

## PROTECTION OF PROPERTY RIGHTS BASED ON THE DOCTRINE OF PIERCING THE CORPORATE VEIL IN THE RUSSIAN CASE LAW

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*In the Russian justice system, the doctrine of piercing the corporate veil was developed at the case law level and is used to prevent abuse in corporate relationships on the part of those who control a legal entity in detriment to the property rights of the legal entity's creditors. Since the principle of limited liability is important for Russian civil circulation, it is necessary to identify the relevant grounds for the application of said doctrine and its application criteria. Our objective is to justify not only the need for preservation of the doctrine of piercing the corporate veil in the Russian legal system, but also the development of the doctrine by giving it concrete substance based on generalization of existing case law. The criteria for applying the doctrine of piercing the corporate veil are: monitoring the activities of a legal entity by another entity which can influence commercial companies' decision making, actually or legally; violations or abuse of rights; existence of a cause-and-effect relationship between a violation or an abuse of rights on the part of the beneficiary and the creditor's losses; the existence of exceptional circumstances in which it is impossible to protect the creditors' legitimate interests with other legal measures; and dispute arising from private law relations. The main consequence of applying the doctrine of piercing the corporate veil is the disregard for the corporate entity. Autonomy can manifest in three areas (extension of a party's debts to the legal entities under its control; acknowledgement that the rights and liabilities are actually vested in the party which managed the legal entity; acknowledgement of the legal entity as a representative of the controlling legal entity).*

*Keywords: property rights; corporate law; corporate veil; piercing the corporate veil; good faith; claims in rem; abuse of rights; affiliation; private international law; conflict of laws; beneficial ownership.*

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## Introduction

Russian corporate legislation concerning the liability of founders and members of commercial companies is built on the principle of separation – a distinct separation of the company’s debts and the member’s debts and limitation of the founder’s liability for the company’s debts. The separate legal entity principle is important in all developed legal systems.<sup>1</sup> To expound the main idea of this principle, courts refer to the Latin aphorism “*Eripitur persona, manet res*” (“Man dies, the case remains”).<sup>2</sup> R.B. Thompson stated that

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<sup>1</sup> See Andrea Boggio, *Linking Corporate Power to Corporate Structures: An Empirical Analysis*, 22(1) Social & Legal Studies 107, 107–108 (2013); Lorraine Talbot, *Critical Company Law* 23–24 (London; New York: Routledge-Cavendish, 2007); Muhammad Zubair Abbasi, *Legal Analysis of Agency Theory: An Inquiry into the Nature of Corporation*, 51(6) International Journal of Law and Management 401 (2009).

<sup>2</sup> Ian M. Ramsay & David B. Noakes, *Piercing the Corporate Veil in Australia*, 19 Company and Securities Law Journal 250, 251 (2001).

as a general principle, corporations are recognized as legal entities separate from their... liability of the entity and not of the shareholders, directors, or officers who own and/or act for the entity.<sup>3</sup>

However, implementation of this principle enables the abuse of corporate rights; the framework of the commercial company can be used to create a risk-minimization scheme wherein the debts are consolidated in one legal entity and the assets in another entity while both entities are controlled by one beneficiary. In this case, the beneficiary builds a chain of controllable and interconnected legal entities. In case of insufficient capitalization of such controllable legal entities, their creditors are unable to protect their property rights. This common situation in Russian civil circulation raises the issue of defining the available and efficient methods of protecting creditors' property rights, both *in personam* and *in rem*.

In striving to find a balance between the interests of the parties controlling the legal entity and its creditors, the doctrine of piercing the corporate veil was developed in the Russian case law. It is important to point out that the achievements of the law of England and the USA, where the Piercing the Corporate Veil Doctrine was originally developed, were taken as a basis for the development of the Russian Piercing the Corporate Veil Doctrine.<sup>4</sup> English corporate law has been evolving over a longer time frame than the corporate law of most countries in continental Europe and Russia. Localization twists this doctrine out of shape to such a degree that all that remains from the original English legal constructs, more often than not, is the idea that gave rise to the doctrine.

The doctrine proceeds from the premise that the party with actual or legal control of a debtor's activities shall defend the creditor's suit in a situation in which a legal entity has been established for appearances or to avoid liability. The corporate veil can be pierced when the court, in spite of the legal entity's autonomy, forces the organization to disclose information on its beneficiary to recover the debts there from, but not from the legal entity itself.

Of particular dispute is the question of defining the legal basis and the content of this doctrine, both at the theoretical level and in case law.

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<sup>3</sup> Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76(5) Cornell Law Review 1036 (1991).

<sup>4</sup> See Maurice I. Wormser, *Piercing the Veil of Corporate Identity*, 12 Columbia Law Review 496 (1912); Otto Kahn-Freund, *Some Reflections on Company Law Reform*, 7(1-2) Modern Law Review 54 (1944); Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42(4) University of Chicago Law Review 589 (1975); Simon P. Ville, *Judging Salomon: Corporate Personality and the Growth of British Capitalism in a Comparative Perspective*, 27(2) Federal Law Review 203 (1999).

## 1. The Principle of Good Faith as a Basis for Applying the Doctrine of Piercing the Corporate Veil in the Russian Legal System

Not having a regulatory basis in the form of a special rule adopted at the legislative level, the doctrine of piercing the corporate veil is based on general provisions of civil legislation. The principle of good faith (cl. 3 of Art. 1 of the Civil Code of the Russian Federation (hereinafter the RF CC)),<sup>5</sup> and its counterpart – knowingly unfair acts, abuse of rights, evasion of the law (Art. 10 of the RF CC) play the main role in regulatory justification of the doctrine.

When establishing controllable legal entities (most frequently in the form of commercial companies), the entity in favor of which the business is structured substantially abuses its right as it gains undue profit at the cost of the legal interests of the creditors of the controllable legal entities. In accordance with Art. 10 of the RF CC it is prohibited to exercise civil rights with the goal of abusing other rights.

All jurisdictions with developed legal systems have the so-called business judgement rule – the owner (shareholder) who makes key decisions on the core aspects of the company's operations is immune to claims for damages as a result of his corporate decision if made within the limits of reasonable business risk.<sup>6</sup> This is precisely the bona fide requirement for a corporate decision.

The literature mentions that piercing the corporate veil gives rise to competition between the principles of legality and equality of civil circulation members (and the equal right to protect their interests) and the principles of autonomy and limited liability of legal entities.<sup>7</sup> Moreover, in applying the doctrine of piercing the corporate veil, the court resolves the issue of the competition of the principle of good faith with the principle of legality and the principle of limited liability of members and founders.

The noted problem of the competition of the civil rights principles can be solved by defining a hierarchy of principles and their subordination. As an alternative, when defining the system of civil rights principles, it is possible to proceed from the premise that the more abstract and universal the idea reflecting a given principle, the more significant it is in the hierarchy of principles. The more abstract the principle, the more exclusive nature it has based on the rule of *lex specialis derogat lex generalis*.

<sup>5</sup> Гражданский кодекс Российской Федерации (часть первая) от 30 ноября 1994 г. № 51-ФЗ, Собрание законодательства РФ, 1994, № 32, ст. 3301 [Civil Code of the Russian Federation (Part One) No. 51-FZ of 30 November 1994, Legislation Bulletin of the Russian Federation, 1994, No. 32, Art. 3301].

<sup>6</sup> See Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57(1) *Vanderbilt Law Review* 83 (2004); Robert W. Baxt, *The Battle Resumes for a Better Business Judgment Rule*, 90(3) *Australian Law Journal* 167, 167–168 (2016); Adina Ponta, *The Business Judgment Rule – Approach and Application*, 5(2) *Juridical Tribune (Tribuna Juridica)* 25, 25–26 (2015).

<sup>7</sup> Гольцблат А.А., Трусова Е.А. Снятие корпоративной вуали в судебной и арбитражной практике России // Закон. 2013. № 10. С. 51 [Andrey A. Goltsblat & Elena A. Trusova, *Piercing the Corporate Veil in the Russian Judicial and Arbitrazh Practice*, 10 *Law* 49, 51 (2013)].

The most abstract, universal and exceptional principle is the principle of good faith, and the issue of the subordination of civil law principles can be solved in favor thereof. Of course, this approach is ambiguous, but the issue of the subordination of principles is raised not even by the civil law theory, but by the case law. There is a notable statement by one English judge in a settlement of a similar dispute:

Good faith is the most important principle prevailing even over the fundamental principle of the company's separate legal personality.<sup>8</sup>

It is difficult to formulate a definition of the principle of good faith, and this situation is typical for Russian law as well as for foreign legal systems. Scientists of common law countries are skeptical about the possibility of successful formulation of the definition, but at the same time, the effect of the principle of good faith is actively researched especially in contract law.<sup>9</sup>

Various points of view on the definition of the principle of good faith proceed from the different ideas that form the basis of the definition. It is often stated that it is necessary to consider good faith through morals and morality. This principle is related to honesty, justice, and rationality prevailing in society.<sup>10</sup>

It was proposed to articulate the concept of good faith through a negative definition by reference to absence of bad faith.<sup>11</sup> In English case law there are more capacious definitions of good faith – honesty, contractual fidelity, and compliance with business standards (*Yam Seng Pte. Ltd. v. International Trade Corp. Ltd.*<sup>12</sup>).

In U.S. law, the legal concept of implied covenant of good faith and fair dealing arose in the mid-19<sup>th</sup> century.<sup>13</sup> In 1933, in the case of *Kirke La Shelle Co. v. Paul Armstrong Co. et al.*<sup>14</sup> the New York Court of Appeals said:

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<sup>8</sup> Ruth Bonnici, *The Principle of Separate Corporate Personality*, Gh.S.L. Online Law Journal (2013) (May 3, 2018), available at <http://perma.cc/9M4N-RA7K>.

<sup>9</sup> See John W. Carter & Wayne Courtney, *Good Faith in Contracts: Is There an Implied Promise to Act Honestly?*, 75(3) Cambridge Law Journal 608 (2016); Jay M. Feinman, *The Duty of Good Faith: A Perspective on Contemporary Contract Law*, 66(4) Hastings Law Journal 937, 938 (2015); Anthony Gray, *Good Faith in Australian Contract Law after Barker*, 43(5) Australian Business Law Review 358 (2015); Chris D.L. Hunt, *Good Faith Performance in Canadian Contract Law*, 74(1) Cambridge Law Journal 4 (2015); David Campbell, *Good Faith and the Ubiquity of the "Relational" Contract*, 77(3) Modern Law Review 475 (2014); Todd D. Rakoff, *Good Faith in Contract Performance: Market Street Associates Ltd. Partnership v. Frey*, 120(5) Harvard Law Review 1187, 1188 (2007).

<sup>10</sup> John F. O'Connor, *Good Faith in English Law* 102 (Aldershot: Dartmouth Publishers, 1990).

<sup>11</sup> Robert S. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54(2) Virginia Law Review 195, 202 (1968).

<sup>12</sup> *Yam Seng Pte. Ltd. v. International Trade Corp. Ltd.* [2013] E.W.H.C. 111, Rn. 137 ff.

<sup>13</sup> Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80(2) St. John's Law Review 559, 561 (2006).

<sup>14</sup> *Kirke La Shelle Co. v. Paul Armstrong Co. et al.*, 263 N.Y. 79; 188 N.E. 163 (N.Y. 1933).

In every contract there is an implied covenant that neither party shall do anything, which will have the effect of destroying or injuring the right of the other party, to receive the fruits of the contract. In other words, every contract has an implied covenant of good faith and fair dealing.

In the American Uniform Commercial Code good faith is defined as “honesty in fact” and “compliance with reasonable commercial standards of fair dealing in trade” (Art. 2-103(1)(b)).

In the countries of continental Europe, good faith is thought of as a standard of conduct. Article I.-1:103(1) of the Draft Common Frame of Reference states:

The expression “good faith and fair dealing” refers to a standard of conduct characterised by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question.<sup>15</sup>

The principle of good faith is necessary because in the modern conditions of developing civil circulation it is rather difficult to find the border between situations in which laws are infringed and observed. There is a “grey” zone wherein the entity’s actions do not infringe on the law and, moreover, formally abide by it, but there are negative consequences of such actions.

Bad faith is a deviation from common, accepted, and widespread norms of behavior. In scientific literature, the principle of good faith is most often defined as a behavioral norm which allows for assessment of the behavior of members in a relationship.<sup>16</sup> Unfair acts are characterized by artificiality and farfetchedness.

Following this line of reasoning, the creation of a chain of interconnected, controllable legal entities which provide the opportunity to influence corporate decisions is, formally, legal. However, if these actions create unfavorable consequences for any third parties, they can be assessed as knowingly unfair. The issue is that such business structuring allows for the redistribution of risk from the controller to the creditors of the controllable entity, which will not be able to receive consideration in the event of the debtor’s insufficient capitalization. In connection with this, it should be understood that by virtue of cl. 4 of Art. 1 of the RF CC, nobody is entitled to benefit from one’s own inequitable conduct.

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<sup>15</sup> *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR). Outline Edition* (C. von Bar & E. Clive (eds.), Munich: Sellier European Law Publishers, 2009).

<sup>16</sup> *Болдырев В.А. Содержание государственных реестров как фактор, влияющий на оценку добросовестности участников гражданского оборота // Нотариус. 2015. № 5. С. 3–5 [Vladimir A. Boldyrev, *The Content of State Registers as a Factor Influencing the Assessment of Integrity of Participants in Civil Turnover*, 5 Notary 3 (2015)].*

## 2. The Doctrine of Piercing the Corporate Veil in Foreign Systems of Justice

The doctrine of piercing the corporate veil was formed due to legal precedents in the countries with the Anglo-Saxon legal system. It was formulated for the first time in England in *Salomon v. Salomon & Co. Ltd.*,<sup>17</sup> in which the court refused to assert the main shareholder's liability for the company's debts due to the absence of exceptional circumstances allowing for the legal entity's autonomy to be ignored. The case can be summarized as follows: Solomon, who owned a shoe company, established a new company, Solomon & Co., jointly with his family members (he registered 99.97% of shares under his own name and brought in his family members due to the limits on the minimum number of participants – seven), to which he sold the enterprise at a monumental price with security of all of the company's property. After some time, Solomon & Co. went bankrupt, and Solomon received all the assets using the security advantage. The company's creditors attempted to levy execution on Solomon's personal property, but failed. This judicial dispute is of note because the court developed the principle of separate legal personality applied to a situation in which a company is fully controlled by one person. The importance of this case for the development of the doctrine of piercing the corporate veil is that within the framework of the dispute settlement there were arguments concerning usage of the legal entity's framework to deceive the creditors and the permissibility of extending the member's liability for the company's debts.<sup>18</sup>

In English law and in American law, there are several stages of the application of the doctrine of piercing the corporate veil, described in detail in the literature which describes the modern stage of the doctrine's development as a period of decline and seldom use of the concept.<sup>19</sup> Given the availability of a sufficient number of literary sources, it is unnecessary to refer to the history of the establishment of the considered doctrine in England within this paper. Instead, we shall pay attention to the current status of the doctrine's application.

*Prest v. Petrodel Resources Ltd.*,<sup>20</sup> resolved by the Supreme Court of Great Britain, was a dispute concerning the division of property over the course of divorce proceedings. The husband owned several oil companies registered in different

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<sup>17</sup> *Salomon v. Salomon & Co. Ltd.* [1896] U.K.H.L. 1, [1897] A.C. 22.

<sup>18</sup> Alan Dignam & John Lowry, *Company Law* 18–22 (New York: Oxford University Press, 2009).

<sup>19</sup> See Laurence C.B. Gower, *The Principles of Modern Company Law* 207–208 (London: Stevens, 1957); Thomas K. Cheng, *The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines*, 34(2) *Boston College International and Comparative Law Review* 329, 334 (2011); Thompson 1991, at 1066.

<sup>20</sup> *Prest v. Petrodel Resources Ltd.* [2013] U.K.S.C. 34, [2013] 2 A.C. 415.

jurisdictions, and some of these companies owned real estate in the United Kingdom, including a house where the spouses lived. In the first instance, the court levied execution upon the real estate in favor of the wife, including the family house owned by the companies, thus acknowledging that the husband fully controlled them and was a beneficiary.

Upon consideration of the case, the Supreme Court of the United Kingdom determined that the real estate was officially registered with the companies, however they were just nominal holders, i.e. acted as a trustee in the trust, while the husband was the beneficiary of this trust; the companies did not purchase this real estate with their own funds, and use thereof was not directly connected with business operations. In this case, the Supreme Court took the side of the first instance court, but the doctrine of piercing the corporate veil was not applied, and the court used another tool – the concept of trust.

The court found that it was possible to impose the company's actions and assets on the controller not just within the framework of piercing the corporate veil but also in the following situations: when an individual acted as the company's agent (agency theory) or jointly with the company (a joint actor); in cases where company owns assets as a nominee or a trustee; and in cases provided for by corporate law. According to the court, there is no need to pierce the veil if the offender simply hides under the mask of a company, as the court can hold him accountable without this. The corporate veil can be pierced only if the company is being used according to the evasion principle – if a person tries to avoid responsibility for outstanding liabilities, using a company for this purpose.

When the Supreme Court discussed the inapplicability of the doctrine of piercing the corporate veil to the case, it was stated that there were no cases of applying the doctrine properly and successfully; it was impossible to clearly formulate the doctrine itself, its principles and applicability. In this regard, the court advocated to maintain the doctrine of piercing the corporate veil in English law, however, its application was limited. First, only in case of evasion of the law (evasion of an outstanding liability). Second, it can be applied only as an exceptional remedy and can be used only when all the other available methods have been depleted.

In American law, the doctrine of piercing the corporate veil is applied often and has a more utilitarian nature: there is a developed system of tests, as well as a so-called "laundry list" of legal offenses and their manifestations which help the judge to define the applicability of the doctrine to a certain case. The list of 20 partially duplicated clauses is provided in the references.<sup>21</sup> The courts use lists of texts, which, to the contrary, prove the necessity of rejecting the claim for piercing the veil.<sup>22</sup>

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<sup>21</sup> Mark Loewenstein, *Veil Piercing to Non-Owners: A Practical and Theoretical Inquiry*, 41(3) *Seton Hall Law Review* 839, 846–847 (2011).

<sup>22</sup> William J. Rands, *Domination of a Subsidiary by a Parent*, 32(2) *Indiana Law Review* 421, 434–435 (1999).



The classic criteria for applying the doctrine are the following circumstances: the corporation has no autonomy or signs of actual existence; the corporation is used for illegal means; the presence of cause-and-effect relationship between abuse of corporate rights and the claimant's losses. All criteria of application of the Piercing the Corporate Veil Doctrine existing in the USA are based on lack of separate identity of a company in decision-making (instrumentality doctrine, alter ego doctrine, lack of separate identity, sham (shell) doctrine).

In American law, the doctrine of piercing the corporate veil is applied only to closed corporations for which the justification of limited liability is weaker. In general, as American lawyers admit, the question of the applicability of the doctrine of piercing the corporate veil is most intricate in corporate law, in which it is impossible to find distinct and clear rules.<sup>23</sup>

The statutory concept of the Piercing the Corporate Veil takes place in the law of Belgium, Germany, France, the Netherlands, and other EU countries.<sup>24</sup> In the Romano-Germanic law family (in Germany for example) the doctrine was developed predominantly at the theoretical level, was rarely used in practice, and took the name of "piercing liability" (Durchgriffshaftung and Zurechnungsdurchgriff<sup>25</sup>).

If in Anglo-Saxon law the application of the doctrine of piercing the corporate veil is characterized by utility and pragmatism, in German law it is characterized by the drive to understand the nature of an institution. Thus, the Supreme Court of Germany hesitated when defining the legal basis for imposing liability for the debts of a limited liability company violation of "corporate good faith" (gesellschaftsrechtliche Treu in 1975); application of joint-stock legislative rules to groups of GmbH companies on the annual indemnity of losses on an analogical basis in 1985; introduction of a structure of certain liability for "destructive interference in the company's affairs" (existenzvernichtende Eingriff) in 2001; and application of the general provisions to delict (para. 826 of the German Civil Code) in 2007. The delictual nature of the controller's liability for the debts of a controllable company allows for resolution of the issue of insufficient legislative regulation on the doctrine of piercing the corporate veil. Piercing liability is of delictual nature in Netherlands Law as well.<sup>26</sup>

In Austrian law, one of the most frequently applied legal grounds for piercing the corporate veil is a company's insufficient capitalization on the part of the founder, which increases the risk of default through fault of the founder. In addition, the

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<sup>23</sup> *Piercing the Corporate Veil* 5 (E.S. Fenton (ed.), Mechanicsburg: Pennsylvania Bar Institute, 2012).

<sup>24</sup> Karen Vandekerckhove, *Piercing the Corporate Veil: A Transnational Approach* 11 (Alphen aan den Rijn: Wolters Kluwer Law & Business, 2007).

<sup>25</sup> Chee H. Tham, *Piercing the Corporate Veil: Searching for Appropriate Choice of Law Rules*, 1 *Lloyd's Maritime and Commercial Law Quarterly* 22, 23–24 (2007).

<sup>26</sup> See Karen Vandekerckhove, *Piercing the Corporate Veil: A Transnational Approach*, at 24–25; Karen Vandekerckhove, *Piercing the Corporate Veil*, 4(5) *European Company Law* 191, 192 (2007).

grounds for piercing the corporate veil can be a mixture of the company's property and the founders' personal property, as well as a mixture of the companies' business spheres.<sup>27</sup>

### 3. Implementation of the Doctrine of Piercing the Corporate Veil in the Russian System of Justice

The doctrine of piercing the corporate veil was introduced in the Russian justice system at the level of a legal determination by the Supreme Arbitrazh Court of the Russian Federation (hereinafter the SAC RF) Presidium. The doctrine of piercing the corporate veil was mentioned for the first time by the SAC RF Presidium in the case of *Parex Bank* (resolution of the SAC RF Presidium No. 16404/11 of 24 April 2012). Based on this legal determination, a branch or a representative office is deemed to exist even if the legal entity has no legal subdivision on the territory of a foreign state but, nonetheless, carries out its activities in said territory via an independent company with a similar name which does business on its behalf and in fact acts as a subdivision of this legal entity.

In this regard, by force of p. 4 of Art. 170 of the Arbitrazh Procedure Code of the Russian Federation,<sup>28</sup> arbitrazh courts are entitled to refer to the resolution of the SAC RF Presidium in the statement of reasons. We can conclude that the approach to implementation of the doctrine of piercing the corporate veil formulated by the SAC RF has a precedential power regarding disputes considered by arbitrazh courts of various instances.

It should be noted that in said resolution the doctrine was not clearly formulated, which leaves the issue of justifying its application open. Russian court authorities interpret the doctrine of piercing the corporate veil rather extensively, deviating from the classical understanding developed in the Anglo-Saxon law. In theory, the doctrine of piercing the corporate veil implies that the founders of a legal entity which was established only for appearance (as an operating legal entity established to withdraw from responsibility) are held responsible. The conclusions made by the SAC RF in the example differ from this framework in terms of application and results. It appears that the framework used by the SAC RF as piercing the corporate veil differs from the classical doctrine. The preceding legal case formed the grounds for implementing the doctrine in the Russian system of justice, although in a unique form.

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<sup>27</sup> Суханов Е.А. Ответственность участников корпорации по ее долгам в современном корпоративном праве // Проблемы современной цивилистики: Сборник статей, посвященных памяти профессора С.М. Корнеева [Evgeny A. Sukhanov, *Liability of a Corporation's Participants for Its Debts in Modern Corporate Law in Problems of Modern Civil Law: Collection of Articles in Memory of Professor S.M. Korneev*] 107 (Moscow: Statut, 2013).

<sup>28</sup> Арбитражный процессуальный кодекс Российской Федерации от 24 июля 2002 г. № 95-ФЗ, Собрание законодательства РФ, 2002, № 30, ст. 3012 [Arbitrazh Procedure Code of the Russian Federation No. 95-FZ of 24 July 2002, Legislation Bulletin of the Russian Federation, 2002, No. 30, Art. 3012].

The SAC RF applied the mechanism of piercing the corporate veil previously but it did not name it in the text of the court order. It is stated in the resolution of the SAC RF No. 17095/09 of 20 April 2010 with regard to case No. A40-19/09-OT-13 that the matter of taking measures to secure the claim filed to the International Arbitration Court was submitted for new consideration to the court of cassation, as the SAC RF had the expertise to consider disputes on taking measures in the form of a seizure of a private individual's property to secure a claim resulting from the economic (business) relationship which was considered in the arbitrazh court, and therefore, the court had no grounds to terminate the proceedings and cancel the injunctive remedies. In the case under consideration, the debt of the private individual occurred due to the issue of a guarantee to secure the legal entity's obligations for payment for the purchased shares. In this regard, the individual acted as a party controlling the activities of this legal entity. This conclusion was made upon consideration of the nature of the economic relationship in which the individual took part. The individual controlled the activities of the company, which acted as a buyer under a contract for which the individual himself was a grantor, and also issued a bill to the company in which the individual specified himself as a beneficiary owner. As a result, the court resolved that the personal property of the private individual had been involved in carrying out economic (business) activities by piercing the corporate veil of the participants of the transaction considered in the case.

This practice changed due to the liquidation of the SAC RF. The Supreme Court of the Russian Federation (hereinafter the SC RF) waived this approach in the spring of 2015. The issue of the jurisdiction of disputes between a creditor (legal entity) and a grantor (private individual) who is the beneficiary of a debtor (legal entity) was resolved in favor of the jurisdiction of the general jurisdiction courts (Judicial Review of the SC RF No. 1 (2015) (approved by the SC RF Presidium on 4 March 2015)).

We believe that the legal stance that the stated category of cases must be within the jurisdiction of the arbitrazh court is more consistent and logical. The grantor's actions are aimed to ensure financing of the business activities of the legal entity which is under its control and in which he is a beneficiary. Acting as a grantor in such situation, the private individual voluntarily pierces the corporate veil, revealing the business structure.

In the practice of first instance arbitrazh courts there were cases of applying the considered doctrine even before adoption of the legal position of the SAC RF. The resolution of the Arbitrazh Court of the Krasnoyarsk Territory with regard to case No. A33-18291/2011 is of interest because it considered both the regulatory and the doctrinal bases of applying the mechanism of piercing the corporate veil in reasonable detail. According to court documents, a dispute arose between a municipal unitary enterprise and the individual entrepreneur (IE) Zykov concerning cold water supply and waste water collection. The municipal unitary enterprise demanded the collection of debt from IE Zykov as an entity consuming electric energy. IE Zykov objected,

noting that Zykov & Co. Limited Liability Company was liable for the debts, as the contract of energy supply had been signed with this company.

In satisfying the demands for collection of the debt from the IE under the contract, the arbitrazh court pierced the corporate veil of Zykov & Co. LLC and acknowledged IE Zykov to be a defendant in the case. To justify its position, the court stated that

the legal entity is an independent participant of civil circulation, however, essentially, it is a legal fiction.

In addition, it was determined that S.N. Zykov had been engaging in economic turnover using two forms of individual participation in the business activity – as an individual entrepreneur and by establishment of a legal entity in which he was the sole founder and director. The court concluded that IE Zykov had actually gained profit from the economic relationship, irrespective of the fact that the contract had been renewed in favor of the company. In addition, the court concluded that the defendant's actions have

signs of abuse of the law in the form of circumvention of his counterparty regarding the interests of which economic entity he represented – himself as an individual entrepreneur, the limited liability company as a director, or an authorized person.<sup>29</sup>

In its resolution, the court stated that the doctrine of piercing the corporate veil exists in the civil law,

which states that if a legal entity has been established only for appearance or to evade responsibility, the actual business owner shall defend a suit.

In the appeals instance, the Third Arbitrazh Court of Appeal upheld the first instance judgement by its resolution of 29 May 2012, though it used slightly different arguments. The court simply noted that the user changed in the legal sense, while one and the same person gained profit in the economic sense, and the renewal of the contract from IE Zykov to Zykov & Co. LLC was purely formal.<sup>30</sup>

This judgement was very progressive, as it was the first time in the Russian case law when the court not only referred to the existence of the doctrine of piercing the corporate veil but also applied this doctrine to protect the creditor's property rights.

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<sup>29</sup> Решение Арбитражного суда Красноярского края от 15 февраля 2012 г. № А33-18291/2011 [Judgement of the Arbitrazh Court of the Krasnoyarsk Territory of 15 February 2012 with regard to case No. А33-18291/2011].

<sup>30</sup> Постановление Третьего арбитражного апелляционного суда от 29 мая 2012 г. по делу № А33-18291/2011 [Resolution of the Third Arbitrazh Court of Appeal of 29 May 2012 with regard to case No. А33-18291/2011].

In this case, the court concluded that the legal entity's responsibility should rest with its controllers. The act of ignoring the legal entity's autonomy was preconditioned by the fact that it was operative, i.e. it was not established for carrying out autonomous activities, but to serve the activities of another legal entity.

#### **4. Attempts of Normative Consolidation of the Doctrine of Piercing the Corporate Veil in the Russian Legislation**

The doctrine of piercing the corporate veil is opposed by the theory of affiliation of parties in the Russian system of justice. Affiliation of parties refers to parties interested in closing some sort of deal or an interrelationship of parties based on a common goal, economic similarities, and financial and organizational interests. Opposite to this framework, the doctrine of piercing the corporate veil is linked to a more private situation – control over the activities of a formally-autonomous legal entity. In affiliation, there is a concordance of will based on the community of interests and the presence of an interconnection between the entities. The corporate veil is pierced in situations where the legal entity's will is controlled by another party influencing the economic entity's decision-making.

The acknowledgment of a party as an affiliate of another party who is interested in completing a business deal results in legal consequences in the form of the acknowledgement of the particular party interested in completing the given business deal. In accordance with corporate legislation, an interested, affiliated party shall be deprived of the right to vote with all its voting shares at shareholder meetings when voting on the approval of an interested-party transaction.

Of the two competing legal frameworks, Russian legislators have chosen the path for developing the institution of affiliation introduced by Art. 53.2 in the RF CC on 1 September 2014, subject to which:

In cases where this Code or any other law puts forth the occurrence of legal consequences conditional upon the existence of interrelations (affiliation) between parties, the presence or absence of such relations is determined in accordance with the law.

It should be noted that the initial draft of changes to the RF CC based on the Civil Legislation Development Concept contained two special articles which fixed the definition of a party controlling a legal entity (Art. 53.3) and liability of such parties.<sup>31</sup>

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<sup>31</sup> Проект федерального закона «О внесении изменений в части первую, вторую, третью и четвертую Гражданского кодекса Российской Федерации, а также в отдельные законодательные акты Российской Федерации» [Draft federal law "On Amendments to Parts One, Two, Three and Four of the Civil Code of the Russian Federation, as Well as Individual Legislative Acts of the Russian Federation"] (May 4, 2018), available at [www.rg.ru/2012/04/06/gk-popravki-site-dok.html](http://www.rg.ru/2012/04/06/gk-popravki-site-dok.html).

However, the above articles were excluded from the draft in further readings and Art. 53.2 was considerably shortened.

Out of the large number of norms offered in the Civil Legislation Development Concept and the draft of changes to the RF CC on piercing the corporate veil, the law included only the rule of cl. 3 of Art. 53.1, subject to which

A party actually able to define the legal entity's actions, including the ability to give instructions to the parties named in clauses 1 and 2 herein, shall act in the best interest of the legal entity, reasonably and in good faith, and be liable for the losses caused to the legal entity due to its fault.

The sphere of application of this norm concerns only the losses of the company itself and not the losses of creditors of the legal entity's controller. However, the ability itself to recover losses from the party which actually controls the legal entity's activities is significant, and the law also defines losses of the controllable legal entity itself. However, this law can be also applied to piercing the corporate veil through analogy of the statute. Clause 3 of Art. 53.1 validates the concept of "shadow directors," i.e. a person whose instructions are followed by the heads of the company despite the person not being official member, shareholder, or head of said legal entity.<sup>32</sup>

This assumption suggests that piercing the corporate veil will remain a judicial doctrine for a long time and will not be validated by statute. The doctrine under consideration will surely not be left without a legislative framework, it can be applied by virtue of cl. 3 and cl. 4 of Art. 1 and Art. 10 of the RF CC.

### **5. Criteria for the Application of the Doctrine of Piercing the Corporate Veil by Russian Courts**

It is not possible to pierce the corporate veil arbitrarily; application of said doctrine by the court requires detailed justification. To justify the usage of the mechanism of piercing the corporate veil it is necessary to draw from the following criteria, which are conditions for application of the doctrine.

*First*, control over a legal entity's activities by another party which has actual or legal influence on decision-making by said economic entity.<sup>33</sup> Edward Herman directly links corporate control to influence over corporate decision-making.<sup>34</sup>

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<sup>32</sup> Colin R. Moore, *Obligations in the Shade: The Application of Fiduciary Directors' Duties to Shadow Directors*, 36(2) *Legal Studies* 326 (2016).

<sup>33</sup> Ian F. Fletcher, *Insolvency in Private International Law* 357 (Oxford: Oxford University Press, 2005).

<sup>34</sup> Edward S. Herman, *Corporate Control, Corporate Power* 17, 19 (New York: Cambridge University Press, 1981).

For example, the resolution of the Arbitrazh Court of the West Siberian District of 13 April 2016 with regard to case No. A03-14308/2015 states that

the claimant's judgement that the mechanism of "piercing the corporate veil" is applicable to Shulginsky Brewery LLC and Shulginskoe LLC in the form of a "crossover penetration" is unsound, as there is no common subject of control in the composition of the controllers of Shulginsky Brewery LLC and Shulginskoe LLC, on the one hand, and Shulginsky Brewery CJSC, on the other hand, which would govern its actions, including those which led to the claimant's losses.

The absence of the identity of the two legal entities due to the absence of "a common subject of control" of the old and the new company points to the absence of the control criteria, which served as grounds for not applying the doctrine of piercing the corporate veil.

In another example, in consideration of case No. A51-21076/2009 on the vindication of property items, the Arbitrazh Court of the Far Eastern District stated in resolution No. F03-786/2016 of 11 May 2016 that

inasmuch as the matter of recovery of the corporate control was not the subject of examination in this dispute and the annulment of the contract of sale of the share in the company's registered capital was denied per the enforceable court rulings in case No. A45-7713/2011... the judicial board believes that the doctrine of piercing the corporate veil cannot be applied in this case, as the company ArtemInvestStroy is an autonomous economic entity in proprietary relations.

It is important to understand that control over a legal entity's activities by another party is not enough alone for application of the doctrine. Although it should be noted that in the Russian case law there are cases in which the court's decision was based solely on the control on the part of the beneficiary. Upon consideration of case No. 11-16173, the Moscow City Court levied execution on real estate items which had been owned by the legal entities controlled by Russian entrepreneur S. The court established the fact of control over the legal entities on the part of entrepreneur S. Apart from this fact, the court did not establish any other breaches of the law on the part of Mr. S., including any abuse of the law (appellate ruling of the Moscow City Court of 2 August 2012 with regard to case No. 11-16173).

For example, the United States Supreme Court in *United States v. Bestfoods*<sup>35</sup> concluded that ordinary interrelation between companies can't be considered legal

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<sup>35</sup> *United States v. Bestfoods*, 524 U.S. 51 (1998).

basis for the piercing the corporate veil. A similar conclusion has been drawn in scientific research as well.<sup>36</sup>

In and of itself, one legal entity controlling another is not an offense, even if it is actual control. To utilize the doctrine under consideration, other circumstances must also be present.

*Second*, the corporate veil is pierced in case of an offense or an abuse of a right, including in the form of evasion of a law or any other knowingly unfair act. "Institutional abuse" is a criterion pointing at the need to pierce the corporate veil to identify a party which must reimburse the creditors' losses.

Cases when knowingly unfair acts constitute grounds for application of said doctrine can be exemplified by the business structuring scheme widespread in the sphere of cargo transportation: an individual entrepreneur leases his title to a vehicle to an economic entity established and controlled by him to transfer the ownership status of a source of increased danger and to limit his liability under Art. 1079 of the RF CC. This form of LLC incorporation eliminates the risk of any losses being imposed on the controllers.

In the decision of the Eighth Arbitrazh Court of Appeal No. 08AP-4159/2015 of 25 May 2015 with regard to case No. A75-8869/2014 the court referred to Art. 10 of the RF CC and concluded as follows:

In the case under consideration, IE Volchansky B.K. and SeverSpetsServis LLC, using the seemingly legal mechanism of vesting the company with vehicle owner status by giving appearance of lease relations under a formal contract of lease, burdened the latter with the risk of losses of IE Volchansky B.K. from the special equipment owned and operated for his own purposes and for his benefit. Thus, the court of appeal states that IE Volchansky B.K. is a proper defendant in the case, and the claimant's losses must be collected from him.

*Third*, the doctrine of piercing the corporate veil is applied if there are unfavorable civil legal consequences to creating a corporate shield. The most widespread consequence is the presence of debts of the controllable legal entity when it does not have enough property to redeem the debts, i.e. in case of a material undercapitalization.<sup>37</sup> The founder does not sufficiently finance the controllable legal entity, which puts into question the legal entity's ability to fulfill its obligations. Without adequate financing, the participant shows clear negligence of the creditors' interests, enriching himself with the amount of savings.<sup>38</sup>

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<sup>36</sup> Douglas G. Smith, *Piercing the Corporate Veil in Regulated Industries*, 4 Brigham Young University Law Review 1165, 1173 (2008).

<sup>37</sup> Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100(1) Cornell Law Review 99, 101 (2014).

<sup>38</sup> Thomas K. Cheng, *Form and Substance of the Doctrine of Piercing the Corporate Veil*, 80(2) Mississippi Law Journal 497, 577 (2010).



An example of this criterion is the cassational ruling of the SC RF No. 3-UDp14-2 of 30 July 2014, in which the doctrine of piercing the corporate veil is not named, but applicability of the mechanism itself was pointed out by the court.

The sole participant and the general director of a LLC was accused under cl. "b" of p. 2 of Art. 199 of the RF CC of evading taxes from the organization. Within the criminal case, a claim for recovery under Art. 1064 of the RF CC, which consisted of a VAT refund illegally obtained by the LLC from the federal budget, was filed by the tax authority against said person. The inferior courts rejected the claim of tax authority on the assumption that the general director was not a taxpayer, and actual imposition of tax collection from the person was impossible in that case. However, the SC RF submitted the case for new consideration, pointing out:

In the course of the new consideration of the case, the court must cumulatively analyze the interrelations of the criminal, criminal procedure, civil, and tax legislative norms regulating the procedure of reimbursement of damages caused by a crime, including a crime connected with tax evasion, carefully check the arguments of the prosecution on the necessity to apply this procedure to accused Z. and the justification of the claims stated against Z., and make a legal and reasonable decision within the civil legal proceedings based on the obtained results.

It should be noted that the approach of the court to such claims is not quite logical, as public tort (nonfulfillment of the tax payment obligation) cannot serve as grounds for civil liability (reimbursement of damages) together with the application of the private law mechanism of piercing the corporate veil. The sole executive authority is liable for his or her own unfair or injudicious actions to the legal entity itself (cl. 1 of Art. 53.1 of the RF CC) but not to the state. In the case under consideration, the tax arrears resulted from non-payment due to the actual operating activities of the legal entity, not from artificial operation.

As shown in case law, holding a party criminally responsible for a crime provided for by Art. 199 of the RF CC does not give rise to his obligation to reimburse for damages in the form of taxes unpaid by the organization at its own cost, as the party legally obliged to pay taxes (reimburse for the damage in the form of compulsory payments not received by the state) is not a private individual accused of a crime but a taxpaying organization; the defendant's crime, evasion of taxes payable by the organization, does not change the nature of the monetary funds unpaid to the federal budget.<sup>39</sup>

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<sup>39</sup> Апелляционные определения Свердловского областного суда от 25 июля 2014 г. по делу № 33-9255/2014 и от 19 марта 2014 г. по делу № 33-3329/2014 [Appellate rules of the Sverdlovsk Regional Court of 25 July 2014 with regard to case No. 33-9255/2014 and of 19 March 2014 with regard to case No. 33-3329/2014].

Moreover, there is a long-held belief in court practice that the doctrine can only be applied in the sphere of private-law disputes, as will be described below.

*Fourth*, to pierce the veil there must be a cause-and-effect relationship between the offense or abuse of a law on the part of the beneficiary and the losses of the creditor acting as claimant.

Case No. F04-7094/2011 serves as an example of this. The claimant claimed for joint damages in the form of profits lost from non-participation in a strategic partnership in favor of a third party. Per the claimant (shareholder), the defendants, being parent companies, exploited the opportunity to shape the decisions made by the company by blocking its participation in the strategic partnership, which resulted in its losses. By the ruling of the West Siberian District No. F04-7094/2011 of 6 June 2012 with regard to case No. A70-7811/2011, the case was submitted for new consideration, as no consideration was given to the fact that the directors whose voting blocked the company's participation in the strategic partnership were not independent directors.

*Fifth*, the doctrine of piercing the corporate veil can be applied only if there are exceptional circumstances due to which no other remedies can be used to protect the creditors' legal interests. The exceptionality of the doctrine of lifting the corporate veil is noted by R.B. Thompson. He writes that

piercing the corporate veil refers to the judicially imposed exception to this principle by which courts disregard the separateness of the corporation and hold a shareholder responsible for the corporation's action as if it were the shareholder's own.<sup>40</sup>

The doctrine of piercing the corporate veil is an equitable remedy. In the ruling of the West Siberian District of 13 April 2016 with regard to case No. A03-14308/2015 it is stated that:

The judicial instances have reasonably stated that the reference by Vneshekonombank to the defendants' abuse of the law is subject to rejection, as the claimant itself did not take any reasonably necessary actions to protect its interests.

On the grounds that piercing the corporate veil is an equitable remedy, the court rejected its application with a reference to the claimant's ability to protect its property rights with other civil remedies.

The exceptionality of the mechanism for piercing the corporate veil is shown in that in when property interests can be protected by application of other legal frameworks, their competition is inadmissible. For example, there is an alternative

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<sup>40</sup> Thompson 1991, at 1036.

method in taxation to achieve the same goal for which piercing of the corporate veil is usually applied. We are referring to the judicial doctrine of unjustified tax benefit, the final edition of which was formed by the resolution No. 52 of the SAC RF Plenum entitled "On the Arbitrazh Courts' appraisal of the validity of the taxpayer's obtaining of a tax benefit." One of the aspects of this approach to the fight against abusive taxpayers comes from the acknowledgement of a company's activities by the activities of the party controlling it for taxation purposes. In case of competition in applying these two doctrines, the one deemed more specific, i.e. the doctrine of unjustified tax benefit, should be prioritized.

*Sixth*, the doctrine of piercing the corporate veil can be applied only to private-law relationships in any spheres of civil regulation: corporate law, material law, contractual law, etc. Thus, in the resolution of the Federal Arbitrazh Court of Moscow District of 5 September 2013 with regard to case No. A40-41781/13-69-197 it is stated that

the doctrine of piercing "the corporate veil" can be applied only to private-law relationships formed between the founders of a legal entity and the legal entity itself, as well as between legal entities of one economic group, but not to public relationships, the relationship between the city of Moscow and the Department of Construction being one of such.

Transfer of the case to the SAC RF Presidium was denied, and in the ruling of the SAC RF No. VAS-16126/13 of 23 December 2013 concerning this case it was stated that the doctrine of piercing "the corporate veil" was inapplicable because "such relationships are not private-law in nature."

The conclusion made by the SAC RF is the most logical one; in modern practice of the SC RF, the doctrine of piercing the corporate veil is often applied by courts in tax disputes which are difficult to classify as private-law disputes.<sup>41</sup> Moreover, the tendency which appeared after liquidation of the SAC RF is that it is more difficult to achieve application of the considered doctrine in a dispute between individuals, while courts more consistently refer to the possibility of piercing the corporate veil to identify the interrelation of parties in disputes involving tax authorities.

## **6. The Reasons Behind the Rare Application of the Doctrine of Piercing the Corporate Veil by Russian Courts**

Despite the fact that interrelated chains of legal entities, including offshores and trusts, are widely used in structuring large business in the Russian economy, the

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<sup>41</sup> See кассационное определение Верховного Суда РФ от 30 июля 2014 г. № 3-УДп14-2; определение Верховного Суда РФ от 14 января 2016 г. № 305-КГ15-11546 по делу № А40-138879/14-75-404 [Cassational ruling of the SC RF No. 3-UDp14-2 of 30 July 2014; ruling of the SC RF No. 305-KG15-11546 of 14 January 2016 with regard to case No. A40-138879/14-75-404].

doctrine of piercing the corporate veil is not utilized very often in court practice. Let us discuss the main reasons the doctrine of piercing the corporate veil is rarely applied in courts.

First, there is no agreement among Russian civil law scholars on the implementation of the doctrine under consideration. According to professor Evgeny Sukhanov, application of the doctrine piercing the corporate veil in the Russian law is incorrect, as it ignores the autonomy of the legal entity, which does not only lead to the incorrect interpretation of the legal entity but also to an incorrect understanding of the subject of law in general, turning the structure of the legal entity into fiction.<sup>42</sup> We submit that the doctrine of piercing the corporate veil is not so harmful for the Russian legal system and it can be an efficient remedy against offshore schemes. In addition, it is necessary to prove the legal entity's lack of autonomy and control over its activities on the part of the beneficiary to pierce the corporate veil, as it is the control of the beneficiary itself which puts the autonomy of the legal entity under question.

In many respects, the goal in creating a legal entity is the creation of a "corporate shield," i.e. a legal barrier, between the creditors and the founders of the legal entity. In global legal practice, there are three models to ensure the proper use of the corporate shield determined by the specific nature of an establishment and the incorporation of legal entities.

The European continental model (inlet control) is based upon requirements being strictly fixed into law, making the establishment of a legal entity more difficult and allowing for the elimination of cases of establishment of nominal legal entities (those created without the goal of carrying out economic activities).

In the Anglo-Saxon model (outlet control), the procedure for establishing a legal entity is rather simple, but there is strict liability for any breaches of corporate law. For example, up to one third of the norms of the UK Companies Act of 2006 provide for criminal liability. It is easy to raise the corporate shield, but it is also easy to knock it down.

The Russian model (current control) comes from the premise that the legislation sets a simple establishment procedure and a simple liquidation procedure, but there are powerful capabilities for auditing the legal entity's activities on the part of the public authorities. In the formal approach of interpreting corporate legislation, the Russian structure of legal entities allows the founders and beneficiaries to abuse their rights, as in this situation the corporate shield protects only them and becomes impenetrable for the creditors, which destabilizes civil circulation. It is quite logical that the simplified establishment of a legal entity must be predicated by ease in piercing the corporate veil. In this regard, non-disclosure of the identity of the beneficiary controlling the legal entities already suggests that a business was structured to gain unjustified advantages.

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<sup>42</sup> Суханов Е.А. Сравнительное корпоративное право [Evgeny A. Sukhanov, *Comparative Corporate Law*] 152 (Moscow: Statut, 2014).

Second, Anton Ivanov, former chairman of the SAC RF, identified the factors which impede a broad implementation of the doctrine into legal practice in one of his interviews:

The issue is the mentality of judges who were brought up with a commitment to formalism and the parties who do not assert such claims... But the time will come when courts will consider the problems of “piercing the corporate veil.” If the parties assert and justify such claims, the courts will be obliged to consider them.<sup>43</sup>

Rare attempts by Russian enforcers to apply the doctrine under consideration were not successful due to the formal approach in interpretation of the law by the courts<sup>44</sup> which leads to a lack of protection of the creditors’ interests.

For example, in the resolution of the Thirteenth Arbitrazh Court of Appeal of 1 October 2012 with regard to case No. A56-38334/2011 it is stated:

An appeal to apply the doctrine “of piercing the corporate veil” is actually a presentation of the claimant’s position on the merits of the dispute, which is subject to appraisal upon consideration of the appeal. Application of any doctrine in the course of proceedings as a separate procedural step of the RF Arbitrazh Procedure Code is not provided.

<sup>43</sup> Иванов А.А. Государство рискует лишиться крупных активов // Коммерсантъ. 31 июля 2012 г. [Anton A. Ivanov, *The State Risks Losing Major Assets*, Kommersant, 31 July 2012], available at [www.kommersant.ru/doc/1991007](http://www.kommersant.ru/doc/1991007).

<sup>44</sup> See постановления Федерального арбитражного суда Восточно-Сибирского округа от 10 февраля 2014 г. по делу № А33-6328/2013, от 17 сентября 2013 г. по делу № А19-11062/2011; Федерального арбитражного суда Дальневосточного округа от 12 августа 2013 г. № Ф03-3534/2013 по делу № А73-15127/2012; Федерального арбитражного суда Западно-Сибирского округа от 6 июня 2012 г. по делу № А70-7811/2011; Федерального арбитражного суда Северо-Западного округа от 20 февраля 2013 г. по делу № А56-38334/2011; Арбитражного суда Московского округа от 21 января 2015 г. № Ф05-15548/2014; Федерального арбитражного суда Уральского округа от 24 марта 2005 г. № Ф09-2962/04-ГК, от 12 мая 2012 г. № Ф09-727/10 по делу № А60-1260/2009; Пятого арбитражного апелляционного суда от 3 июля 2014 г. № 05АП-6119/2014 по делу № А51-40718/2013; Тринадцатого арбитражного апелляционного суда от 21 января 2013 г. по делу № А56-14749/2010, от 17 июня 2014 г. по делу № А56-55593/2008; Девятого арбитражного апелляционного суда от 15 января 2014 г. № 09АП-42967/2013 по делу № А40-89799/2013 [Resolutions of the Federal Arbitrazh Court of the East Siberian District of 10 February 2014 with regard to case No. A33-6328/2013, of 17 September 2013 with regard to case No. A19-11062/2011; Federal Arbitrazh Court of the Far Eastern District No. F03-3534/2013 of 12 August 2013 with regard to case No. A73-15127/2012; Federal Arbitrazh Court of the West Siberian District of 6 June 2012 with regard to case No. A70-7811/2011; Federal Arbitrazh Court of the North Western District of 20 February 2013 with regard to case No. A56-38334/2011; Arbitrazh Court of the Moscow District No. F05-15548/2014 of 21 January 2015; Federal Arbitrazh Court of the Ural District No. F09-2962/04-GK of 24 March 2005, No. F09-727/10 of 12 May 2012 with regard to case No. A60-1260/2009; Fifth Arbitrazh Court of Appeal No. 05AP-6119/2014 of 3 July 2014 with regard to case No. A51-40718/2013; Thirteenth Arbitrazh Court of Appeal of 21 January 2013 with regard to case No. A56-14749/2010, of 17 June 2014 with regard to case No. A56-55593/2008; Ninth Arbitrazh Court of Appeal No. 09AP-42967/2013 of 15 January 2014 with regard to case No. A40-89799/2013].

The court referenced other grounds for the non-application of the doctrine, but the cited passage demonstrates both the court's confusion of material and procedural legal institutions and a misreading of the doctrine under consideration.

Application of this doctrine is most frequently denied because the circumstances of the current case differ from those in the cases in which the SAC RF did apply the doctrine. In the resolution of the Fifth Arbitrazh Court of Appeal No. 05AP-6119/2014 of 3 July 2014 with regard to case No. A51-40718/2013 it was stated:

the circumstances which served as grounds for forming the practice of applying "the doctrine of the corporate veil" do not coincide with the circumstances of the current case.

Such argument is universal, as there are no identical legal cases when it comes to the application of frameworks based on a principle as complicated as the principle of good faith.

There are even more original and flagrant arguments by courts refusing to apply the legal opinion of the SAC RF regarding the possibility of piercing the corporate veil. For example, in the resolution of the Arbitrazh Court of the West Siberian District of 13 April 2016 with regard to case No. A03-14308/2015 the court stated, *inter alia*, that the claimant's claim of grounds for application of cl. 4 of Art. 10 of the RF CC is meritless, as the relationship to which the claimant refers in the claim occurred before the date of enactment of cl. 4 of Art. 10 of the RF CC (from 1 March 2013). For this reason, this legal norm is not subject to application. If one follows the court's logic in this reasoning, if a party abused the law and it resulted in an abuse of the other party's right before 1 March 2013, the party is not obliged to reimburse for the losses – a victory of formalism over common sense.

Application of the doctrine of piercing the corporate veil is denied since it can only be applied in a situation when the claimant asserts a claim to bring a parent company or a founder to responsibility. The doctrine cannot be restricted to the category of cases provided above. Such restrictive interpretation can be exemplified by case No. A73-8193/2014. The claimant demands the contracts of purchase and sale of the organizations' shares be recognized as invalid and the application of the consequences of these transactions' invalidity in the form of return of the monetary funds and shares. The claimant believes that the contracts are void, as the parties of these transactions were interested not in shares in the organizations, but in the leasehold rights to the wood plots, and the rights abuse occurred at the conclusion thereof. Upon consideration of the case, the court stated that the argument of the cassation appellant concerning the necessity to apply "the principle of piercing the corporate veil" cannot be acknowledged as justifiable in this case. In the resolution of the Arbitrazh Court of the Far Eastern District No. F03-1778/2015 of 19 May 2015 with regard to case No. A73-8193/2014 it is stated that

as it has been correctly noted by the first instance court, the doctrine mentioned by the claimant cannot be applied to this dispute as the claims do not concern holding the parent company or founder liable.

Third, courts often apply the doctrine of piercing the corporate veil but do not name the framework used.<sup>45</sup>

## 7. The Consequences of Applying the Doctrine of Piercing the Corporate Veil

As you can see, in Russian court practice the results of applying this doctrine vary widely. The consequences depend directly on the circumstances supporting the application of this doctrine. A common consequence of applying this doctrine that the court can assert the legal entity's responsibility against its controllers. However, this consequence can have different modifications. Upon analysis of current Russian court practice, we can outline the following consequences of applying the doctrine most frequently used by the courts.

**1. Ignoring the legal entity's autonomy.** This consequence is applicable if the legal entity is used as an operating or nominal entity. In foreign practice, such grounds are called "use of the legal entity's framework as one's own alter ego or façade." In this situation, the legal entity is used only to veil the activities of another party.

The corporate veil is subject to piercing when the legal entity's structure is used as a nominal party – i.e., it was not established for carrying out direct economic activities. Nominal parties are most frequently established for the formal consolidation of property which must not be connected to the actual owner. This is confirmed by the fact that the legal entity has no signs of real existence: no assets, employees, or office; the post of the sole executive body is occupied by a person who cannot exercise management functions based on his/her work experience, etc.

The corporate veil must be also pierced when a transaction is made by an operating legal entity – an economic entity established to accompany the activities of another legal entity but not for its own autonomous activities. In France there is a concept of "a fictitious organization" ("société fictive") – a legal entity established only to veil the activities of another entity, thus eliminating its risks.<sup>46</sup>

<sup>45</sup> See постановления Арбитражного суда Волго-Вятского округа от 15 октября 2014 г. по делу № А79-8878/2013; Арбитражного суда Западно-Сибирского округа от 4 июня 2015 г. № Ф04-18515/2015 по делу № А45-12142/2014; Западно-Сибирского округа от 6 июня 2012 г. № Ф04-7094/2011 по делу № А70-7811/2011; Восьмого арбитражного апелляционного суда от 25 мая 2015 г. № 08АП-4159/2015 по делу № А75-8869/2014 [Resolutions of the Arbitrazh Court of the Volga-Vyatka District of 15 October 2014 with regard to case No. A79-8878/2013; Arbitrazh Court of the West Siberian District No. F04-18515/2015 of 4 June 2015 with regard to case No. A45-12142/2014; West Siberian District No. F04-7094/2011 of 6 June 2012 with regard to case No. A70-7811/2011; Eighth Arbitrazh Court of Appeal No. 08AP-4159/2015 of 25 May 2015 with regard to case No. A75-8869/2014].

<sup>46</sup> Vandekerckhove, *Piercing the Corporate Veil: A Transnational Approach*, at 363–365.

In Russian practice, this scheme is widespread: fixed production assets are recorded as assets of one legal entity, all the necessary production items are purchased via a second legal entity, the finished products are sold via a third legal entity, and labor relations with the employees are formalized via a fourth legal entity. The latter three legal entities enable the activities of the first one without carrying out any autonomous activities. In this regard, in accordance with cl. 1 of Art. 48 of the RF CC a legal entity is an autonomous organization which has *solitary* assets and is liable to the full extent of *its* assets.

In case of such a business structuring scheme, the commingling of assets (French “*confusion de patrimoines*”, German “*Vermögensvermischung*”) often occurs both between legal entities and between legal entities and private individuals. This occurs, for example, when personal debts are redeemed with the legal entity’s assets; the controller actually uses the assets formally owned by the controllable entity, and *vice versa*.

The legal consequence in question manifests in three variants. *First*, the legal entity can be acknowledged as a representative of another (controlling) legal entity.

The application of the doctrine of piercing the corporate veil to oppose the usage of operating legal entities formed the basis of the resolution of the SAC RF No. 16404/11 of 24 April 2012 with regard to case No. A40-21127/11-98-184 on the claim of Olimpia LLC against Parex Bank. In said Resolution, the SAC RF Presidium specified that the company’s registration as a permanent representative and the company’s ability to conclude contracts on behalf of the foreign organization did not constitute a characteristic criterion to qualify the organization’s activity as a dependent agent. The following criteria were named as characteristic: 1) clear understanding of the service users that the company is a permanent representative; 2) ability of the service users to make transactions at the company’s location without direct contact with the headquarters.

Another example is case No. A40-138879/14-75-404, in which the courts of all instances acknowledged the legitimacy of tax claims against the Russian division of Oriflame Cosmetics due to the illegal application of a royalty scheme under the contract of commercial concession, referencing the dependent nature of the activities carried out by the legal entity who served as royalty payer. The subsidiary of Oriflame Cosmetics LLC registered in Russia was acknowledged to be a representative of Luxemburg Oriflame Cosmetics S.A. In the ruling of the SC RF No. 305-KG15-11546 of 14 January 2016 concerning this case it is stated that the courts ruled upon the establishment of a permanent representative of Oriflame Cosmetics S.A. on the territory of the Russian Federation and not an autonomous legal entity.

In the judicial decision of the Arbitrazh Court of Moscow of 4 December 2014 in regard to this case, it is stated that the content of this or that phenomenon or circumstance shall be subject to appraisal in isolation from their legal implementation. On these grounds, the first instance court found that it was necessary to pierce the corporate veil in this case.



*Second*, acknowledgement that the rights and obligations were in fact exercised by the private individual or legal entity which actually managed the legal entity.

This is exemplified by case No. A33-18291/2011 of the Arbitrazh Court of the Krasnoyarsk Territory. The court established the fact that Mr. Zykov was exercising control over legal entity Zykov & Co. LLC and additionally “discovered signs of abuse of the law in the form of systematic circumvention of its counterparty,” as within the contractual relationship, Mr. Zykov simultaneously acted on his own behalf as an individual entrepreneur and on behalf of Zykov & Co. LLC as its representative. In other words, Zykov used the framework of a legal entity as a façade, in contrast to its actual purpose, which served as grounds for applying the provisions of the doctrine of piercing the corporate veil and acknowledging Mr. Zykov as a proper defendant despite the fact that the contract had been concluded with Zykov & Co. LLC (judgement of the Arbitrazh Court of the Krasnoyarsk Territory of 15 February 2012 with regard to case No. A33-18291/2011).

*Third*, expansion of the party’s debts to its controllable legal entities if the assets of these legal entities were formed by the debtor to veil property from creditors.

It is possible to provide example of the application of the mechanism of piercing the corporate veil by the courts of general jurisdiction. Cyprian legal entity Dalemont Ltd. filed a claim to the court to recover debt from Mr. S, which arose out of the guarantee of unrecovered credit granted by a Russian bank. Subject to the appellate ruling of the Moscow City Court of 2 August 2012 with regard to case No. 11-16173, the first instance court satisfied the claimant’s claims, recovering the debt to the bank from Mr. S, and levied execution on several property items. It should be noted that this property was not owned by the person himself but by several Russian legal entities controlled by this person. It is specified in the court’s ruling that

the first instance court has established that S. has beneficiary possession of the property via all the legal entities brought into the proceedings as defendants, i.e. he is the actual owner of the property subject to execution as per the claim... S. is the owner of real estate though a chain of corporate (joint-stock) control, in which the defendants are the final links.

This finding by the court allowed it to levy execution upon the legal entities’ assets to recover the debt of the private individual. It is evident from the judicial acts that “the chains of corporate control” did not only consist of legal entities owning shares and portions of other legal entities, but also Anglo-Saxon trusts and the Jersey foundation.

In terms of legislation and the doctrine, the judicial act under consideration is quite progressive, but was weakly justified by the court. In this case, the courts did not clearly formulate which actions by S. served as grounds for applying the doctrine to his controllable legal entities. Many terms and legal frameworks used

by the court are completely unknown in Russian Law. The court did not refer to the fact that creation of the chain of legal entities was aimed at veiling property from the creditors. This judicial act was partially cancelled out by the ruling of the SC RF No. 5-KG13-61 of 18 June 2013: two items out of several dozens of property items were excluded from the list of the foreclosed property. The remainder of the judicial act was upheld, including the justification of the judgements.

In the above case, the corporate veil was pierced in an opposite way. In fact, it was not piercing of, but penetration from under the corporate veil: from the member (founder) to the controllable legal entity. It should be noted that the court did not invent such framework but rather took foreign practice as basis for its use. In the Anglo-American law, the relevant doctrine is called "reverse piercing" and has two types: outside reverse piercing and inside reverse piercing. In outside reverse piercing, a claim is filed by the creditor of the party controlling the company at which the assets veiled from the creditor are recognized; in inside reverse piercing a claim is filed on behalf of the legal entity's members who wish to obtain execution from the third parties or to protect their assets from a claim by a third party.<sup>47</sup>

The progressiveness of the above judicial act lies in the fact that the court applied reverse piercing of the corporate veil. However, the situation is uncertain because the court neglected to offer detailed reasoning for the application of this framework. Such practice is substantially situational and does not constitute a legal proposition.

**2. Refusal to protect the rights acquired with application of non-public offshore companies.** The use of non-public offshore companies which do not disclose information on their beneficiary (figuratively and poetically called non-disclosing offshores).

The legislation of offshore zones often permits the establishment of non-public economic entities, which are not obliged to disclose the composition of their members and the identity of the final beneficiary to any third parties. Russian judicial practice has developed a mechanism to encourage these offshore companies to disclose such information. If an offshore company does not disclose its beneficiary, it is a sign of the bad faith of said entity. In the resolution of the SAC RF Presidium No. 14828/12 of 26 March 2013, upon consideration of a dispute concerning the application of an action in replevin, the court expressed an opinion, in accordance with which,

if a question of applying the provisions of Russian legislation protecting third parties concerns an offshore company, the burden of proving presence or absence of circumstances which protect the offshore company as an autonomous entity in its relationship with any third parties shall be vested with the offshore company. It is possible to prove this, primarily, by disclosure

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<sup>47</sup> Nicholas B. Allen, *Reverse Piercing of the Corporate Veil: A Straightforward Path to Justice*, 85(3) St. John's Law Review 1147, 1153–1154 (2011).

of information on the party backing of the company, i.e. disclosure of information on its final beneficiary.

In the case under consideration, the defendant was judged to be acting in bad faith in accordance with Art. 302 of the RF CC on the assumption that it was connected to the first real estate buyer via an offshore. Consequently, a legal entity which does not disclose information on its beneficiary bears the risk of the consequences provided for in Art. 10 of the RF CC, which is a retaliatory measure against inequitable conduct. In this regard, it should be noted that in the case under consideration, an action in replevin was claimed, and the court analyzed the applicability of Art. 302 of the RF CC, which provides for, *inter alia*, the defendant's good faith to restrict the replevin.

This application of the doctrine cannot be called definitive as if an offshore does not disclose the beneficiary it is impossible to pierce the corporate veil. It appears that the doctrine is only effective if the beneficiary is voluntarily disclosed, i.e. additional conditions are required. Therefore, the negative consequences in said example were not vested in the undisclosed beneficiary but with the offshore company itself.

**3. The unfair acts of parties controlling a legal entity have no legal consequences.** In the resolution of the Eighth Arbitrazh Court of Appeal No. 08AP-4159/2015 of 25 May 2015 with regard to case No. A75-8869/2014, the court found that actions within an attempt to eliminate the risk of losses being imposed on the controllers by assigning a source of increased danger to a LLC controlled by the owner of said source of increased danger were in bad faith. It served as grounds for the non-application of the consequences from concluding a lease contract and the formal transfer of ownership of the source of increased danger. It was specified in this judicial act that

The failure to protect the right of the party which abused the right implies protection of the infringed rights of the party whose rights were abused. Therefore, the direct objective of said sanction is not punishment of the abuser but protection of the rights of the party exposed to the abuse. Consequently, to protect the infringed rights of the complainant, the court can refrain from accepting the abuser's claims substantiating correspondence of its actions in exercising its rights with the formal legislative requirements.

**4. Reimbursement of losses.** Such measures can only be applied if the controller's actions resulted in an infringement of the rights of another party which can claim reimbursement of losses under p. 4 of Art. 10 of the RF CC.

An example of this is case No. A45-12142/2014, wherein the doctrine of piercing the corporate veil was applied. The claimant filed a claim for joint recovery of damages in the form of funds paid under a credit agreement. The claimant (creditor) specified that upon liquidation of the debtor, it suffered damages in the form of the

amounts paid to settle the liabilities of the debtor, for which it acted as a guarantor. The claimant's claim was approved, since the debtor's liquidation procedure was violated, as the liquidator did not notify the creditor of the liquidation in writing, did not take its debts into account, did not make settlements with the creditor, and the liquidation balance sheet did not contain exact information about the debt.

In the resolution of the Arbitrazh Court of the West Siberian District No. F04-18515/2015 of 4 June 2015 with regard to case No. A45-12142/2014, it is specified that considering the liquidation of MOKOM subsidiary (debtor) was initiated by Gamma Unipak parent company, the liquidator (defendant) is the head of Mokom LLC and Gamma Unipak LLC (defendant) which are interconnected by a parent company-subsiary corporate relationship and by a creditor-debtor relation under the credit agreement, the courts came to the justified conclusion that the liquidator and Gamma Unipak LLC could not be unaware of such relationship. Having determined the defendants' actions to be aimed at depriving the claimant of the opportunity to receive reimbursement per the debt service obligations performed for the debtor (Art. 387 of the RF CC) as a rights violation, the court concluded that there were grounds to recover damages jointly from the liquidator and Gamma Unipak LLC, in accordance with Arts. 15, 322, and 1080 of the RF CC.

### **8. The Conflict-of-Laws Aspect of Applying the Doctrine of Piercing the Corporate Veil**

It is often necessary to apply the doctrine of piercing the corporate veil in relationships complicated by a foreign element or in international private law. When considering these categories of cases, the selection of the applicable law is particularly significant.

Within the framework of restructuring civil legislation, it has been suggested to settle the matter of piercing the corporate veil of foreign legal entities when considering disputes in Russian courts. Thus, it is specified in cl. 1.9 of sec. III of the Civil Legislation Development Concept that the penalty for an offshore company failing to meet their obligation of depositing information in the Russian register will be the joint liability for the offshore company's debts by the parties which determine, legally or actually, the actions of such company and/or are authorized to act on its behalf.<sup>48</sup> This suggestion resulted from the development of the idea to include the principle of good faith in the Russian civil legislation, including in the collision law.

The aforementioned provision of the concept was partially transferred into current legislation. By virtue of cl. 9 of p. 2 of Art. 1202 of the RF CC, the personal law of the

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<sup>48</sup> Концепция развития гражданского законодательства Российской Федерации (одобрена Советом при Президенте РФ по кодификации и совершенствованию гражданского законодательства 7 октября 2009 г.) [The RF Civil Legislation Development Concept (approved by the Presidential Council for Codification and Improvement of the Civil Legislation on 7 October 2009)].

legal entity shall be applied, *inter alia*, in the settlement of disputes concerning the liability of the organization's founders and members for its obligations. P. 4 of Art. 1202 of the RF CC sets an exception to this rule. If an entity established abroad carries out business activities predominantly in the territory of the Russian Federation, its creditor is entitled to choose which state's legislation will be applied to the requirements for liability of a legal entity's obligations on the part of its founders, participants, or other parties entitled to give instructions or those who are otherwise able to determine its actions. In this case, it is necessary to apply Russian law or, at the creditor's choice, the personal law of such legal entity. Consequently, p. 4 of Art. 1202 of the RF CC sets a complex alternative conflict-of-laws norm, wherein the creditor is empowered to choose one point of contact.

Not only Russian courts face such problems. In the *VTB case*, the English claimant demanded the piercing of the corporate veil of a Russian legal entity to vest liability under contracts which complied with the English law with principal from Russia and the British Virgin Islands. In this case, the Supreme Court of England refused to consider the idea of choosing an applicable law. However, the court mentioned that different connecting factors could be applied: (a) the law of the country where the company is incorporated (rule of incorporation); (b) the law of the court; (c) any other law, for example, the law of the place where the contract was executed. The judge additionally emphasized that it was impossible to choose one rule to determine the law for consideration of the case.<sup>49</sup>

Several approaches can be offered to solve the issues of choosing an applicable law in piercing the corporate veil in a dispute complicated by a foreign element. The first approach is based on ability to use the connecting factor of the personal law of the legal entity by determining the applicable legislation according to the national affiliation of the debtor. This is the easiest variant to determine the applicable law, as personal law regulates the basic organizational and corporate matters of the legal entity's status (cl. 2 of Art. 1202 of the RF CC).

This approach is widely applied by foreign jurisdictions, such as the USA, England, and Canada. For example, in the case of *Risdon Iron and Locomotive Works v. Furness*,<sup>50</sup> the English court ruled that the personal liability of the shareholder of the company, which was established in accordance with the English laws, must be regulated by the English law, despite the fact that the shareholder concluded and executed contracts in accordance with the law of California.

The first approach has several weaknesses: first, the criteria of national affiliation of legal entities vary and are defined not at the level of international unifications but on the basis of the applicable national legislation. In addition, there can be even a more complicated situation in which the legal entity will be vested with double nationality due to differences in the criteria of national affiliation. For example, a legal

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<sup>49</sup> *VTB Capital plc. v. Nutritek International Corp.* [2013] U.K.S.C. 5, [2013] 2 A.C. 337.

<sup>50</sup> *Risdon Iron and Locomotive Works v. Furness* [1906] 1 K.B. 49 (CA).

entity incorporated in Cyprus, which has incorporation criterion (the nationality of the legal entity is set at the place of its incorporation), but carrying out its production activities on the territory of Greece, which has operation center criterion (according to the place where basic economic activities are carried out).

Second, it's impossible to exclude the development of a situation in which legal entities will be deliberately incorporated in jurisdictions where application of the doctrine of piercing the corporate veil is barred. In this case, it is highly improbable that the creditor will be able to pierce the corporate veil from a legal entity.

In accordance with the second approach, it is proposed to follow the personal law of the party held accountable for the debtor's actions. In this case, the applicable law shall be determined by the personal law of the party which actually or legally controls the debtor and which is the final beneficiary.

The strong point of such approach is that the personal law of the entities generally remains unaffected during the entire period of the legal entity's activities. Consequently, the creditor does not raise questions concerning the jurisdiction of the entities. In this case, the court can qualify the manipulation of personal status to encumber selection of the applicable law as a knowingly unfair act.

Difficulties in applying the second approach arise if the final beneficiaries of the legal entity to which the doctrine of piercing the corporate veil is applied are not fully known. This happens most frequently if the corporate veil of offshore companies is pierced, as offshore jurisdictions often legislatively permit the incorporation of non-public companies, which are not obliged to disclose the composition of their founders nor the final beneficiary to any third parties. In this case, the court is unable to request disclosure of the information from the offshore company, as within the framework of this approach it is impossible to determine the applicable law without identifying the beneficiary.

The third approach in choosing the applicable law is based on applying the connecting factor of the law of the court's land, which can be applied as a result of making a public policy clause claim.

The use of the connecting factor under the law of the court's land is particularly efficient in cases of public policy if the corporate veil is pierced from legal entities registered in offshore jurisdictions. If an offshore legal entity is not obliged to disclose its final beneficiaries but its activity poses a threat to the public policy of the Russian Federation, the Russian court has grounds for applying Russian law to protect the interests of the company and the state.

Incorporation and activity of an offshore company do not constitute a violation or an evasion of law.<sup>51</sup> There exists, for example, the resolution of the SAC RF Presidium No. 14828/12 of 26 March 2013, which contains the following legal opinion:

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<sup>51</sup> Подшивалов Т.П. Обход закона в международном частном праве // Журнал российского права. 2016. № 8. С. 150 [Tikhon P. Podshivalov, *Evasion of Law in Private International Law*, 8 Journal of Russian Law 145, 150 (2016)].

Registration of a title for real estate located in the Russian Federation with a legal entity which is incorporated in the offshore zone and, therefore, did not disclose its beneficiary, is not a violation of the law in and of itself.

Despite the importance of such approach (protection of the interests of the company and the state), it seems to be rather hazardous for the normal development of civil circulation. The interests of the state are often placed ahead of the interests of other business entities despite the equality of the participants of a civil relationship (cl. 1 of Art. 1 of the RF CC) and the prevalence of the private interests over public (Art. 2 of the RF Constitution).

Another option for determining the applicable law for piercing the corporate veil can be the application of *lex loci delicti commissi* (the law of the place where the delict was committed). The fourth approach has also been applied in the practice of foreign courts. In the case of *Foresight Shipping Co. v. Union of India*,<sup>52</sup> the Canadian court determined that it was necessary to apply *lex loci*, to be more exact – *lex loci delicti commissi* (incident) (paras. 11–13). Application of this option is rather limited as it is necessary to prove all the component elements of the civil crime: damage, illegality, cause-and-effect relationship and, most importantly, guilt. Beyond this, there can be different readings of *lex loci delicti commissi*.

Selection of applicable law depends mainly on the grounds for piercing the corporate veil. In addition, the court must proceed with the law that can achieve the most efficient result in a dispute settlement. In a dispute concerning the usage of a legal entity as an operating, nominal entity, to transfer risks and liability, it is logical to use the laws of incorporation for such entity.

We believe that out of all the above options, the approach of applying the personal law of the debtor is the most justified. When the court decides to pierce the corporate veil, it primarily deprives the legal entity of its autonomy, making its beneficiary accountable for its liabilities. Such a resolution must comply with the law applicable to the establishment of the legal entity. In this case, to achieve flexible regulation it is prudent to determine an alternative connecting factor, in which the first option for the applicable law is the personal law of the legal entity and the second option is up to the court's discretion. Based on the aforementioned, we believe that the Russian legislative resolution which determined the alternative connecting factor for choosing the applicable law in cl. 4 of Art. 1202 of the RF CC is correct.

## Conclusion

In summarizing the research on protecting property rights based on the application of the doctrine of piercing the corporate veil, we can make a series of strategic conclusions.

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<sup>52</sup> *Foresight Shipping Co. v. Union of India* [2004] F.C. 1501.

First, piercing the corporate veil is a delicate tool for professionals which requires detailed justification from the enforcer when considering a specific civil dispute. Naturally, piercing the corporate veil nullifies the issue of the autonomy of the controllable legal entity and the limited liability of its members, but only as an exceptional measure used in a situation when it is impossible to otherwise protect the third parties' interests. The modern Russian system of justice needs the doctrine of piercing the corporate veil.

Second, the doctrine of piercing the corporate veil was implemented into the Russian judicial practice by the SAC RF, was accepted by the system of arbitrazh courts of all instances and was applied by the general jurisdiction courts. Currently, the SC RF does not mention the legacy of the SAC RF in its acts, but it does apply the construct of piercing the corporate veil.

Third, the doctrine under consideration is applied by the Russian courts rather inconsistently, which has been repeatedly noted above. For example, the doctrine has a wide sphere of application in the Russian judicial practice, but in addition to this, in disputes between two private entities, courts resort to piercing the corporate veil less often than in disputes of tax authorities with tax payers. In an ideal scenario, it should be *vice versa*, as the doctrine under consideration concerns only private relationships. In the interest of fairness, it must be noted that there are no distinct criteria for application of this doctrine even in the countries of the Anglo-Saxon legal system where it appeared.

The doctrine of piercing the corporate veil has today evolved from a specific legal mechanism to an abstract framework and is applied by the SC RF strictly on a case-by-case basis. Moreover, courts *quo* perceive this doctrine as an odd thing or as a "strange magical wand" which can help justify judgment in situations of legal uncertainty. This tendency can be broken using scientific research to systematize the available judicial acts. The generalizations offered in this paper can help make the doctrine of piercing the corporate veil more precise.

Fourth, it is necessary to preserve the initiative by the SAC RF to expand debts from the economic entity under control to the controller's property. Moreover, the doctrine under consideration has been successfully integrated into the Russian legal system and fully complies with the Russian system of establishing legal entities governed by the current principles of control. If the requirements posed to legal entities are tightened, at least as it pertains to increasing the size of the registered capital subject to the "inlet" control model, there will be no need to apply the doctrine. But before this, the doctrine of piercing the corporate veil must remain an operational mechanism.

Fifth, piercing the corporate veil is a remedy against unfair acts of the legal entities' beneficiaries. Therefore, the legal consequences of piercing the corporate veil are identical to the consequences fixed in Art. 10 of the RF CC which define knowingly illegal practices.



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