL PIERCING

An empirical analysis has highlighted the shortcoming and difficulties of the jurisprudence in finding veil piercing theories, mainly due to the fact that Judges are restricted to base their decisions and interpretations strictly according to the laws and regulations in force. Therefore, their elaborations could be limited to the boundaries already established by the legislator. In order to overcome such a limitation and elaborate theories aimed at finding a solution to an issue that concerns the public interest and involves both the juridical and the economic field, it is believed by the writer that someone should take into consideration the solutions proposed by scholars, rather than by the jurisprudence. Indeed, only scholars - throughout their capacity to freely formulate abstract theories that could go beyond any pre-settled statutory or jurisprudential boundaries - would be able to better suggest the legislator. Moreover, it should be noted that among the most common circumstances indicating the existence of an abuse of limited liability are for instance the *confusion* and *commingle* of

[35] Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc. 974 F.2d 545 (4th Cir. 1992) in Bainbridge, *Limited liability*, 97.

[36] Sea-Land Services, Inc. v. Pepper Source, 941 F.2d 519, 1991 U.S. App. LEXIS 19125 (7th Cir. Ill. Aug. 20, 1991).

[37] Krivo Indus. Supply Co. v. Nat'l Distillers Chem. Corp., 483 F.2d 1098, 1105 (5th Cir. 1973).

assets, business and personnel, the *undercapitalization*, the *fraud*, the avoidance of contract or legal obligation and a *general undue control* of the shareholder over the corporation[38]. In order to clarify the foundations of veil piercing reworking, it should be observed that the said circumstances commonly recognized by Judges to disregard shareholders' liability, can be divided into three items. These items would consist in: (1) the precondition for the execution of the abuse; (2) the types of the abuse; (3) the end result of the abuse.

(i) As far as the first item is concerned, it is a matter of fact that the *precondition* for the occurrence of the abuse of limited liability, in most cases is the *undue control* over the corporation carried out by one or more shareholders. Indeed, it seems that phenomena such as corporate *undercapitalization* or assets *confusions* are mere consequences of the shareholder's power to dominate and control the entity. This power of control permits shareholders to use the corporation to pursue their private interests, in contrast with the interests of creditors or potential minority shareholders, whose best interest is the solvency of the corporation. Among the theories mentioned in the empirical analysis conducted in this article, there are some that have already tried to ward off and shape the concept of shareholders undue control. This is for instance, the case of the German *principle of capital maintenance* dealing with shareholders who tamper improperly and selfishly with corporate assets[39] or of

[38] See Fan Jian (范健), Wang Jianwen (王建文), *Gongsi fa* (公司法) [*Company Law*], (Beijing, Falu chuban she, 2018), 188-221; Nadia Zorzi, *L'abuso della personalità giuridica: tecniche sanzionatorie a confronto* (Padova, CEDAM, 2002), 119-136; Hui Huang, "Piercing the Corporate Veil in China: Where is it Now and Where is it Heading," *American Journal of Comparative Law* 60, No. 3 (Summer 2012), 743-774.

[39] Cheng, *Piercing the Corporate Veil*, 35 et seq.

the American doctrine stating that the corporation might be considered as the *alter ego* of some shareholder[40].

(ii) The other item to be taken into consideration is the *type of abuse.* This refers to the concrete cases and specific kinds of abuse that occurred because of the precondition of undue control over the corporation. Among the most common types, Judges have recognized the *confusion* or *commingling* of assets, business and personnel, and the case of *undercapitalization*.

(iii) Finally, we have the *end result* of the abuse, that is the purpose - intentional or not - pursued by the shareholders. As noted by part of the Chinese doctrine, the end result may consist in the *avoidance of contractual obligations* or *avoidance of legal obligations*.

Once the distinction between *preconditions*, *types,* and *end results* of the abuse of limited liability has been clarified, two are the questions to be answered in order to rework veil piercing and thus attempt to solve the problem of the abuse of limited liability.

The first question is, which approach should we use to address the enigma of veil piercing? Although some scholars argue that veil piercing can be solved only analysing case by case - since the concept of abuse of limited liability is dramatically changeable from judge to judge and case by case - it is believed that outlining definitions of abuse of limited liability, as clearly and firmly as possible, might be the best approach. These definitions are essential since they could be considered as the pre-requirement for judges to justify the disregard of shareholders' limited liability. This approach has economic implications for companies since the more we have uniform definitions of abuse of limited liability the better will be the certainty of the law, being this latter essential for the well-functioning of a market (i.e. the *public interest*). Indeed, although it is

---

[40] Walkovszky v. Carlton, 223 N.E.2d 6 (N.Y. 1966).

clear that limited liability boosts investments, hence the economic development of a country, it is also evident that market players would be encouraged to invest in a market where the threshold between their personal liabilities and the liabilities of the corporation is clearly defined. However, if providing a firm and clear definition of limited liability abuse is likely the best approach to veil piercing, how should we define the abuse of limited liability?

To answer the question, two definitions could be taken into consideration, namely a general definition of *abuse as a deviation from the purpose of the law* and a more specific definition of *abuse as a way to deceive creditors*.

In accordance with the *definition of abuse as a deviation from the purpose of the law*, we can say that "*there is abuse when the shareholder's conduct in using the corporation and their rights to limited liability divert from the public policy, that means, it is contrary to the intentions of the legislator inherited into the law*". This approach allows Judges to adopt the *presumption* under which *public policy* is the one in compliance with a general concept of *public interest*. In this regard and from an empirical point of view, interesting insights might come from the German methodology of the *teleological reduction*, which allows for provisions to be disregarded when their application would counterfeit their purpose[41]. In other words, limited liability could be disregarded when shareholders use this granted power to deceive the intention

[41] Accordingly, following this reasoning, a second phase opens, in which a meaning is to be attributed to the *public interest*. This latter might be understood as an interest that could be satisfied by: 1 assuring the economic and social development of the community as a whole; 2 assuring the certainty of the law through an interpretation in accordance with principles of *fairness* and *justice*. Indeed, by ensuring investors aware of the circumstances and requirements they need to meet to have their rights recognized (the right to enjoy limited liability included), they might be more willing to invest, thus contributing to the social and economic development of the community (i.e. the *public interest*).

of the legislator. However, this definition of abuse is so general that deriving the real and original intention of the legislator might prove difficult[42]. Hence, to solve this problem, Judges could use the second definition of *abuse as a way to deceive creditors* as an integration of the *abuse as a deviation from the purpose of the law*.

According to this second definition, the abuse of limited liability might be understood as "*an unpredictable action of the shareholders that created - even if unintentionally - a false perception in creditors when assessing their investment risk*". In order to clarify this definition, we should take into consideration the following: "*the burden of being updated about the solvency of the corporation could be laid on creditors".* These latter should duly acquire information about the identity of the corporation and its shareholders, the amount of capital, the risks related to the business, the solvency ratio, the structure of the corporation, if it owned by a holding, and so forth. It is up to the judges to evaluate through principles of *fairness* and *justice*[43] whether or

[42] A limited applicability of this theory might concern the case of undercapitalization. In this case, in applying the aforementioned general definition we may distinguish two types of abuse. The first one is an undercapitalization that cannot justify veil piercing, that is to say when the company has been undercapitalized to buy equipment, rent commercial facilities, pay employees, and more generally to meet those expenses necessary to maintain and develop the corporation. The second one is an undercapitalization that justifies veil piercing. This case might occur when the capital of the corporation has been suddenly emptied for the sole purpose of satisfying shareholders' personal purposes, without minding about the preservation of the corporation and therefore about the needs of the creditors. This latter case is not in compliance with the public interest, namely the development and maintenance of the corporation and the principles of fairness and justice.

[43] In the present case, for *fairness* is understood the impartial treatment, thus using the same criterions of justice to judge each individual. For *justice* is understood the

not creditors have fulfilled their duties to inquire information. At this point, two might be the cases. The first case is when shareholders properly disclosed the information, therefore, creditors had any opportunity to *predict* their *investment risk* but failed doing so. In this case veil piercing should not be permitted and shareholder should remain limited liable. On the other hand, there is case when creditors tried to accomplish their duties to collect information, but they could not do so or the said information disclosed were not *per se* sufficient to make an evaluation about the *investment risks*, due to their *unpredictability*. Accordingly, it is in this latter case that veil piercing should be permitted, and shareholders should be considered liable for corporate debts. The obstacles creditors meet in obtaining the needed information shall consist in a "*false representation",* be it intentionally or accidentally provoked by the shareholders[44]. In this case, veil piercing might be permitted, since creditors did not have any possibility to know or simply to be aware about their *investment risks*. Thus - as in *Van Dorn Co. v. Future Chemical and Oil Corp* – shareholders promoted *an injustice* or, in the worst of cases a *fraud.*

This second case lays the basis for a definition of abuse as a way to deceive creditors, and it tells us how much is important the transparency about the investment risks, something that should be properly assure by the shareholders by disclosing the information creditors need to assess their investment risks. Therefore, it is believed that the grounds on which veil piercing should be admitted, would result in the finding that the said

---

act of judging by taking into consideration the existence or not of substantial preconditions behind the possibilities, namely the existence of the possibilities of creditors to evaluate their risk of investment.

[44] If it was provoked by the board of director itself without any manipulation of the shareholders, these latter should not be considered liable and veil piercing cannot be implemented.

transparency is a pre-condition for the well-functioning of the market and thus it is in accordance with the *public interest*.

4. CONCLUSIONS

Ensuring a principle of limited liability is beneficial for a country's social and economic development but at same time, limited liability might contrast with any sense and principle of fairness and justice. This is why Judges started elaborating theories of piercing the corporate veil by relying on other principles and provisions. Therefore, in elaborating veil piercing theories, scholars should take into consideration that two are the contrasting interests used to characterize the veil piercing issue. On the one hand is the economic and social development ensured by respecting the principle of limited liability, on the other hand is the sense of justice ensured by allowing the *piercing* of the veil of limited liability. Now the arising question is: between these two interests, which is more beneficial for society as a whole? Indeed, some scholars argued in favour of limited liability while others highlighted the role of justice as the foundation of a rule of law system and thus of a democratic system.

In this regard, it is the belief of the writer that justice for company creditors cannot be sacrificed in the name of the economic and social development. Indeed, if Judges do not guarantee justice for creditors, not only the fundamental principle of rule of law, typical of modern democracies, would be compromised, but even market players would be discouraged from contributing to the well-functioning of the market as a whole. Accordingly, it is upheld that the well-functioning of a market should be considered as compromised when shareholders cheat or simply mislead company creditors by providing fake or misleading information, that is to say when they create *false representations*. Indeed, the transparency of such information is a precondition for creditors to evaluate their investment risks, which in turn is an essential pre-requirement for the good functioning of the market. Just think about the economic consequences of loans wrongly granted by a bank to a company on the bases of misleading or fake information. In this case a rigorous recognition of limited liability, thus of the powers of shareholders would conflict even with the public interest.

In conclusion, it is only when judges recognize *fake representations* that veil piercing should be implemented and shareholders should be considered unlimited liable towards creditors for corporate debts. Therefore, it is believed by the writer that, although in most cases justice should prevail over economic and social development, limited liability cannot be indiscriminately disregarded pursuant to a general concept or principles of fairness and justice. The boundaries within which judges should apply veil piercing must be limited to those cases where there is evidence of fake or misleading information that deceive creditors in evaluating their investments risks.

References

- Nicholas A., “Reverse Piercing of the Corporate Veil: A Straightforward Path to Justice”, St. John's Law Review, 85(3), (2011), 1147-1188.

- Bainbridge, S. M. & Henderson, T. M. Limited liability. A legal and Economic Analysis. Massachusetts. Edward Elgar Publishing, Inc., 132-133, (2016).

- Barber, D. H., “Piercing the Corporate Veil”, Willamette Law Review, 17(2), (1981), 371-404.

- Beurskens, M. & Noack, U., “Of Tradition and Change - The Modernization of the German GmbH in the Face of European Competition”, German Law Journal, (2008), 0037.

- Bratton, W. W. McCahery, J. A., “An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition”, Washington and Lee Law Review, 54(2), (1997), 629-686.

- Bruno, F., “Crisi di impresa e responsabilità da fatto illecito delle società alla luce dell'esperienza dei sistemi di common law”, PhD diss., Faculty of Law, Università degli Studi di Napoli Federico II (2006).

- Bucy, P. H., “Corporate Ethos: A Standard for Imposing Corporate Criminal Liability”, Minnesota Law Review, 75(4), (1991), 1095-1184.

- Carmeto, A., “Piercing the Corporate Veil – Italy”, International Business Lawyer 6(2), (1978), 130.

- Cheng, T. Wang, H. Hofmann, J. C., “Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives”, NUS Law Working Paper, 25, (2018), 44-45.

- Cheng, T. K., “The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines”, Boston College International and Comparative Law Review, 34(2), (2011), 329-412.

- Dodd, E. M., “The Evolution of Limited Liability in American Industry: Massachusetts”, Harvard Law Review, 61(8), (1948), 1351-1379.

- Fan, J. (范健), Wang, J. (王建文). Gongsi fa (公司法) [Company Law]., Beijing: Falu chuban she, (2018).

- Figueroa, D., "Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America", DUQ. L. REV. 50, (2012), 683-699.

- Fimmanò, F., "Supersocietà di fatto ed estensione di fallimento alle società eterodirette". Il Caso.it Blog. (2016), http://blog.ilcaso.it/.

- Galgano, F., "La repressione dell'abuso della personalità giuridica", In Le società – I gruppi di società, (2001), 232-233.

- Graziotto, F., "Fallimento esteso alle società di capitali socie di fatto", Diritto 24, (2016), http://www.diritto24.ilsole24ore.com/art/dirittoCivile/2016-10-27/fallimento-esteso-societa-capitali-socie-fatto-145022.php.

- Gsell B. Krüger W. Lorenz S. Reymann C., "Grosskommentar Bürgerliches Gesetzbuch", Beck Online, (2018), 242(1).

- Hannigan, B., "Wedded to Salomon: Evasion, Concealment and Confusion on Piercing the Veil of the One-Man Company", Irish Jurist 50, (2013), 11-39.

- Harris, R., "The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business", Washington and Lee Law Review, 63(4), (2006), 1421-1478.

- Häublein, M. & Hoffmann-Theinert, R., "Kommentar Handelsgesetzbuch", Beck Online, (2018), 128(1).

- Holzmiller, E., "Responsabilità del socio gestore nelle società a responsabilità limitata", Diritto e Pratica delle Società, Sole 24 ore, 7(8), (2011), 77-81.

- Howard, S. E., "The Société Anonyme: From Joint Account to Business Corporation. The Accounting Review", 8(1), (1933), 11-21.

- Huang, H., "Piercing the Corporate Veil in China: Where is it Now and Where is it Heading", American Journal of Comparative Law, 60(3), (2012), 743-774.

- Liton, C. B., “Approach of the UK Court in Piercing Corporate Veil”, SSRN Electronic Journal, (2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2438217.

- Luttermann, C., “Accounting as the Documentary Proof of Good Corporate Governance”, German Corporate Governance in International and European Context, (2007), 177-204.

- Lutz, M. Heidinger, A. Leible, S. Schmidt, J., “Kommentar zum Gesetz betreffend die Gesellschaften mit beschänkter Haftung”, GmbH-Gesetz, 13(331), (2017).

- Machen, A. W. Jr., “Corporate Personality”, Harvard Law Review, 24(4), (1910-1911) 253-267.

- Malmendier, U., “Law and Finance ‘at the Origin’”, Journal of Economic Literature, 47(4), (2009), 1076-1108.

- Micklethwait, J. & Wooldridge, A., The Company: A Short History of a Revolutionary Idea, New York City: Modern Library, (2005).

- Morini, G., “Abuso del diritto: i recenti orientamenti giurisprudenziali”, Altalex, (2019).

- Mucha, A. Piercing V., “Lifting the Corporate Veil: Prest Decision in the Light of the Economic Analysis of the Company's Limited Liability”, SSRN Electronic Journal, (2017), https://www.ssrn.com/index.cfm/en/.

- Nzafashwanayo, D., “Wrongful Trading: The Liability of Directors for the Obligations of the Company Under Rwandan Law”, SSRN Electronic Journal, (2016), https://ssrn.com/abstract=2833820.

- Payne, J., “Lifting the Corporate Veil: A Reassessment of the Fraud Exception”, Cambridge Law Journal, 56(2), (1997), 284-290.

- Rosengarten, J. Burmeister, F. Klein, M., “The German Limited Liability Company” Munich, (2015), 14(201).

- Säcker, F. J. Rixecker, R. Oetker, H. Limperg, B., "Münchner Kommentar zum Bürgerlichen Gesetzbuch", Beck Online, (2016), 242(237).

- Sangiovanni, V., "La responsabilità del socio di s.r.l. Le rassegne: Società", (2011), 531-538.

- Taylor, T., "The Limited Liability Corporation is the Greatest Single Discovery of Modern Times", (2017). EconomicBlogs.org. https://leaders.economicblogs.org/conversable-economist/2017/liability-corporation-times/.

- Tsang, K. F., "The Elephant in the Room: An Empirical Study of Piercing the Corporate Veil in the Jurisdictional Context", Hastings Business Law Journal, 12(2), (2016), 185-240.

- Ventoruzzo, M. Conac, P. Goto, G., Comparative Corporate Law, West Academic, (2015).

- Wang, J. (王军), Zhongguo Gongsi Fa (中国公司法) [Chinese Company Law]. Beijing: Gaodeng jiaoyu chuban she, (2015).

- Ying, Y. H. & Yeo, R. "Revisiting the Alter Ego Exception in Corporate Veil Piercing", SAcLJ, 27, (2015), 177-206.

- Yu, K. B. Krever, R., "The High Frequency of Piercing the Corporate Veil in China", Asia Pacific Law Review, 23(2), (2015), 63-87.

- Zhong, X. T., "New Era of Corporate Veil-Piercing: Concealed Cracks and Evaded Issues", Singapore Academy of Law Journal, 28(1), (2016), 209-241.

- Zorzi, N., L'abuso della personalità giuridica: tecniche sanzionatorie a confronto. CEDAM, (2002).