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Abuse of Companies

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CHAPTER 8

Veil Piercing and Abuse of the Corporate Form

Diederik Bruloot, Louis De Meulemeester & Christoph Van der Elst

§8.01 INTRODUCTION

Limited liability is considered one of the key features of the company.¹ However, it comes at a cost: it shifts risks from shareholders to creditors who do not necessarily have the possibility to protect themselves. It opens the doors for abusive use of the protective mechanism of limited liability. Hence the question is raised how legal instruments can help to mitigate this risk. Piercing the corporate veil is considered one of the traditional techniques to protect third parties against the risks stemming from limited liability, next to the directors' liability for breach of their, often very broadly defined, duties vis-à-vis the company.² This chapter specifically examines the concept 'veil piercing' as one of the core remedies in case of abuse of companies. Particularly, it aims at identifying the different types of abuse of companies that can lead to veil piercing. 'Veil piercing' turns to be a highly divergent concept but shows the key characteristic that there is a court order that sets aside legal personality or limited liability of the company leading to the personal liability of shareholders for the debts of the company.

By drawing up our typology regarding types of abuse that can lead to veil piercing, we take an international, comparative viewpoint, searching for what could be called 'generally accepted principles' on veil piercing in case of abuse of companies, rather than collating a complete catalogue of the different grounds on which the

1. J. Armour, H. Hansmann, R. Kraakman, M. Pargendler, *What is corporate law?* in R. Kraakman, J. Armour, P. Davies et al. (eds.), *The anatomy of corporate law: a comparative and functional approach*, Oxford University Press, 5 (2017).

2. For a detailed assessment of directors' liability for abusing the company, see Chapter 7 of this book.

corporate veil is being pierced around the world. As other chapters in this book focus on different aspects of abuse of companies, this chapter specifically addresses the piercing of the corporate veil vis-à-vis shareholders.

This contribution starts with setting out the basic characteristics of veil piercing by particularly explaining the highly divergent character of veil piercing (section §8.02). It then turns to a typology and analysis of these types of abuse that are most common to lead to veil piercing (section §8.03). Finally, we put forward some insights regarding the role that legislators can play in reducing the uncertainty caused by the concept of veil piercing.

§8.02 VEIL PIERCING: A DIVERGENT CONCEPT

[A] Denying Legal Personality Versus Denying Limited Liability

‘Veil piercing’ or ‘lifting the corporate veil’ are concepts that, in different ways, can be found in almost all jurisdictions.³ It seems to serve as an inevitable – be it often underdeveloped – complement to the concepts of legal personality and limited liability. In some but highly exceptional circumstances, the legal fiction that is being created by one of the aforementioned concepts can be set aside by a court. In that respect, a distinction must be made between a court denying the legal personality of a legal entity or denying the limited liability of a company’s shareholders. As veil piercing is used to the benefit of (defrauded) creditors, their interests are considered to be best served with a court decision that holds the shareholders (or some among them) personally liable for the company’s debts (wholly or partially). The company itself (the legal entity) remains in existence and can, for instance, still be put in a formal insolvency proceeding.

The other seemingly more far-reaching option is that the court denies the entire legal fiction of legal personality, thus treating the persons behind the corporate veil as would there be no legal entity at all. At first sight, this option seems to differ predominantly from the other because the legal entity is no longer existing for other purposes, such as for instance the winding up of the entity within a formal insolvency proceeding. In practice, however, this option proves to be particularly helpful in cases of fraudulent asset shielding. This refers to situations in which individuals, whether or not incorporated, defraud their creditors by shifting assets to separate legal entities, thus avoiding that creditors of those individuals can seize their assets. By piercing the corporate veil of the latter entities, creditors can execute their rights on the unlawfully

3. For a historical overview of the development of veil piercing see Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives*, NUS law working paper series 2018/025, 2-10, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).

shielded assets. It shows that veil piercing is a relevant technique for both limited liability companies and partnership-type entities.⁴

It should further be noted that in other legal areas outside company law, multiple companies or a company and the controlling shareholder are sometimes qualified as one legal entity for specific duties and liabilities (usually called ‘enterprise doctrine’ or ‘economic unity doctrine’)⁵. This is for instance clearly the case in European competition law where the legal form is in principle irrelevant to the identification of the enterprise concerned. This chapter focuses solely on veil piercing in company law.

[B] Diverging Incidence

Immediately after limited liability and the separate legal form became the new standard, it was generally perceived that it comes with certain limits. It cannot be extended beyond its reason.⁶ However, a straightforward theory identifying the appropriate application of both key features is not developed. Case law filled this gap. Nevertheless, as far as we could ascertain there are only few empirical studies assessing the likelihood of how often courts pierce the corporate veil. Ramsay and Noakes found that Australian courts pierced the corporate veil in 39% of the cases where the plaintiff requested veil piercing, this percentage being lower if the shareholders are legal entities.⁷ In China and the United Kingdom, court cases show higher levels of veil piercing of more than 60%⁸ and almost 50% respectively,⁹ but in the latter country, in 2013, the House of Lords introduced guiding principles which make veil piercing less likely.¹⁰ American studies show veil piercing rates from 35% to 49% with significant variety in the number of investigated cases.¹¹

A recent empirical study assessed how readily the courts in different countries are receptive to piercing the corporate veil. Thereto, the authors analysed 16 countries where the law is familiar with the enterprise approach ‘*a concept that allows courts to pierce the corporate veil under the premise that a parent firm and its subsidiaries constitute a single entity*’.¹² Furthermore, the scholars assessed how many factors the court is willing to take into account for piercing the corporate veil, whether piercing the veil is limited to insolvency or fraud and a likelihood score of veil piercing in a country

4. I.e. entities with legal personality having their own assets and debts, but in which the partners bear unlimited liability for the debts of the partnership. The separate legal personality makes its assets unavailable for attachment by the partners’ personal creditors.

5. K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 381 (2007).

6. Tan Cheng Han, *Veil Piercing: A Fresh Start*, *Journal of Business Law* 20, 29 (2015).

7. Ramsay and Noakes, *Piercing the Corporate Veil in Australia*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=299488 (accessed 11 Apr. 2019).

8. Hui Huang, *Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading*, 60 *American Journal of Comparative Law* 743, 746 (2012).

9. Charles Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 *Company Financial & Insolvency Law Review* 15 (1999).

10. *Prest v. Petrodel Resources Ltd.*, UKSC (2013).

11. S. Belenzon, H Lee & A. Pataconi, *Towards a legal theory of the firm: The effects of enterprise liability on asset partitioning, decentralization and corporate group growth*, Working Paper NBER no. 24720, n. 130 (June 2018).

12. *Ibid.*, p. 4.

based upon the availability of empirical data.¹³ According to that study, the targeted type of veil piercing is the least likely to happen in the UK and Sweden while courts in Germany and Italy are more readily open to veil piercing with the United States and China being in the middle.¹⁴

[C] Abuse of Companies Versus Abuse in Companies

Distinction should further be made between ‘abuse of companies’ and ‘abuse in companies’. The first concept is the one which is traditionally linked with veil piercing. A shareholder uses the corporate form and the accompanying limitation of his or her personal liability in order to defraud creditors. When a court comes to this conclusion, it can decide to deny either the entire legal personality of the company as such or ‘only’ the limited liability of the shareholders (compare *supra*). The second concept, abuse in companies, refers to situations in which companies’ insiders (directors and/or shareholders) behave unlawfully and for which behaviour they are held personally liable towards third parties. This personal liability is very similar to the liability a shareholder incurs when a court decides to pierce the corporate veil in case of abuse of a company, but it is necessary to distinguish between both concepts.

In this chapter, we basically focus on ‘abuse of companies’, and thus not on insiders’ personal liability towards third parties (particularly creditors) as a result of certain unlawful or even fraudulent behaviour within a company. However, it should be noted that although distinct, both concepts (abuse of vs. abuse in companies) are closely intertwined and are frequently at stake at the same time. This is actually true for all cases of ‘abuse of companies’ as abuse of the entire corporate form will inevitably come with unlawful acts by insiders. In those cases, creditors can actually choose one of the concepts to rely on in order to hold the insiders personally liable. The close relationship between both concepts can probably explain why courts often do not distinguish between them.¹⁵

§8.03 TYPES OF ABUSE THAT LEAD TO VEIL PIERCING

The existing materials on veil piercing allow us to distinguish between two main categories of abusive situations in which courts decide to pierce the corporate veil. It concerns [A] a factual situation in which there is complete disregarding of the corporate form and [B] different kinds of situations of undercapitalisation of the company.

13. This likelihood is commonly zero as empirical data are only available in the US, the UK, Australia and China.

14. The results should be read with caution as the authors weighed the results and provided the most weight to the enterprise approach, being the highest in Germany as the latter country developed group law.

15. K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 12 (2007).

[A] Disregarding of the Corporate Form**[1] Introduction**

A first category of situations that can lead to veil piercing can be labelled as ‘disregarding of the corporate form’. This concept broadly refers to situations in which a company has no real separate existence from its shareholder, being only but a ‘shield’ behind which shareholders hide.

A company is a separate legal person, independent from its shareholders, which can be granted the benefit of limited liability. However, in certain circumstances, shareholders can wrongfully dominate the company in their sole interest and to the detriment of creditors. In those circumstances, courts sometimes lift the corporate veil, particularly when they find that the company and its shareholder(s) need to be assimilated and thus to be considered as one person because they are too intermingled, and therefore the shareholders should not benefit from the advantage of limited liability related to the legal form.

[2] The US Approach**[a] Overview**

Compared with other jurisdictions, in the US, veil piercing is well studied and reported. According to these studies, courts frequently pierce the corporate veil when they conclude that a company is a mere ‘agent’, ‘instrumentality’, ‘alter ego’, ‘dummy’ or ‘shell’ for its shareholders. In his 1991 empirical research, Professor Thompson found that in ‘successful’ veil piercing cases one or more of these elements were almost always mentioned by the courts.¹⁶ The underlying idea is that when a company has no distinct existence or identity from the dominating shareholders, the company can be used in the sole advantage of the shareholders at the expense of third parties.¹⁷

The mere fact, however, that a corporation is controlled and dominated by a shareholder does not suffice to conclude that the corporate veil should be pierced. This would undermine the whole purpose and benefit of limited liability.¹⁸ Especially in single member companies or other close corporations with a small number of shareholders, it is quite unrealistic to suppose that the corporate purpose would substantially differ from the interests of the dominating shareholder.¹⁹ In most states, it is

16. R. B. Thompson, *Piercing the corporate veil: an empirical study*, 76 Cornell L. Rev., (1036) 1064 (1991).

17. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 21, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

18. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 92 (2016).

19. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 23, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

therefore acknowledged that even the fact that a corporation is a mere alter ego of the individual shareholder does not suffice to conclude to veil piercing.²⁰

Traditionally, US veil piercing theory in this respect distinguishes between three different doctrines: the ‘instrumentality’, the ‘alter ego’ and the ‘identity’ doctrine. However, in our view, these theories do not differ substantially from each other, and share identical key elements.²¹ Summarised, proof is required that ‘(1) *the defendant shareholder dominated and controlled the corporation and that (2) the defendant abused that control by committing fraud, illegality, or some other form of injustice*’.²²

[b] *A Two-Pronged Test*

For the first stage of the two-pronged test (the proof that the company is dominated), courts take multiple factors into consideration. In fact, long ‘laundry lists’ of factors are frequently used in the assessment of domination. Some of the important examples are:

- (1) the commingling of funds and assets
- (2) the treatment of the company’s assets for personal purposes, or
- (3) a failure to maintain minutes or corporate records.²³

The assessment will always require a case by case analysis, and because the different factors taken into consideration by the courts are unweighted, it is hard to determine which exact factors are decisive.²⁴ It should be noted that the factors which courts cite go well beyond the normal control of the company ways of ‘controlling’ and ‘dominating’ a company, which is typical for majority shareholders. In fact, even without considering the second step in the two-pronged test, this behaviour of the dominant shareholder is unlawful from an internal perspective (abuse *in* companies). Although these acts are already unlawful by themselves (for example, siphoning assets out of a company in breach of the rules on profit distributions), this is not considered sufficient to conclude to veil piercing.

An example of how courts approach veil piercing can be found in the following Seventh Circuit Court of Appeals’ opinion in *Sea-Land Services, Inc. v. Pepper Source*:

The first and most striking feature that emerges from our examination of the record is that these corporate defendants are, indeed, little but Marchese’s playthings. Marchese is the sole shareholder of PS, Caribe Crown, Jamar, and Salescaster. He is one of the two shareholders of Tie-Net. Except for Tie-Net, none of the corporations ever held a single corporate meeting. (At the handful of Tie-Net meetings held by Marchese and Andre, no minutes were taken.) During his deposition, Marchese did not remember any of these corporations ever passing

20. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 91 (2016).

21. P. I. Blumberg, *The law of corporate groups*, 111 (1987).

22. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 103 (2016).

23. *Ibid.*, 106.

24. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 20, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

articles of incorporation, bylaws, or other agreements. As for physical facilities, Marchese runs all of these corporations (including Tie-Net) out of the same, single office, with the same phone line, the same expense accounts, and the like. And how he does “run” the expense accounts! When he fancies to, Marchese “borrows” substantial sums of money from these corporations - interest free, of course. The corporations also “borrow” money from each other when need be, which left at least PS completely out of capital when the Sea-Land bills came due. What’s more, Marchese has used the bank accounts of these corporations to pay all kinds of personal expenses, including alimony and child support payments to his ex-wife, education expenses for his children, maintenance of his personal automobiles, health care for his pet - the list goes on and on. Marchese did not even have a personal bank account! (With “corporate” accounts like these, who needs one?).²⁵

The failure to observe corporate formalities is frequently mentioned as a reason to pierce the corporate veil.²⁶ For example, when no general meeting is held, no board of directors is appointed, or when decision making is never documented by board notes, this may indicate that the corporation is merely fictional. However, authors rightfully state that even when corporate formalities are severely neglected, this sole fact can doubtfully be a sufficient basis for veil piercing.²⁷ There is no necessary causal link between the failure to keep up corporate formalities and a creditor’s damage.²⁸ Nevertheless, Thompson’s empirical research showed that the failure to keep corporate formalities was mentioned in two-thirds of successful veil piercing cases, and in more than 90% of unsuccessful piercing cases.²⁹ Other empirical research confirms these findings.³⁰

As already mentioned, mere proof of these elements will not suffice for a successful veil piercing claim as there is a second step to take. Proof of ‘fraud, illegality or some other injustice’ is necessary. The mere fact that a creditor’s claim against the company is unsatisfied is insufficient in that respect as this would be the case with every veil piercing claim.³¹ In the case quoted earlier, the US Seventh Circuit held that the additional ‘wrongful element’ was not proven by the trial court because the decision was only motivated on the ground that due to the limited liability, the companies’ creditor would be denied a full judicially-imposed recovery.

25. 941 F.2d 519, 521 (7th Cir. 1991).

26. R. B. Thompson, *Piercing the corporate veil: an empirical study*, 76 Cornell L. Rev., (1036) 1067(1991); D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 25, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

27. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 25, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

28. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 109 (2016).

29. R. B. Thompson, *Piercing the corporate veil: an empirical study*, 76 Cornell L. Rev., (1036) 1064 and 1065, n. 141 (1991).

30. P. B. Oh, *Veil piercing*, Texas Law review, (81) 133 (2010).

31. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 113 (2016).

On remand, the court should require that Sea-Land produce, if it desires summary judgment, evidence and argument that would establish the kind of additional “wrong” present in the above cases. For example, perhaps Sea-Land could establish that Marchese, like Roth in Van Dorn, used these corporate facades to avoid its responsibilities to creditors; or that PS, Marchese, or one of the other corporations will be “unjustly enriched” unless liability is shared by all. Of course, Sea-Land is not required fully to prove intent to defraud, which it probably could not do on summary judgment anyway. But it is required to show the kind of injustice to merit the evocation of the court’s essentially equitable power to prevent “injustice.” It may well be that, after more of such evidence is adduced, no genuine issue of fact exists to prevent Sea-Land from reaching Marchese’s other pet corporations for PS’s debt. Or it may be that only a finder of fact will be able to determine whether fraud or “injustice” is involved here. In any event, the record as it currently stands is insufficient to uphold the entry of summary judgment.³²

As illustrated, the required proof of an additional ‘wrong’ or fraud next to domination is a barrier to a successful veil piercing claim. Fraud is generally used in a broad sense, as ‘bad faith’ or ‘unfairness’, but these vague terms do not give any further clarification on this matter.³³ It is difficult to determine the real decisive factors that courts take into consideration in this second stage of the two-pronged test, which can be seen as the most important cause of the vagueness of the US veil piercing doctrine.³⁴

In this respect Macey and Mitts conclude:

Scholars often claim that the inquiry into whether the corporate form should be disregarded has become oddly separated from the question of why the corporate form should be disregarded. In particular, the generic justifications such as undercapitalization, failure to observe corporate formalities, and preventing injustice offered to justify piercing are unpersuasive because they are either complete non sequiturs or vacuous due to the fact that they are wholly conclusory.³⁵

Bainbridge and Henderson argue that courts give:

ex-post rationalizations of a conclusion reached on grounds that are often unarticulated.³⁶

Summarised, veil piercing is a vague concept, and the exact criteria on which US courts base their piercing decisions are rather hard to structure. When it comes to veil piercing because of disregarding of the corporate form, it is clear, however, that courts first make an analysis whether a shareholder dominated the company and conducted business with it disregarding the corporate form (such as asset commingling or absence

32. *Sea-Land Services, Inc. v. Pepper Source*, 941 F.2d 519, 524 (7th Cir. 1991).

33. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 24, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

34. H. Hansmann, R. Squire, *External and internal asset partitioning: corporations and subsidiaries* in J.N. Gordon, W-G. Ringe, *The Oxford handbook of corporate law and governance*, (251) 269 (2018).

35. J. Macey, J. Mitts, *Finding order in the morass: the three real justifications for piercing the corporate veil*, Cornell law review, (99) 152 (2014).

36. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 111 (2016).

of corporate formalities). Subsequently, proof of fraud or injustice is required. This second step makes clear that in order to trigger veil piercing, more than violations against the corporate form are required, and a certain intentional element must be at hand. The latter is particularly responsible for the vagueness that is traditionally associated with the veil piercing concept. It should be noted that the US two-pronged test clearly illustrates the distinction between abuse *in* and abuse *of* companies as mentioned earlier. When shareholders violate the corporate form (the first step in the test), there is abuse *in* the company. However, the US doctrine on veil piercing requires more to lift the corporate veil. Proof of fraud or injustice must be provided to consider it abuse *of* the corporate form, and so to justify the ultimate remedy of veil piercing.

[3] *Continental European Experiences*

Veil piercing on grounds of disregarding of the corporate form is not limited to the US. The 'laundry list' approach to determine whether a shareholder wrongly dominated the company can also be found in other jurisdictions. For example, Belgian and French doctrine also list factors as the absence of corporate bookkeeping, the intermingling of bank accounts, payment of private expenses by the company, absence of corporate formalities, etc., as indications of abuse of legal personality that can justify veil piercing.³⁷ Piercing decisions are rare, however, and will only take place in extreme situations when shareholders clearly neglect to act in the interest of their company and thereby harm creditors.

Asset commingling serves as a good example. It is a predominant element in veil piercing decisions and refers to the situation where assets of the company are used by shareholders for personal use and vice versa. In many continental European countries, courts use the presence of asset commingling for justifying veil piercing. However, not every situation of asset comingling can justify a veil piercing claim. We illustrate with examples from Germany, France and Belgium.

The *German* Supreme Court, the Bundesgerichtshof (BGH), acknowledged that veil piercing ('*Durchgriffshaftung*') is an appropriate remedy when the assets of the company and the shareholder(s) are indistinguishably intermingled.³⁸ This is only allowed, however, in extreme circumstances when normal restitution mechanisms cannot be applied because of the complete disorganisation of the company's administration, and not for the general sanctioning of bookkeeping irregularities. Veil piercing is, for instance, only supported when the lack of transparency caused by improper accounting makes it impossible for third parties to attribute transactions to the company, and it is only applicable to the responsible shareholders who misused their

37. M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés*, Paris, Lexisnexis, 86, no 185 (2016); K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 387 and 435 (2007); V. Simonart, *La personnalité morale en droit privé comparé*, 478-481, no 550 (1995).

38. BGH II ZR 178/03, Nov. 14., 2005, 2006 NZG 350.

influence.³⁹ Moreover, in 2007, the BGH changed its ‘*Durchgriffshaftung*’ doctrine to the concept of ‘*existenzvernichtenden Eingriffs*’ by stating that shareholders, when they intentionally endangered the company through unlawful behaviour, can only be held liable on a tort basis (abuse *in* the company).⁴⁰ However, the BGH explicitly pointed out that in the case of asset commingling, veil piercing based on *Durchgriffshaftung* (abuse *of* the company) remains applicable.⁴¹

Compared to the US, the German approach does not involve a two-pronged test. German law rather stresses the concept of subsidiarity. Intentionally defrauding creditors is not the central requirement. Veil piercing is rather seen as the *ultimum remedium* for those cases where no other remedies (general principles of law or explicit statutory provisions) are available to creditors.⁴²

In France too, asset commingling is seen as an element that can lead to the assimilation between the shareholder(s) and the company. French doctrine interestingly uses the concept of the ‘*société fictive*’ (fictional company), the situation where a company was founded without any ‘*affectio societatis*’. This is a rather ambiguous concept used to describe whether the founders truly wanted to work together in a company and undertake an economic activity.⁴³ However, when the company is a mere cover for a shareholder to hide, the company lacks this consent from the shareholders and is purely fictional.⁴⁴ When the only purpose of the company was to limit the creditor’s recourse, the use of the company constitutes an abuse.⁴⁵ The use of a concept such as ‘*affectio societatis*’ puts forward the intentional element, resembling the second step from the American veil piercing test (the proof of a fraud or wrong).

French legal doctrine argues that asset commingling is a different legal concept than a purely fictional company because asset commingling constitutes a wrong committed by directors that may lead to their responsibility (an abuse *in* the company).⁴⁶ However, courts frequently use both concepts without clear distinction and with the same consequences, making asset commingling a determining factor to ascertain whether the company has any real existence.⁴⁷

In Belgium, it is accepted in legal literature that the corporate veil can be pierced when essential rules of company law are severely violated, especially when the

39. *Ibid.*, par. 17; T. Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives*, NUS law working paper series 2018/025, 39, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).

40. BGH 16 July 2007, II ZR 3/04 (*Trihotel*).

41. *Ibid.*, par. 27; T. Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives*, NUS law working paper series 2018/025, 41, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).

42. *Ibid.*

43. M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés*, 29e édition, Lexisnexis, 81, no 173 (2016).

44. M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés*, 29e édition, Lexisnexis, 82, no 175 (2016). For an example: Cass. Com. 9 June 2009, *Rev. Sociétés* 2009, 781, note N. Mathey.

45. J.-J. Daigre, “Société fictive”, *Rép. dr. soc.*, no 18.

46. J.-J. Daigre, “Société fictive”, *Rép. dr. soc.*, no 25.

47. I. Tshotoutian, *Vers une définition de l’affectio societatis lors de la constitution d’une société*, L.G.D.J., 202, no 336 (2011); J.-J. Daigre, *Société fictive*, *Rép. dr. soc.*, 25-28.

company has no proper management and when the personal assets of the shareholders' and those of the company are intermingled.⁴⁸ Veil piercing is only allowed if shareholders manifestly abused the company, having no respect of its separate existence making it only a cover for the shareholders' own activities. In that respect, similarly to German law, judicial veil piercing is seen as an '*ultimum remedium*' to resolve cases where statutory rules fall short.⁴⁹ Shareholders cannot be allowed to invoke the benefits of the institution of limited liability when they have not respected the rules related to it; in that case, they can be seen to have forfeited the right to enjoy limited liability.⁵⁰ Proof of an intentional element or fraud is, however, not generally required. It should be mentioned that although veil piercing was frequently invoked and allowed in the 1970s and 1980s, recent veil piercing cases are extremely rare or even non-existent.

[B] Undercapitalisation

[1] Overview

The second category of situations that may lead to veil piercing concerns undercapitalisation. In the context of this chapter, undercapitalisation is used in a broad sense covering different situations in which shareholders have made insufficient investments in their company to let it operate properly. Undercapitalisation is potentially highly detrimental to the interests of creditors as in those cases, creditors actually bear the ultimate business and insolvency risk of the company instead of the shareholders.⁵¹ Therefore, undercapitalisation can be qualified as one of the basic types of abuse of companies with limited liability. Similar to cases of disregarding of the corporate form (*supra*), in many jurisdictions veil piercing serves as the ultimate sanctioning mechanism in case of this type of abusive use of limited liability companies.

Undercapitalisation can be at stake at all stages of the corporate lifecycle. Most clear is the case for denying limited liability where the undercapitalisation is the result of shareholders actively shifting assets out of their company (asset stripping). Alternatively, undercapitalisation can be present already at the time of a company's formation, in which case a company is being set-up while it is, from the onset, deemed to go bankrupt. Finally, when a company continues its operations behind the moment on which it should have been clear that insolvency was inevitable, undercapitalisation will be at stake too. However, undercapitalisation does not always lead to veil piercing as additional conditions must be fulfilled.

48. E. Dirix, R. Steennot, H. Vanhees, *Handels- en economisch recht in hoofdlijnen*, Antwerpen, Intersentia, 48 (2014); K. Geens, M. Wyckaert, *De Vennootschap - Algemeen deel in Beginselen van het Belgisch Privaatrecht*, Kluwer, 342 (2011).

49. K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 33 (2007).

50. *Ibid.*; K. Geens, M. Wyckaert, *De Vennootschap - Algemeen deel in Beginselen van het Belgisch Privaatrecht*, Kluwer, 342 (2011).

51. P. Davies, *Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency*, *European Business Organization Law Review*, (301) 306 (2006).

Beyond disregarding of the corporate form, directors may also in some way be involved in and bear the responsibility for the undercapitalisation of their company. Moreover, several specific cases of undercapitalisation were identified by the legislators in many countries, leading to statutory rules defining shareholders' and/or directors' liability in certain cases in this respect. This clearly reduces vagueness and uncertainty compared to veil piercing in case of disregarding of the corporate form. However, it makes the picture more complex, particularly from a legal comparative perspective, as questions arise as to who can be held liable, whether separate or joint liability exists, and to which amounts.

[2] *Asset Stripping*

A straightforward example of undercapitalisation that can be considered abuse of the corporate form and therefore lead to veil piercing is when shareholders unlawfully take assets out of the company and leave the company 'undercapitalised' behind. This behaviour deteriorates creditors' chances of full repayment.

Asset stripping can be analysed in different ways. First of all, particularly in a US context,⁵² it could be seen as a case of disregarding the corporate form rather than a case of undercapitalisation. Asset stripping will frequently coincide with commingling of assets. Shareholders use the company's assets for their own benefit, thus neglecting the separate legal personality of their company. As previously explained, 'commingling of assets' figures on the laundry list of situations that may lead to the conclusion that the corporate form is disregarded, which in its turn may lead to veil piercing (compare *supra* §8.03[A][2][ii]).

In a continental setting, asset stripping (which leaves the company undercapitalised) is mostly analysed in the context of distributions to shareholders. A good example in that respect can be found in the *Netherlands*. In multiple cases, the Dutch Supreme Court acknowledged that shareholders can be held personally liable in case of asset stripping.

Most famous is the *Nimox* case.⁵³ In this case, the sole shareholder of a company decided to pay out a substantive dividend. This decision was taken with respect of the Dutch statutory rules on profit distributions at that time⁵⁴ as the dividend was entirely paid out of distributable reserves. Shortly after the payment of dividend, the company went bankrupt. It had suffered losses for several years, including the year in which the distribution took place. The shareholder was held liable because it had not considered the possibility that the continuation of the company's activities could be endangered by the distribution of dividend. Importantly, the court stated that the statutory distribution rules are not the only rules that need to be taken into account when deciding on

52. See, e.g., S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 108 (2016); J. Macey, J. Mitts, *Finding order in the morass: the three real justifications for piercing the corporate veil*, Cornell law review, (99) 107 (2014).

53. Hoge Raad 8 Nov. 1991, *NJ*, 174.

54. See Art. 15 Second Directive of 13 Dec. 1976 (Capital Directive) (77/91/EEC).

dividends, but also the general duty of care. The essential element leading to shareholder liability seems to be that the shareholders are responsible for shifting excessive risks towards the company's creditors by not taking into account the possibility of a deficit or discontinuation of the company when reducing the assets of the company.⁵⁵

It should be noted that according to Dutch jurisprudence, asset stripping leads to shareholder liability, which is distinct from real veil piercing. In the Netherlands, "direct" veil piercing, by which limited liability or even legal personality is being entirely set aside, is not or hardly recognised by the courts.⁵⁶ 'Direct' veil piercing can only be used as an *'ultimum remedium'*. Situations where 'direct' piercing would be appropriate are when tort claims would provide no recourse, for example in the context of groups of companies where the assets of the individual companies are completely commingled.⁵⁷ This underlines the link between undercapitalisation and disregarding of the corporate form as grounds for veil piercing. The main difference between veil piercing and shareholder liability lies in the amount of damages that can be due.⁵⁸ In the former case, the shareholder is liable for all debts of the company. In the latter case, the shareholder can only be held liable for the actual damage caused by his or her fraudulent act.⁵⁹

The German BGH follows a very similar approach. Shareholders can be held liable for *'existenzvernichtenden Eingriffs'*, for example in case of unauthorised distributions of the company's assets, or the misuse of corporate assets for personal purpose, or transactions with shareholders that are not at arm's length. In its 2007 *Trihotel* case, the court made clear that claims for *'existenzvernichtenden Eingriffs'* need to be handled on a tort basis (compare *supra* §8.3[A][3]).⁶⁰ Before the *Trihotel* case, the court used a different approach, called *'Durchgriffshaftung'*, which is to be understood as direct veil piercing.⁶¹ After the *Trihotel* case, the latter concept can only be invoked in a very limited number of cases not covered by the theory on *'existenzvernichtenden Eingriffs'*.⁶²

55. J. Barneveld, *Financiering en vermogensonttrekking door aandeelhouders*, Deventer, Kluwer, 483 (2014).

56. Asser/Maeijer/Van Solinge & Nieuwe Weme 2-II 2009, 1068, no 836.

57. M.L. Lennarts, *Concernaansprakelijkheid*, Deventer, Kluwer, 243 (1999).

58. Hoge Raad 13 oktober 2000, *Rainbow products/ontvanger*, 698 (NJ 2000); J. Barneveld, *Financiering en vermogensonttrekking door aandeelhouders*, Deventer, Kluwer, 471 (2014).

59. J. M.M. Maeijer, comment on Hoge Raad 13 oktober 2000, (698) p. 16 (NJ 2000). E.g., in the case of asset stripping, the fact that certain assets were withdrawn from the company is not necessarily the cause for the bankruptcy, and correspondingly, shareholders are not necessarily responsible for the whole net loss of the company. When the asset stripping itself caused the bankruptcy, the situation is different.

60. BGH 16 July 2007, II ZR 3/04 (*Trihotel*).

61. BGH 24 June 2002, II ZR 300/00 (*KBV*).

62. T. Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives*, NUS law working paper series 2018/025, 41, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).

[3] *Undercapitalisation upon Formation*

Undercapitalisation can be present from the moment of establishment of the company, that is when it is being set-up and the founders know or should have known that the lack of financing for the planned activities would result in bankruptcy. Remarkably, only a few jurisdictions explicitly recognise this phenomenon. This is particularly the case in Belgium, where statutory rules exist with regard to the liability of founders in case of inadequate funding of a company at the time of its formation.

If a company goes bankrupt within three years of its formation, the founding shareholders can be held jointly liable when it is established that the start-up capital was manifestly insufficient for the normal operation of the business for two years consequent to its formation.⁶³ When it is proven that the company was undercapitalised upon formation, the founders are liable for the net loss of the company. Proof that the undercapitalisation upon formation led to bankruptcy, or proof of a fault as such are not necessary.⁶⁴ The personal liability does only apply to the founding shareholders.

When establishing a company, the founders need to draw up a financial plan. In this financial plan, the founders need to outline and determine the financial needs of their company sufficient for its operational activities during the first two years. In case of bankruptcy, the court will investigate this financial plan for determining whether the company was undercapitalised at the time of its formation if the appointed liquidator requests to. The founders can only be held liable if the total initial financing of the company was manifestly inadequate.⁶⁵

Even if the statutory conditions are not fulfilled, for example when bankruptcy occurs later than three years after the incorporation, the majority of the Belgian doctrine accepts that common tort rules can still be invoked to hold a shareholder liable

63. Art. 229, 5° Belgian Company Code. The notion ‘capital’ can be misleading, since not only equity, but also other financial resources (such as shareholder loans, external credit or subsidies) must be taken into account. P. Coussement, M. Tison, *Oprichteraansprakelijkheid in Bestendig Handboek Vennootschap & Aansprakelijkheid*, afl. 4, 58, no 4100 (2003).

64. H. Braeckmans, R. Houben, *Handboek Vennootschapsrecht*, Antwerpen, Intersentia, 548, no 1010 (2011).

65. The original financial assessments from the financial plan are subject to a marginal appreciation by the court that must take the perspective of the time of incorporation with the information that was available at that time. The capital is considered to be manifestly insufficient when this should have been clear to every reasonable person (in this context, any reasonable founder). In principle, the fact that the insolvency was caused by external factors (e.g., insolvency of a major client or a total market collapse) is not relevant if the courts find that the company was manifestly undercapitalised. However, external factors can liberate the founders from liability when those external elements were not foreseeable at the time of incorporation. P. Coussement, M. Tison, *Oprichteraansprakelijkheid in Bestendig Handboek Vennootschap & Aansprakelijkheid*, afl. 4, 55, nrs. 4086 and 4108 (2003).

for the undercapitalisation upon formation of the company.⁶⁶ However, it will be much harder to hold a shareholder accountable.⁶⁷

These explicit statutory rules concerning the adequate financing upon formation of the company contrast with other jurisdictions. However, the fact that shareholders need to provide sufficient funds is not unique. In the Netherlands, for example, it is accepted that a company must be adequately funded upon formation, and that shareholders can be held liable when undercapitalisation is apparent.⁶⁸

[4] *Undercapitalisation in Other Stages of the Corporate Lifecycle*

Can undercapitalisation be at stake in other situations besides the company's formation and cases of asset stripping? Of course. At any time in the corporate lifecycle, a company can experience the absence of insufficient means which may prevent it from operating properly.

Although frequently cited in veil piercing cases,⁶⁹ US doctrine generally acknowledges that undercapitalisation is, in itself, insufficient to justify veil piercing.⁷⁰ Arguments put forward for considering undercapitalisation being insufficient are, inter alia, the fear for hindsight bias in combination with the risk of requiring too much capital as

66. H. De Wulf, *Concernaansprakelijkheid in Bestendig Handboek Vennootschap & Aansprakelijkheid*, afl. 3, 98 (2002); K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 118 (2007).

67. Because proof is needed of (1) a fault (the undercapitalisation), (2) damage and (3) a causal link. This option is in practice, however, not so often used by the courts; K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 120 (2007).

68. C. Asser, G. Van Solinge en M.P. Nieuwe Weme, *Rechtspersonenrecht: NV en BV Oprichting, vermogen en aandelen*, in *Mr C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk recht*, Deventer, Kluwer, 174-175 (2013); J. Barneveld, *Financiering en vermogensonttrekking door aandeelhouders*, Deventer, Kluwer, 505 (2014).

69. R.B. Thompson, *Piercing the corporate veil: an empirical study*, 76 *Cornell L. Rev.*, (1036) 1065 (1991).

70. See for instance *Walkovszky v. Carlton*, 223 N.E.2d 6 (N.Y. 1966); S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 128 (2016); J. Macey, J. Mitts, *Finding order in the morass: the three real justifications for piercing the corporate veil*, *Cornell Law Review*, (99) 15 (2014). In the famous *Walkovszky v. Carlton* case, Mr Walkovszky was severely injured when he was run down by a taxicab company owned by Mr Carlton. The company had no other assets than the cab and only the minimum automobile liability insurance required by law (in the amount of USD 10,000) was carried on the cab. Mr Carlton had many of these 'cab companies' that allegedly were operated as a single entity. Mr Walkovszky requested the personal liability of the shareholders for his damages. The court held that his claim was inadequately stating a cause of action. However, Judge Keating had a dissenting opinion and stated that 'a participating shareholder of a corporation vested with a public interest, organised with capital insufficient to meet liabilities which are certain to arise in the ordinary course of the corporation's business, may be held personally responsible for such liabilities'.

a precaution.⁷¹ Moreover, openly holding shareholders liable in all cases of undercapitalisation would completely contradict the idea of limited liability.⁷²

It is generally accepted that shareholders do not have a duty to make additional investments in their companies when the company is running out of money to manage its business properly, so this cannot lead to veil piercing. On the other hand, shareholders and their agents are at any time supposed to act with an appropriate level of care. As long as the company is in going concern and is not suffering from financial difficulties, this has no direct implications with regard to creditors, except in cases of asset stripping (compare supra §8.03[B][2]). This picture completely changes, however, when a company is on the vicinity of insolvency as at that moment creditors become the ultimate risk bearers.⁷³ At that point, the company's agents should take the interests of the creditors into account to act according to the proper standard of care. If they do not and continue the company's operations beyond the point where it is clear that the company is deemed to go bankrupt, undercapitalisation constitutes an abuse of limited liability. Limited liability is used to gamble for resurrection or for other purposes, to the clear detriment of creditors.

Continuing a limited liability company beyond the point at which it is clear that insolvency is unavoidable can be considered a case of abusive undercapitalisation that might lead to veil piercing. Given the importance and frequency of these types of situations, most jurisdictions developed more detailed and nuanced rules in this respect, whether through statutory law or through jurisprudence.⁷⁴ Reference can be made to the UK rules on wrongful trading,⁷⁵ the German rules on the timely filing of insolvency procedures,⁷⁶ or the French '*action en comblement de passif*'.⁷⁷

It should be noted that in developing these more specific rules, legislators and courts expressly shift liability for these situations of wrongful undercapitalisation from the shareholders to their agents, the directors. In closed corporations, however, directors and shareholders will often be the same individuals. Moreover, in most

71. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 127 (2016).

72. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 28, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

73. P. Davies, *Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency*, (301) 306 (EBOR 2006).

74. See for an overview S. Kalss, N. Adensamer & J. Oelkers, *Director's duties in the vicinity of insolvency – a comparative analysis with reports from Germany, Austria, Belgium, Denmark, England, Finland, France, Italy, the Netherlands, Norway, Spain and Sweden* in M. LUTTER (ed.), *Legal Capital in Europe*, ECFR Special Volume 1, 112-143 (2006).

75. S. 214 Insolvency Act 1986.

76. § 15(a)1 Insolvenzverordnung; see for a comparison between the UK and the German approach T. Bachner, *Creditor protection in private companies: Anglo-German perspectives for a European legal discourse*, Cambridge, Cambridge University Press, 180-247 (2009).

77. Art. L651-2 Code de commerce. See in that respect, e.g., M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés*, Paris, Lexisnexis, 191, no 391 et seq. Historically, Belgium has a similar liability rule, but an additional UK-style of wrongful trading rules has been introduced recently (2018), see Art. XX.227 of the Belgian Code of Economic Law.

jurisdictions, liability also applies to shadow directors and de facto directors,⁷⁸ which, in many cases, will lead to a situation very similar to veil piercing. A company's dominating insider is being held personally liable for – at least a part of – the company's debts.

[C] Intermediary Conclusion

The possibility to pierce the corporate veil can be seen as an essential attribute of the concepts of legal personality and limited liability. In those cases where the essential characteristics of these concepts are being abused to the detriment of third parties, it is deemed appropriate that they can be set aside.

Veil piercing is a severe sanction which can have a positive deterring effect, but adds an important level of uncertainty to the crucial concept of limited liability too. Consequently, courts worldwide seem to be highly reluctant to conclude to veil piercing. We identified two main categories of situations in which veil piercing claims can be successful: non-observance of the corporate form, and undercapitalisation. The former referring to abuse of the entire concept of legal personality, and the latter more specifically directed to abuse of the feature of limited liability.

What became clear is that mere situations of absence of capital, undercapitalisation or lack of complying with corporate formalities never suffice to conclude to veil piercing. Additional elements are required, whether it is proof of an intention to defraud creditors, specific circumstances (insolvency) or the intentional inactivity of corporate incumbents and shareholders. According to the jurisdiction at stake, these additional elements are quite divergent, but have in common that they add a certain level of vagueness to the concept of veil piercing.

Another downside of veil piercing, besides this ambiguity of the applicable criteria, is its boldness. In its most severe version, the entire construction of legal personality is being set aside. It results in the refusal of belief in the company itself and the latter cannot longer be subjected to other statutory rules or procedures. Even if lifting the veil only leads to the denial of limited liability, instead of the rejection of legal personality as such, the results are outspoken. In cases where several shareholders with different positions or even other insiders were involved, this may be problematic.

The uncertainty, vagueness and bold character of veil piercing seem to have brought many legislators to develop statutory rules with regard to situations which are traditionally seen as abusive situations that could lead to veil piercing, particularly with regard to undercapitalisation. Moreover, in some jurisdictions also the highest courts seem to prefer to develop alternative, more nuanced theories to hold shareholders liable based on tort rather than applying veil piercing. In that respect, reference can particularly be made to the above-mentioned evolutions in Germany and the Netherlands.⁷⁹

78. See for the difference between both concepts, e.g., A. Keay, *Company directors' responsibilities to creditors*, Abingdon, Routledge-Cavendish, 8 (2007); P. Davies, *Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency*, (301) 312 (EBOR 2006).

79. *Supra* §8.3[B][2].

§8.04 ABUSE OF COMPANIES, VEIL PIERCING AND THE ROLE OF STATUTORY LAW

As established in the preceding paragraphs, in most jurisdictions, regarding abuse of the essential characteristics of a company, a complex but interesting combination coexists of statutory rules, jurisdictional rules on shareholder responsibility, often based on tort, and finally the jurisdictional concept of veil piercing. From a policy perspective, an important question in this respect is whether an optimal combination and equilibrium between these different approaches can be developed.

The approach based on *statutory rules* has the advantage to provide more legal certainty. It makes the work of courts and liquidators easier, and it allows nuance and specification. Particularly, it allows allocating liability more adequately. Examples illustrating this approach relate, *i.a.*, to asset stripping. Almost all jurisdictions have rules on profit distributions⁸⁰ and accompanying liability rules for both directors and shareholders.⁸¹ The same applies to undercapitalisation in the vicinity of insolvency, a situation that legislators worldwide have scrutinised, whether it be through rules on wrongful trading targeted at directors and shadow directors, whether through insolvency filing duties, or whether through US-style fraudulent transfer rules.⁸² Also, many situations that are traditionally associated with non-observance of the corporate form are targeted by statutory rules. Many jurisdictions have express provisions on – sometimes even criminal – liability for neglecting the rules on corporate bookkeeping or the improper use of corporate assets.⁸³

The appropriateness of the latter statutory rules leading to the conclusion of non-observance of the corporate form for solving all specific situations can be questioned.⁸⁴ There is room for the proper role of veil piercing doctrine. In some cases, the application of the statutory rules will not lead to a useful result, for instance, because the director who is being held liable is insolvent or because it is hard to prove the causal link between the unlawful behaviour and the injury of the creditors. In those situations, veil piercing is a helpful instrument. When a creditor or liquidator can prove that the essential features of the company are being abused in order to defraud creditors, irrespective of whether (other) statutory rules are being respected, courts should be able to pierce the corporate veil and thus to set aside the entire legal fiction of limited liability and/or legal personality. However, veil piercing should remain an extraordinary measure for extraordinary circumstances and only serve as an ultimate backstop.

Statutory rules on abusive practices and veil piercing doctrine can and should coexist. The better those statutory rules are designed and applied in a certain

80. Whether it be balance sheet test or solvency test-based rules or a combination of both; see, e.g., W. Schön, *Balance sheet tests or solvency tests – or both?*, 181-198 (EBOR 2006).

81. See, e.g., Art. 2:216 par. 3 of the Dutch Civil Code or Art. 263 of the Belgian Companies Code.

82. See in this respect, e.g., § 548 of the US Bankruptcy Code.

83. See, e.g., the French rules concerning *L'abus de biens sociaux* (art. L241-3 Code de commerce).

84. See, e.g., D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 3, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

jurisdiction, the less important the doctrine on veil piercing will become, and the more certainty can be provided. In its current setting, it seems that many uncertainties remain in the different countries where veil piercing is found in case law. First, a variety of persons responsible for the shortcomings in the company's performance leading to the question to pierce the corporate veil can be found: the parent company, the controlling shareholder(s), director(s) or shadow director(s). Second, there is a dichotomy as to when piercing the corporate veil can be introduced as a plea: in cases of insolvency or even outside the scope of formal insolvency proceedings. It results in different parties that can file a case for veil piercing. Third and not least, the reasons for applying the lifting of the corporate veil are different: they range from general misconduct over specific actions, such as asset commingling, to even faultless liability. The latter often affects the size of the claim that can be initiated.

Statutory rules can further reduce these uncertainties. At the European level, two relatively novel approaches deserve to be studied as to their effectiveness. First, the Alternative Investment Fund Directive provides limitations of asset stripping.⁸⁵ When an alternative investment fund acquires control over a non-listed company, the latter company is, for a period of two years, not allowed to make any distribution, capital reduction, share redemption or acquisition of own shares when it would adversely affect the financial condition of the company⁸⁶. The alternative investment fund is not allowed to vote for any kind of asset stripping that the governing body of the company lists as an item on the agenda at the general meeting, and the fund must even use its best efforts to prevent any kind of asset stripping. The latter rules add objective elements⁸⁷ as to what can trigger the liability of a controlling shareholder. Second, according to the proposal for a directive on cross-border conversions, mergers and divisions, Member States' supervisory agencies must prevent that 'artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members' can take place.⁸⁸ This approach brings in an *ex ante* assessment which could help preventing that *ex post* court assessments leading to veil piercing would take place.⁸⁹

Alternatively, the question can be raised to what extent there is room for *other related doctrines* to protect creditors from certain abusive practices developed by the courts based on general principles of law. This is particularly the case for the German and Dutch jurisprudence on asset stripping based on tort law. Another important

85. Art. 30 of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, *Pb. L* 175, 1 July 2011 (hereinafter the AIFM Directive).

86. The conditions can be found in Art. 30, §§ 2 and 3 of the AIFM Directive.

87. It should be noted that according to the AIFM Directive, the alternative investment fund can still withhold its votes and consequently, the resolution can be passed. We would support the statutory rule that the controlling shareholder must vote against this resolution. However, the alternative investment fund must show how it tried to prevent any kind of asset stripping.

88. Art. 86 c and 86 k of the proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, 25 Apr. 2018, SWD(2018) 141 final.

89. Critically, however, Karsten Engsig Sørensen in Chapter 12 of this book.

example in that respect is the jurisprudence that exists in some countries regarding the subordination of shareholder loans,⁹⁰ which could be considered a sort of shareholder liability in case of undercapitalisation. Particularly in a European continental setting, we are rather critical as to the desirability of the latter type of concepts on shareholder liability developed by the courts, besides the doctrine of veil piercing. Where the essential characteristics of a company are being abused to the detriment of creditors, and statutory rules cannot lead to a desirable outcome, veil piercing seems to be the appropriate answer. Other doctrines developed by the courts create more uncertainty and threaten to undermine the idea of limited liability.⁹¹

§8.05 CONCLUSION

Our analysis shows that most legal systems acknowledge that the corporate form can be abused. The corporate form not only brings great prosperity but it can also, in rather exceptional circumstances, be helpful to defraud other parties involved in corporate life. However, making a distinction between an appropriate and an inappropriate use of the corporate form is particularly difficult and therefore requires very careful investigation and consideration in order to avoid that the major benefits of establishing a company are forfeited. Consequently, many countries have a specific, most of the time, *ex post* judicial approach for veil piercing and some sort of liability rules for shareholders. However, legislators also try to play an important role in reducing the uncertainty that is being caused by the concept of veil piercing. An illustration of a legislative *ex ante* measure is the requirement for establishing a financial plan upon formation of the company in which the founders must determine the financial needs of their company sufficient for its operational activities. Despite all the measures, uncertainty remains as to when abuse of the corporate form exists, as well as the questions how to prevent and to remedy the abusive use of the corporate form.

One measure which we suggest to further limit the likelihood of the abusive use of the corporate form is the generalisation of the limitation for alternative investment fund managers supporting a distribution of a company's assets in the aftermath of a take-over. Similarly, supervisory agencies should be given a chance to contribute to the prevention of the abusive use of the corporate form by raising questions in circumstances of cross-border conversions, mergers and divisions of companies. These statutory rules can help in reducing the uncertainty surrounding the application of veil piercing, but we acknowledge that the role of the courts in assessing the behaviour of corporate incumbents justifying veil piercing will remain pivotal.

90. See in this respect, e.g., A. Cahn, *Equitable subordination of shareholder loans?* 287-300 (EBOR 2006).

91. Like it has been the case in the Netherlands where the Nimox jurisprudence (cf. *supra*) served as one of the arguments to completely reform the (liability) rules on profit distributions for closed companies; *Kamerstukken II* 2006/07, 31058, no 3, p. 33.