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VEIL-PIERCING UNDER AMERICAN, GERMAN, AND TAIWANESE COMPANY LAW

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The veil-piercing doctrine allows courts to pierce the metaphoric corporate veil that shields shareholders from being held personally liable for a company's debts and liabilities. Since it is an exception to the statutory guarantees of limited liability and separate legal personality, it should be applied cautiously and infrequently. The decision of whether to pierce highly depends on juridical interpretations and decisions. As a result of this, the development and application of veil-piercing vary across jurisdictions and countries. This paper aims to provide an overview and critical analysis of the different approaches taken by the U.S., Germany, and Taiwan and further uses the observations from the theoretical analysis to evaluate whether the Union should harmonize veil-piercing in the EU in order to facilitate the freedom of establishment.

KEYWORDS

Piercing the corporate veil, disregard legal personality, limited liability, freedom of establishment

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1 Introduction

The most important attributes of the modern company are the principle of separate legal personality and the principle of limited liability.[1] Together they create a separation between shareholders' and company's assets and put a limitation on shareholders' liability. This privilege creates a metaphoric 'corporate veil' to protect entrepreneurs and investors from losing all their personal assets to a company's creditors when a company fails to repay its debts.[2]

However, this privilege could be abused when shareholders use the company as a vehicle to conduct wrongful acts, such a committing fraud, and cause injuries or losses to the company's creditors.[3] To compensate and provide a remedy for these victims, courts, in cases where shareholders use a company entity for illegitimate purposes or abuse the privilege of limited liability, will disregard the separate legal personality and pierce through the corporate veil to hold shareholders directly liable to creditors for debts incurred and injuries caused by the company.[4] This is known as piercing the corporate veil.[5]

The topics of academic discussions on veil-piercing can generally be divided into two categories.[6] One category focuses on piercing the corporate veil between affiliated companies. In this case, courts hold the parent or controlling company liable for the debts of its subsidiaries or controlled company. The other category is piercing the corporate veil between a company and its individual shareholders. Courts impose personal liability on the shareholders responsible for the situation. This paper focuses on cases that involve piercing individual shareholders and only uses affiliated company cases for further illustrations.

This paper aims to provide an overview and critical analysis of various applications of veil-piercing as well as use these observations to evaluate whether the Union should harmonize veil-piercing in the EU in order to facilitate the freedom of establishment.

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[1] *Hudson,* Understanding Company Law, p. 9.
[2] *Ridley/ Shepherd,* Company Law, pp. 26-27.
[3] *Matheson,* Berkeley Business Law Journal 7(1) 2010, p. 6.
[4] *Millon,* Emory Law Journal 56(5) 2007, p. 1325.
[5] *Presser,* Piercing the Corporate Veil. cited by *Bainbridge,* University of Illinois Law Review 77 2005, p. 5 and *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 480.
[6] Based on this student's observations from research.

Since the veil-piercing doctrine is intrinsically linked with the principle of separate legal personality and limited liability, this paper plans to begin by laying down the fundamentals. Part 2 provides an overview of the principle of separate legal personality and the principle of limited liability. It also discusses the justifications, from the creditors' perspective, for accepting limited liability as a default rule for companies. Since the level of involvement of shareholders is significantly different in public and private companies, the rationales for accepting limited liability would be different for voluntary[7] and involuntary[8] creditors. In this light, four scenarios are separately and thoroughly analyzed: contract creditors of public companies, tort creditors of public companies, contract creditors of private companies, and tort creditors of private companies.

With the justifications of limited liability in hand, Part 3 introduces the veil-piercing concept with an economic and doctrinal analysis. The conclusion drawn from these analyses confirms that veil-piercing should be applied cautiously and infrequently to avoid undermining the privilege of limited liability guaranteed to companies.

However, the analysis of U.S. veil-piercing in Part 4 indicates that U.S. courts may have pierced in cases where veil-piercing was not the optimal solution. As the U.S. is the birthplace of this principle[9], it provides the most comprehensive studies and cases to help understand the development and application of veil-piercing. Veil-piercing in the U.S. has become a concept with an extensive scope but incoherent in the application.[10]

By contrast, a review of German veil-piercing shows that German courts intentionally narrow the scope of veil-piercing and only pierce in the situations when shareholders commingle personal assets with company assets.[11] German courts strongly uphold the principle of limited liability and emphasize that piercing must be applied cautiously otherwise it would bring detrimental effect to limited liability and consequently the economy.[12]

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[7] This paper uses the terms 'voluntary creditors' and 'contract creditors' interchangeably.
[8] This paper uses the terms 'involuntary creditors' and 'tort creditors' interchangeably.
[9] *Farat/ Michon,* Common Law Review 9(1) 2008, p. 23.
[10] *Thompson,* Connecticut Law Review 37(3) 2005, p. 626.
[11] *Schulz/ Wasmeier,* The law of business organizations: A concise overview of German corporate law, p. 106.
[12] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 177.

Following Germany, the next subsection considers the development of veil-piercing in Taiwan. As a relatively young country with a set of company laws that is influenced by both the American and German laws[13], Taiwan has just begun the process of shaping its own regime of veil-piercing. At the moment, it appears that Taiwanese courts are more inclined to adopt the U.S. approach. However, it remains to be seen as to how this theory will develop since veil-piercing is a concept that depends highly on the facts and circumstances of the cases and juridical decisions.

The analyses of veil-piercing in these countries indicate that it would be impossible to establish a standardized rule or approach for veil-piercing because each jurisdiction has its unique approach for this concept. In the EU context, would the national differences of veil-piercing hinder the freedom of establishment? Part 5 argues that harmonization of veil-piercing based on Article 50 TFEU would be neither justified nor needed because national differences of veil-piercing could facilitate the free movement of establishment and cross-border conversion within the EU.

2 The hallmarks of modern companies – the principle of separate legal personality and the principle of limited liability

The principle of separate legal personality and the principle of limited liability are the essential elements of modern companies. It is these two principles that facilitate the functioning of our modern economies and investment markets.[14] The principle of separate legal personality allows the separation of a company's assets from shareholders' personal assets.[15] This principle together with the privilege of limited liability allows modern entrepreneurs and investors to invest in companies without worrying about losing all their personal assets when companies fail.[16] This limitation on investor's liability, in turn, incentivizes the

[13] *Wang,* Corporate Law, p. 205.
[14] *Hudson*, Understanding Company Law, p. 28.
[15] *Ibid.,* p. 9.
[16] *Ibid.,* pp. 17-18.

establishments of modern limited liability companies and encourages diversified investments which ultimately facilitates capital formation.[17]

In modern times, in different countries and jurisdictions, there are different beginnings to the establishment or affirmation of these principles. For instance, in the U.S., New York State first introduced the concept of limited liability for manufacturing companies in 1811[18]; the principle of separate personality was established in the case of *Bank of Augusta v Earle*[19] in 1839 in the U.S.[20] Nevertheless, the most famous origin story perhaps is the one from the United Kingdom. The abovementioned positive outcomes of companies to society began when the landmark judgment of *Salomon v. A Salomon & Co. Ltd*[21] was delivered in 1897.[22] In this case, the U.K.'s House of Lords established the principle of separate legal personality and affirmed the principle of limited liability enshrined in the Companies Act 1862.[23]

2.1 The principle of separate legal personality – the Salomon principle

In *Salomon v. A Salomon & Co. Ltd*, Aron Salomon, a sole trader in leather trading and boot manufacturing, converted his sole proprietorship into a limited liability company. In this new company, under the name of Aron Salomon and Company, Limited, Mr. Salomon held 20,001 of the company's 20,007 shares; his wife and five children equally held the remaining six shares.[24] He was the managing director. He was also a secured debenture holder of this company – this would give Mr. Salomon the right to be repaid before unsecured creditors and shareholders in a winding up.[25]

When this company, unfortunately, went into insolvent liquidation, the amount realized from the liquidation was only enough to repay the debentures holders,

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[17] *Pinto/ Branson,* Understanding Corporate Law, pp. 36-38.
[18]The key to industrial capitalism: limited liability, December 1999, available at https://www.economist.com/finance-and-economics/1999/12/23/the-key-to-industrial-capitalism-limited-liability (14 August 2020).
[19] *Bank of Augusta v. Earle,* 38 U.S. 13 Pet. 519 519 (1839).
[20] *Farat/ Michon,* Common Law Review 9 (1) 2008, p. 23.
[21] *Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22.
[22] *Hudson,* Understanding Company Law, p. 28.
[23] *Ibid.,* p. 25.
[24] *Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22, pp. 22-23.
[25] *DeFreitas,* Company Law, p. 3.

Mr. Salomon himself and Mr. Broderip, leaving nothing for the unsecured creditors.[26]

The liquidator, on behalf of the company, filed a claim against Mr. Salomon to have the debenture repayment to Mr. Salomon to be returned to the company.[27] The liquidator contended that since the board of directors and shareholders consisted almost entirely of Mr. Salomon, Mr. Salomon and the company were essentially one and the same.[28] The House of Lords rejected this argument; they held in their famous judgment that

"it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are."[29]

In other words, companies that are established in compliance with the law are granted a legal personality separate from their shareholders.[30] Mr. Salomon's company, Aron Salomon and Company, Limited, thus is a distinct legal person to be distinguished from Mr. Salomon, a shareholder and the sole person who managed the business.

In this light, the principle of separate legal personality established by the *Salomon's Case* allows a company to be treated like a human being on its own: to have its legal duties and obligations, to own property, to sue and be sued, and to sign contracts in the company's name.[31] This, in turn, means that the assets owned by the company belong to the company; they are not shareholders' personal assets. Likewise, shareholders' personal assets are not part of the company's property. The liabilities incur under the company's name belong to the company; they are not shareholders' debts.[32]

[26] *Hudson*, Understanding Company Law, p. 25.
[27] *Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22, pp. 24-25.
[28] *DeFreitas,* Company Law, p. 3.
[29] *Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22., p. 30.
[30] *Hudson*, Understanding Company Law, p. 20.
[31] *Ibid.,* p. 9.
[32] *Ibid.,* p. 9.

2.2 The principle of limited liability

As such, this separateness between the entity and its shareholders leads to and affirms the principle of limited liability.[33] Since a company's debt is not the debt of its shareholders, the principle of limited liability allows shareholders to avoid exposing themselves to the continuous and open-ended risks and debts that business ventures may incur.[34] When a company incurs debts, creditors of the company may not turn to shareholders demanding repayments from these shareholders' personal assets. In other words, when the company becomes insolvent, shareholders' losses are limited to their investments in the company.[35]

Since a company is recognized as a separate body from its shareholders, the notion of a separate legal personality creates a metaphoric 'corporate veil' between the company and its shareholders.[36] When combining with the concept of limited liability, the corporate veil prevents the public, creditors, and courts to reach behind the veil to hold shareholders responsible for debts incurred and torts committed by the company.[37]

2.3 Social benefits of limited liability

The principle of limited liability, together with the notion of a corporate veil that shields shareholders from the company's creditors, increases efficiency and produces numerous benefits to the economy and investment market. [38] If investors' personal liability is limited, this would allow a more efficient decision-making process in a company, particularly in a company that consists of a large number of shareholders. When personal liability is unlimited, even a small obligation that arises from the business may have a claim on shareholders' personal assets.[39] For that reason, investors would want to be able to participate in making decisions for daily business operations and influence the outcomes so that they could minimize the risks for the company, and in turn for themselves. However, this would prolong the decision-making process and create chaos in a

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[33] *Cheng,* Boston College International and Comparative Law Review 34(2) 2011, p. 335.
[34] *Hudson*, Understanding Company Law, p. 17.
[35] *Ibid.,* p. 17.
[36] *Pinto/ Branson,* Understanding Corporate Law, p. 36.
[37] *Hudson*, Understanding Company Law, p. 30.
[38] *Millon,* Emory Law Journal 56(5) 2007, p. 1312.
[39] *Ibid.,* p. 1312.

public company context, where the members and numbers of shareholders are different every day.[40] Under the rule of limited liability, shareholders would be less eager to participate than in the case of unlimited liability because the failure of the company does not affect their personal assets. Limited liability thus facilitates a more efficient and centralized decision-making process in modern companies.

Although the benefits resulted from limited liability pointed out above may seem to be beneficial only for a company's internal functioning, they extend to our economy and society. The most apparent benefit resulted from limited liability is capital formation.[41] With limited personal liability, investors would be more willing to invest in business ventures that they do not have full control over.[42] This facilitates the development of impersonal investments and stock trading, creating capital formation with an aggregation of large amounts of funds from numerous investors.[43] Enterprises benefit from capital formation significantly because it enables financing of an enterprise with capital from multiple investors; these investors would otherwise be reluctant to financially support the entire business venture on their own due to the large scope or high risks.[44]

In addition to capital formation, limited liability reduces shareholders' costs on monitoring the business and their fellow shareholders.[45] Under a regime of unlimited liability, a shareholder has a strong incentive to follow up every step of the business operations in order to minimize his own liability. However, most market participants that seek to make profits from investments usually also have a full-time job.[46] Continuous monitoring of daily operations is costly and time-consuming for investors.

Moreover, unlimited liability means that when a company becomes insolvent and it is unable to repay its debts, shareholders' assets will need to be used to fulfill the debt obligations. In this regard, a shareholder would want to survey and monitor his fellow shareholders to ensure that they have decent creditworthiness and sufficient wealth so that they will be able to share the debt

[40] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 490.
[41] *Pinto/ Branson,* Understanding Corporate Law, p. 37.
[42] *Millon,* Emory Law Journal 56(5) 2007, p. 1312.
[43] *Pinto/ Branson,* Understanding Corporate Law, p. 37.
[44] *Ibid.,* p. 37.
[45] *Millon,* Emory Law Journal 56(5) 2007, p. 1313.
[46] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 490.

burdens when the company cannot pay.[47] If unlimited personal liability were the rule, a shareholder has to put in tremendous effort, time, resources to protect his personal assets by ensuring that he only has to share a small portion of the debt pie.

The reductions in both time and money spent on monitoring investment targets and fellow shareholders further facilitate two important features of our modern economy: diversification of investment[48] and transferability of corporate stock[49]. Limited liability allows passivity on the side of shareholders; they do not need to closely monitor their investments and each other. This passivity enables shareholders to invest in more investment targets and diversify their investment portfolios. Diversification is important for the economy because this helps to finance enterprises and capital formation.[50] From the shareholders' point of view, diversification together with limited liability provides a means to reduce investment risks. When one company fails, a shareholder loses only a portion of his portfolio investment. If he hedges, by investing in competing firms, he may even be better off when the gains of the failed company redound to its competitor company.[51] Therefore, limited liability enables the reduction of monitoring costs which consequently encourages investment diversification.

Limited liability and the reduced effort of monitoring also facilitate the transferability of corporate stock.[52] Under conditions of unlimited personal liability, transfers of stock are less desirable and more difficult due to the following reasons. First, fellow shareholders, the ones that are not transferring the shares, bear new costs as they have to keep track of the identities and the personal wealth of the new shareholders to ensure that these newcomers have sufficient assets. Second, creditors also incur more monitoring costs. To reduce risks, creditors may also prohibit the transfer or require the transferor to remain accountable after the transfer.[53] For these reasons, unlimited liability reduces the liquidity of stocks. On the contrary, transferors encounter no such difficulties and limitations mentioned above when limited liability is in place. The fact that shareholders are separated from the entity and that creditors can

[47] *Millon,* Emory Law Journal 56(5) 2007, p. 1313.
[48] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 490-491.
[49] *Millon,* Emory Law Journal 56(5) 2007, p. 1313.
[50] *Pinto/ Branson,* Understanding Corporate Law, p. 36-37.
[51] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 491.
[52] *Millon,* Emory Law Journal 56(5) 2007, p. 1313.
[53] *Ibid.,* p. 1313.

only hold the company accountable for debts owed makes the transfer of stock more easily.

2.4 Justifications for adopting limited liability as a default rule

From the discussion above, it makes sense for society and shareholders to accept adopting limited liability as a default rule for modern companies since limited liability creates tremendous benefits for investors and society at large. However, a further question arises as to whether limited liability as a default rule would make sense to company creditors.[54]

Statutory limited liability grants the privilege to companies regardless of whether the company is a private company with a few owners or a public company with numerous investors. Likewise, the privilege of limited liability protects shareholders from creditors without distinguishing the type of creditors, e.g. contract creditors and tort creditors.[55]

It would be incorrect to assume that the rationales for accepting limited liability would be the same for contract creditors, who have *ex ante* opportunities to bargain with the company,[56] and tort victims, who involuntarily bear the risks resulting from corporate activities.[57] Since the relations between a company and a contract creditor are consensual while the relations with tort creditors are not, the justifications for limited liability for these two types of creditors involve different policy considerations and rationales.[58] For contract and tort creditors to accept limited liability as a default rule depends also on the corporate governance and ownership structures.[59] To analyze the justifications for having limited liability as a default rule under different circumstances, the below discussion is divided into four scenarios: contract creditors of public companies, tort creditors of public companies, contract creditors of private companies, and tort creditors of private companies.

[54] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 487.
[55] *Millon,* Emory Law Journal 56(5) 2007, p. 1314.
[56] *Ibid.,* p. 1318.
[57] *Ibid.,* p. 1324.
[58] *Ibid.,* p. 1314.
[59] *Bainbridge,* Journal of Corporation Law 26(3) 2001, pp. 487-488.

2.4.1 Contract creditors of public companies

Admittedly, it seems counterintuitive for creditors to accept the idea of limited liability since this privilege to companies and shareholders would leave creditors with no protection or guarantees for repayments when companies fail. Yet, the benefits of limited liability and separate legal personality for contract creditors in the public company context come in twofold.

First, contract creditors can minimize the cost of monitoring since they only need to ensure the company has decent creditworthiness and sufficient assets. If unlimited liability were the rule, creditors would need to credit check each investor to ensure that someone would be able to repay the debts in case the company is unable to repay.[60] This is particularly troublesome in the public company context because the pool of investors changes every single day. It would be extremely costly to keep track of all shareholders' creditworthiness and financial situations.

Second, the principle of separate legal personality allows creditors to bring lawsuits against the company rather than bring individual suits against hundreds or thousands of investors.[61] Again, in the public company context, suing a large number of investors is extremely costly. Cost is not the only concern here. Since public companies have investors nationwide, if not worldwide, the troubles include, for instance, how to locate these shareholders and which law (state law, federal law, or foreign law) is applicable.[62] Needless to say, suing individual investors in this context is also troublesome.

While contract creditors would prefer unlimited liability to ensure that they will be repaid when the company defaults, they are not necessarily worse off under the rule of limited liability. Contract creditors have opportunities to factor in the default risk, the risk that the company will not be able to repay its debts, and negotiate for personal guarantees or prior claims on the company's assets during liquidation.[63] Thus, even under limited liability, contract creditors retain effective means to reduce their risks. Contract creditors of public companies therefore would not fully reject the idea of limited liability as a default rule for entities.

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[60] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 492.
[61] *Ibid.,* p. 492.
[62] *Ibid.,* p. 492.
[63] *Millon,* Emory Law Journal 56(5) 2007, p. 1316.

2.4.2 Tort creditors of public companies

Tort claims range from product liability to environmental damages.[64] Unlike contract creditors who could bargain with the debtor company before concluding a contract, tort victims are not provided with these *ex ante* opportunities.[65] For instance, a pedestrian hit by a taxi; the pedestrian has no prior opportunity to know that the company that owns the taxi has no sufficient assets to pay for the losses and injuries he or she suffers.[66] In this way, it is said that tort creditors involuntarily assumed the risk of company insolvency.[67]

Against this background, it is apparent that tort creditors would be less willing to accept limited liability for companies. Nevertheless, limited liability still is justified as it brings out several benefits to tort creditors that would otherwise not be there under the alternative option, unlimited liability.

First, similar to the case for contract creditors of public companies, tort victims of public companies, under the rule of limited liability, can avoid the troublesome task of tracking down and suing geographically diverse investors.[68] Even if tort creditors successfully bring lawsuits against some of the shareholders, the remedy received may not outweigh the high costs put into these litigations because these investors may only hold a small portion of the company's shares.[69]

Second, in the public company context, the investor pool changes constantly. If the rule were unlimited personal liability, it would be difficult to determine who is liable, for instance, which investors owned the shares at the time of injury. A potential solution could be to attach liability at the time of judgment.[70] However, shareholders would have an opportunity to evade liability by selling the stocks after the claim is filed but before the judgment is delivered.[71] In this regard, unlimited liability does not seem to be an effective regime for tort victims.

Furthermore, one of the benefits of limited liability is that it facilitates equity investment and stock trading. If there is more capital flowing into a public

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[64] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 494.
[65] *Peterson,* Journal of Business & Technology Law 13(1) 2017, p. 79.
[66] *Walkovszky v. Carlton,* 223 N.E.2d 6 (N.Y. 1966).
[67] *Millon,* Emory Law Journal 56(5) 2007, p. 1316.
[68] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 496.
[69] *Ibid.,* p. 496.
[70] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 497.
[71] *Ibid.,* p. 497.

company, tort victims would have a higher probability of being compensated.[72] In essence, tort creditors could benefit from the bigger and safer capital and assets cushion that unlimited liability could not provide.

2.4.3 Contract creditors of private companies

Limited liability is harder to justify in the private company context. This is because, in private companies, the separation of ownership and management is not as distinct as in the public company context. Shareholders in a private company usually also serve as managers, executing the company's daily operations.[73] In this light, when a private company goes bankrupt, it is likely caused by decisions made by managers who are also shareholders of the company.

Another reason for the limited liability regime not being as appealing to contract creditors of private companies as to those of public companies is that private companies usually compose of a smaller number of shareholders. Creditors, therefore, face relatively low monitoring costs.[74] Contract creditors could easily monitor each shareholder and, if necessary, bring claims against them individually.

If limited liability is not the preferred regime in this context, then why is this principle still the default rule for private companies? One justification is that a private company may also have a large number of shareholders. If the private company is a one-person company, market participants may prefer unlimited liability.[75] However, if the company has a promising future and attracts hundreds of shareholders, then a limited liability regime would be as appealing as in the situation under the public company discussed earlier.

Furthermore, the economic justification, in this case, is that limited liability allows the party who could avoid a loss at the lowest cost to take precautions.[76] The "cheapest cost avoider"[77] here is the contract creditors.[78] Whereas it would

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[72] *Ibid.*, p. 497.
[73] *Ibid.*, p. 501.
[74] *Bainbridge*, Journal of Corporation Law 26(3) 2001, p. 501.
[75] *Ibid.*, p. 501.
[76] *Ibid.*, p. 501.
[77] *Gilles*, Virginia Law Review 78(6) 1992, p. 1912.
[78] *Bainbridge*, Journal of Corporation Law 26(3) 2001, p. 502.

be difficult for a debtor company to figure out which contract creditor will demand more collaterals, contract creditors can determine, at a lower cost, whether they need to negotiate for better guarantees or higher interest rates to protect themselves from the risk of company insolvency. Contract creditors bear a cheaper cost because they have more information about the debtor company than the debtor company has about them.[79] In this light, limited liability enables a company to shift part of the risks to contract creditors who can bear these risks at a lower cost. From the economic perspective, society at large incurs minimal losses.[80]

2.4.4 Tort creditors of private companies

Similar to the situation observed in the case of contract creditors of private companies, tort victims of private companies have little incentive to consent to have limited liability as a default rule. This is the hardest scenario to justify[81] because in most private companies, shareholders also actively control management. Tort committed is therefore likely a result of business decisions made by these shareholders who act through the company as managers.[82] By contrast, torts are likely not the consequences of shareholders' decisions in the public company context as there is a clearer separation between ownership and management. Furthermore, unlike contract creditors who can ensure only a portion of the default risk will be shifted to them by *ex ante* bargains for extra guarantees, tort victims do not have any prior relations to the company before the injury.[83] Tort creditors therefore involuntarily assume the risk that the company will not be able to provide a remedy for them.

The question arises again as to why limited liability remains the default rule. One of the justifications is that the private company may have hundreds of investors. It would then be impossible to sue them individually. Furthermore, if shareholders have to personally assume all the potential risks of doing business,

[79] *Farat/ Michon,* Common Law Review 9(1) 2008, p. 21.
[80] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 502.
[81] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 487.
[82] *Ibid.,* p. 501.
[83] *Millon,* Emory Law Journal 56(5) 2007, p. 1315.

the development of the economy would be very limited. It would be therefore economically and socially undesirable to convert to purely unlimited liability.[84]

Finally, tort creditors enjoy some benefits of limited liability by free-riding on contract creditors' negotiation results.[85] Since contract creditors frequently demand the company to maintain a certain level of assets besides better collaterals, tort creditors would subsequently face a higher probability that the company is able to pay for at least some of the damages.

2.5 Conclusion

The principle of separate legal personality and the principle of limited liability are the hallmarks of modern companies. Together they sever the link between shareholders and company creditors. A company, as recognized as a separate legal person, owns assets and incurs liabilities on its own. Creditors cannot hold shareholders or investors personally liable for duties and obligations incurred by the company. Shareholders or investors, thus, in the worst-case scenario, when a company goes bankrupt, only lose up to the amount they have invested in the company. This limitation on the shareholders' personal liability encourages investors to diversify and increase their investments, benefiting the modern economies and society greatly.

It would appear that, from the creditors' perspective, adopting the rule of limited liability would undermine their rights, particularly when a company fails to repay its debts or fulfill its obligations. However, after analyzing four different scenarios between the company forms and creditor types, it is evident that limited liability may still create some benefits for both contract creditors and tort victims in both public and private company contexts.

Even though the principle of limited liability, in general, seems to offer benefits, it is a privilege that could be abused or used to achieve illegitimate business goals by cunning shareholders. Courts, in these cases, would neglect the principle of limited liability and pierce the corporate veil to hold shareholders liable for the damages they caused.

[84] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 504.
[85] *Ibid.,* p. 504.

3 Piercing the corporate veil

Despite the statutory guarantee of limited liability for shareholders, courts may decide to disregard the corporate separateness, peek behind the veil, and hold the shareholders personally liable to creditors for the debts of the company. When courts determine the liabilities of the company are in fact the liabilities of the shareholders, this is said that the corporate veil is pierced or lifted.

3.1 The rationales for veil-piercing

Despite the importance of limited liability and the benefits it creates for modern entities and economies, the concept of limited liability is not uncontroversial.[86] Legal scholars have challenged this principle; they argue that the privilege of limited liability should only be granted to certain types of obligations or liabilities and certain forms of company.[87] The controversy comes from the fact that limited liability creates a loophole for shareholders to escape personal liability. More specifically, this limited personal liability regime allows the company and its shareholders to shift a portion of the economic risks to people outside of the entity, e.g. contract and tort creditors.[88]

3.1.1 The risk-taking nature under limited liability

As a consequence of limited liability, companies are more inclined to accept projects and investments that have greater risks. The risk-return trade-off principle tells decision-makers that a project with high risk has a greater probability of higher return.[89] Shareholders, because of the privilege of limited personal liability, would prefer enterprises to take on projects that involve higher risks. If these risky business ventures succeed, shareholders will receive a larger amount of return in the form of dividends or higher prices when selling the stock. On the other hand, if projects unfortunately fail, according to the

[86] For instance, *Hansmann/ Kraakman*, Yale Law Journal 1991, advocating unlimited liability for company torts in both private and public company contexts.

[87] *Hansmann/ Kraakman,* The Yale Law Journal 100(7) 1991, p. 1879.

[88] *Thompson,* Connecticut Law Review 37(3) 2005, pp. 620-621.

[89] MWL Financial Group, The Risk/Return Trade-Off Principle, July 2017, available at https://www.mwl.com.au/the-riskreturn-trade-off-principle/ (20 August 2020).

limited liability rule, shareholders are not accountable for the losses; the company has to bear this burden.[90]

Furthermore, if the company goes bankrupt, creditors of the company have priority over shareholders to claim what is realized from liquidation.[91] Shareholders therefore would prefer projects that have higher risks yielding greater returns so that there would be residuals for the shareholders after the creditors are paid.[92]

3.1.2 Negative externalities caused by limited liability

During the course of operation, if the company has sufficient assets to pay off its debts and obligations, there is no problem. The danger comes when the company takes on projects that are too risky or are beyond its capacity and consequently lead to the company defaulting on its debts; creditors thus bear the costs of bankruptcy.[93] This shift of risk-bearing allows shareholders to externalize some of the economic risks from shareholders to parties outside of the entity.[94]

This externalization sometimes makes economic sense and is justified on the basis that parties outside of the entity may be a more efficient bearer of the risk. This is the "cheapest cost avoider" concept discussed in the previous section. An outside party may have more information about the company's financial situation or could incur lower costs than the company and its shareholders.[95] As such, the shifting of risk to outside parties achieves better economic efficiency.[96]

Furthermore, negative externalities do not always involve a complete transfer of risk to outside parties. Sometimes they are only partially shifted to creditors. For instance, contract creditors have opportunities to conduct a credit check and review financial statements before deciding to transact with the company. They factor in the possibility that they would not be repaid if the asset-poor company

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[90] *Bainbridge,* Journal of Corporation Law 26(3) 2001, pp. 488-489.
[91] *Ibid.,* p. 489.
[92] *Ibid.,* p. 489.
[93] *Bainbridge,* University of Illinois Law Review 77 2005, p. 88.
[94] *Peterson,* Journal of Business & Technology Law 13(1) 2017, p. 79.
[95] *Farat/ Michon,* Common Law Review 9(1) 2008, p. 21.
[96] *Ibid.,* p. 21.

fails.[97] They reduce the risks they bear, namely not being repaid, by negotiating and bargaining; they would only settle when a loan to the company is added with a higher lending interest rate, personal guarantees, collaterals, or contract provisions limiting and preventing the company from taking risky projects that would increase the probability of bankruptcy.[98] Therefore, externalizing the economic risk to parties outside of the entity does not always result in a complete shift of the risk.

However, the trouble occurs when tort creditors bear the negative externalities. Contrary to the contract creditors, tort creditors have no prior relations with the company that would allow them *ex ante* opportunities to vet the company's business conditions and financial documents; they also had no way to bargain beforehand for compensations for bearing the economic risk that the company externalized.[99] Tort creditors thus have involuntarily assumed the risk of corporate failure. In that regard, this shifting of economic risk from the inside of the company to the outside parties results in moral hazards[100] and social costs. These negative externalities shift the risks to people who are not the most efficient risk bearer.[101] Courts should aim to correct these unfair externalizations of risks by piercing the corporate veil.[102]

3.2 Veil-piercing as an equitable remedy

The principle of limited liability is a result of the assessment of an economic trade-off balancing the pros, such as the promotion of commerce and industrial growth, and cons.[103] The fact that the company legislation allows limited liability as a statutory default rule for companies implicates that society considers the benefits of limited liability outweighs the risks and it is prepared to tolerate these risks.[104] However, limited liability is not absolute.[105] Without an equitable remedy, creditors who are wronged by the company are not compensated. More

[97] *Millon,* Emory Law Journal 56(5) 2007, p. 1316.
[98] *Ibid.,* p. 1316.
[99] *Ibid.,* p. 1316.
[100] *Ibid.,* p. 1317.
[101] *Thompson,* Connecticut Law Review 37(3) 2005, p. 621.
[102] *Ibid.,* p. 621.
[103] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 150.
[104] *Ibid.,* p. 150.
[105] *Millon,* Emory Law Journal 56(5) 2007, p. 1325.

specifically, since voluntary creditors are partially compensated by their *ex ante* bargains, involuntary creditors are the ones subsidize companies for their excessive risk-taking.[106]

To minimize the effect of negative externalities and to compensate creditors, courts have recognized the need for imposing constraints on the principle of limited liability.[107] The concept of veil-piercing aims to hold the shareholders responsible for their abusive or illegitimate conduct that caused harm and losses to parties outside of the company.[108] Veil-piercing is not just an exception to the separate corporate personality, more importantly, it is an equitable remedy.[109]

As an equitable remedy, veil-piercing aims to provide compensation for victims who suffered from shareholders' abuse or overuse of limited liability. Normally, when a victim suffers from his legal rights being violated, he will be provided with a remedy.[110] If the law is not able to provide an adequate remedy, an equitable remedy will be used.[111] In this light, an equitable remedy is an extraordinary form of relief subject to judicial discretion; it is the last resort.[112] To provide equitable treatment, courts determine what needs to be done in order to individualize justice and remedy in a way that a good conscience would do.[113] This "individualized justice"[114] is achieved by examining the circumstances, intent, and substance, rather than the mere appearance or form, on a case-by-case basis to compensate those victims who had no *ex ante* opportunities to prevent the injuries.[115]

Even though the doctrine of veil-piercing originated from the jurisprudence of equitable remedy[116], meaning that the corporate veil should be disregarded infrequently and only when there is no other remedy at laws, the developments of the doctrine have not strictly followed the maxims of equitable remedy.

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[106] *Peterson,* Journal of Business & Technology Law 13(1) 2017, p. 79.
[107] *Millon,* Emory Law Journal 56(5) 2007, p. 1325.
[108] *Pinto/ Branson,* Understanding Corporate Law, p. 38.
[109] *Peterson,* Journal of Business & Technology Law 13(1) 2017, p. 68.
[110] *Peterson,* Journal of Business & Technology Law 13(1) 2017, p. 69.
[111] *Ibid.,* p. 69.
[112] *Ibid.,* p. 70.
[113] *Ibid.,* p. 69.
[114] *Ibid.,* p. 68.
[115] *Ibid.,* pp. 70-71.
[116] O*h*, Boston University Law Review 93(89) 2013, p. 93.

3.3 Conclusion

The privilege of limited liability induces shareholders to take risky projects for greater potential returns. However, since shareholders are protected by the corporate veil, the risks of failures of business ventures and companies are shifted to creditors. This shift is particularly troublesome if it is a result of abuse or illegitimate use of corporate structure by shareholders. Moreover, this shift is unfair to tort creditors who involuntarily become victims of these risk-taking business decisions.

In an attempt to correct this abusive use of corporate structure and unfair shift of risks, courts have fashioned the so-call 'piercing the corporate veil' doctrine. This is an equitable remedy and an exception to the principle of limited liability. The application of veil-piercing in the U.S, Germany, and Taiwan is discussed in the next section. One can observe that courts in different jurisdictions have developed various tests and evaluating factors to determine when to pierce the corporate veil. As a result of different approaches taken by different judges, the doctrine of veil-piercing has been criticized as a theory that lacks coherence and predictability.[117] As Easterbrook's frequently cited quote summarizes: "Piercing seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled."[118]

4 Veil-piercing in the U.S., Germany, and Taiwan

Even though stemmed from the same fundamental idea, to hold the shareholders liable for their wrongful conduct, the doctrine of veil-piercing is observed to have developed varying approaches in different countries and jurisdictions.

The U.S. has a long history of veil-piercing.[119] Since corporate law is a state law in the U.S.,[120] each state employs different tests and factors to determine when

[117] *Macey/ Mitts,* Cornell Law Review 100(1) 2014, p. 105.
[118] *Easterbrook/ Fischel,* The University of Chicago Law Review 52(1), p. 89 and *Thompson,* Connecticut Law Review 37(3) 2005, p. 624.
[119] *Farat/ Michon,* Common Law Review 9(1) 2008, p. 23.
[120] *Hardee,* Washington Law Review 94(1) 2019, p. 221.

to pierce the corporate veil.[121] In general, the U.S. seems to take a liberal approach to disregard limited liability and hold shareholders directly liable to creditors.[122] The extensive scope of the U.S. veil-piercing, where a liberal application of the doctrine is applied, results in a large number of case law. The concern is that this liberal view of piercing could undermine the principle of limited liability.

Conversely, Germany is more cautious about piercing the corporate veil. Veil-piercing happens rarely in Germany because the courts take the view that piercing the corporate veil without caution would threaten the functioning of modern companies and economies.[123] Currently, commingling of assets is the only situation in which German courts would pierce the corporate veil.

Taiwan, although highly influenced by both the U.S. and German company laws, has just begun to develop its own set of case law and rules for veil-piercing. At the moment, it appears that Taiwanese courts are more inclined to adopt the U.S. approach. However, it remains to be seen as to how this theory will develop and how courts will shape this concept to accommodate the particular company and market structure in Taiwan.

This section compares and critically examines the circumstances under which courts in different jurisdictions decide to set aside the limited liability and pierce the corporate veil.

4.1 Veil-piercing in the United States

Piercing the corporate veil occurs frequently in the U.S.[124] This doctrine has an expansive scope and, in practice, whether and when to pierce a corporate veil is purely dependent on judicial discretion.[125]

In the U.S., corporate law is a state law; each state may lay out its own set of corporate rules. However, regardless of which state a corporation decides to be incorporated in or where a Limited Liability Company (LLC) is to be established,

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[121] *Thompson,* Connecticut Law Review 37(3) 2005, p. 626.
[122] *Bainbridge*, Journal of Corporation Law 26(3) 2001, p. 161.
[123] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 177.
[124] *Thompson,* Connecticut Law Review 37(3) 2005.
[125] *Macey/ Mitts*, Cornell Law Review 100(1) 2014, p. 105.

they are granted statutory limited liability and separate legal personality.[126] Shareholders are not liable for the company's obligations unless a provision to hold shareholders accountable for the company's liabilities is agreed upon and included in the certificate of incorporation.[127]

Due to the differences in company legislation, each state has developed slightly different approaches to tackle the piercing issues. However, all states subscribe to one of the two systematic analytical tests: the 'instrumentality doctrine' and 'alter ego' doctrine, when considering whether to pierce the corporate veil in a particular case.[128]

4.1.1 Systematic analytical tests: the 'instrumentality doctrine' and 'alter ego' doctrine

Instrumentality doctrine, first adopted in *Lowendahl v Baltimore & Ohio R.R.*[129], is a three-prong test.[130] To establish that piercing is necessary in this case, first, it requires evidence showing that shareholders have more than mere control over the company.[131] The evidence has to exhibit that shareholders have

"control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own."[132]

Second, this complete domination is used to commit fraud or wrongdoing violating the plaintiff's rights.[133] Finally, such control and wrongdoing directly cause the victims' injuries or losses.[134] In such a situation, courts find that the company is a 'mere instrumentality' of the owner. This analytical framework was originally articulated by Frederick Powell and was designed to be used to

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[126] *DLA Piper,* DLA Piper Guide to Going Global, 2020, p. 828, available at https://www.dlapiperintelligence.com/goingglobal/corporate/ (24 August 2020).

[127] *Bakst,* Boston College International and Comparative Law Review 19(2) 1996, p. 326.

[128] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 160.

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

[130] *Alting,* Tulsa J. Comp. & Int'l L. 2(2) 1995, p. 195.

[131] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 160.

[132] *Lowendahl v. Baltimore & O. R. Co.,* 287 N.Y.S. 62, 76 (N.Y. App. Div.), *aff' d* 6 N.E.2d 56 (N.Y. 1936), para. 157.

[133] *Alting,* Tulsa J. Comp. & Int'l L. 2(2) 1995, p. 195.

[134] *Ibid.,* p. 195.

determine veil-piercing claims in affiliated companies' situations.[135] This test has now extended to individual shareholder cases.[136]

The alter ego doctrine is also frequently used by U.S. courts.[137] The rules are outlined in *RRX Indus, Inc. v. Lab-Con, Inc.*[138] The alter ego doctrine consists of a two-prong test. It first asks whether the company and its shareholders are fundamentally indistinguishable.[139] The second question asks whether "an inequitable result will follow if the acts are treated as those of the corporation alone".[140] In essence, this analytical framework focuses on finding the lack of distinct separation between the company and its shareholders.[141] If there is lacking independence, it is said that the company is an alter ego of its shareholders.

Despite the differences in the wording and evaluation criteria, courts have acknowledged that these two analytical frameworks are indistinguishable, and they lead to the same results.[142] The common factor of these two doctrines is wrongdoing or fraud. In short, that means some sort of wrongdoing or fraud is committed as a result of shareholders' complete dominance over the entity.

4.1.2 Veil-piercing factors and the laundry list

Besides dominance or control, U.S. courts have identified other piercing factors, such as fraud or misrepresentation, commingling of funds, undercapitalization,[143] lack of corporate formality,[144] overlap,[145] and injustice or

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[135] *Ibid.*, p. 195.
[136] *Cheng*, Boston College International and Comparative Law Review 34(2) 2011, p. 380.
[137] *Bainbridge*, Journal of Corporation Law 26(3) 2001, pp. 508-509.
[138] *RRX Indus, Inc. v. Lab-Con, Inc*, 772 F.2d 543, 545 (9th Cir. 1985).
[139] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 161.
[140] *Ibid.*, p. 161.
[141] *Cheng*, Boston College International and Comparative Law Review 34(2) 2011, p. 381.
[142] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 161.
[143] For instance, in *Matheson*'s empirical study, Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil, p. 12, he defines that undercapitalization is when the shareholders provide insufficient capital at the time of establishment and fail to maintain sufficient level of capital during the course of the operation.
[144] *Pinto/ Branson*, Understanding Corporate Law, p. 43.
[145] For instance, in *Matheson*'s empirical study, Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil, p. 13, he defines that an overlap factor is identified when the shareholders and the company share the same activities, personnel, and/or office space.

unfairness.[146] Although there are some overlapping piercing factors among the states, each jurisdiction has developed its own extensive sets of factors. Laundry lists of factors are thus created by various courts to be used to compare the facts in the case.[147] Unfortunately, the laundry lists do not make the application of veil-piercing more predictable because, first, they can include as many as twenty factors, second, the precise content differs considerably across jurisdictions, and, finally, judges offer no guidance as to how the factors are weighted.[148] Courts thus have enlarged the scope of veil-piercing by creating an extensive list of reasons at the disposal of courts to support their decisions to pierce. However, because of this expansive scope, non-uniform rules, and the unweighted nature, the application of veil-piercing is difficult to predict.

Without statistics and empirical studies, it is difficult to observe the patterns of veil-piercing or identify which factors play more important roles when courts

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[146] *Oh*, Texas Law Review 89(1), p. 90.

[147] An example of laundry list can be observed from the opinion in *Assoc. Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 813-15 (Dist. Ct. App. 1962) (internal citations omitted):

"Among these are the following: [1] Commingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses; [2] the treatment by an individual of the assets of the corporation as his own; [3] the failure to obtain authority to issue stock or to subscribe to or issue the same; [4] the holding out by an individual that he is personally liable for the debts of the corporation; [5] the failure to maintain minutes or adequate corporate records, and the confusion of the records of the separate entities; [6] the identical equitable ownership in the two entities; [7] the identification of the equitable owners thereof with the domination and control of the two entities; [8] identification of the directors and officers of the two entities in the responsible supervision and management; [9] sole ownership of all of the stock in a corporation by one individual or the members of a family; [10] the use of the same office or business location; [11] the employment of the same employees and/or attorney; [12] the failure to adequately capitalize a corporation; [13] the total absence of corporate assets, and undercapitalization; [14] the use of a corporation as a mere shell, instrumentality or conduit for a single venture or the business of an individual or another corporation; [15] the concealment and misrepresentation of the identity of the responsible ownership, management and financial interest, or concealment of personal business activities; [16] the disregard of legal formalities and the failure to maintain arm's length relationships among related entities; [17] the use of the corporate entity to procure labor, services or merchandise for another person or; [18] the diversion stockholder or other person or entity, to the detriment of creditors, or the manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another; [19] the contracting with another with intent to avoid performance by use of a corporate entity as a shield against personal liability, or the use of a corporation as a subterfuge of illegal transactions; [20] and the formation and use of a corporation to transfer to it the existing liability of another person or entity.

[148] *Bainbridge*, Journal of Corporation Law 26(3) 2001, p. 510.

adjudicating piercing cases. Some clarity can be found in Professor Matheson's empirical study[149]. By examining all veil-piercing cases from January 1, 1990 to April 1, 2008 in the U.S., it is evident that fraud or misrepresentation was the strongest determinant for piercing. Courts pierced 88.2% of the overall cases when fraud or misrepresentation was found present.[150] On the other hand, if fraud or misrepresentation was not present, courts pierced only 7.9% of the time.[151] The other top reasons for piercing included unfairness or injustice, commingling of funds, owner control or dominance, and undercapitalization.[152]

The regression analysis from Matheson's empirical study shows that fraud or misrepresentation, owner control or dominance, commingling of funds, and unfairness or injustice were independently significant factors.[153] The presence of any one of these factors was enough for the court to pierce the corporate veil. Undercapitalization, however, did not appear to be an independently significant factor, or at least not as strong as the abovementioned factors.[154] That is, even though the presence of undercapitalization increased the likelihood a court would pierce the veil, it alone may not be sufficient to cause a pierce.

Professor Oh's empirical study,[155] which examines the U.S. piercing cases from the year 1658 up to and including 2006, also confirms that commingling of assets, control or domination, injustice or unfairness, fraud or misrepresentation, and undercapitalization[156] were the most popular piercing rationales. This study also indicates that cases that were grounded in fraud or were found to contain evidence of fraud or misrepresentation were the most successful veil-piercing claims.[157]

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[149] *Matheson*, Berkeley Business Law Journal 7(1) 2010. His dataset includes all cases involving piercing in the U.S. from January 1, 1990 and April 1, 2008. He found a total of 3,129 relevant cases but he had to omit 2,099 cases because of one of the reasons: 1. The claim did not reach the merits of veil-piercing; 2. The claim was a statutory shareholder lability; 3. The claim was to pierce to gain jurisdiction over a party; 4. The claim constituted horizontal piercing; or 5. The claim constituted reverse piercing. He conducted his regression analysis based on the remaining 929 cases.

[150] *Ibid.*, p. 32.

[151] *Ibid.*, p. 32.

[152] *Ibid.*, pp. 29-34.

[153] *Ibid.*, p. 59.

[154] *Ibid.*, pp. 59-60.

[155] *Oh*, Texas Law Review 89(1).

[156] *Oh*, Texas Law Review 89(1), p. 90. Professor Oh uses the term 'inadequate capitalization' for undercapitalization. Although they could be used interchangeably, this paper will use undercapitalization for consistency.

[157] *Ibid.*, p. 90.

4.1.3 Issues of U.S. overarching veil-piercing

Because each state has the authority to determine its rules for corporate governance, the application of veil-piercing varies substantially across jurisdictions. As a result, in practice, the doctrine of veil-piercing contains an extensive yet inconsistent scope. This liberal application has led to piercing the corporate veil in cases where piercing is arguably not the best solution and, if not careful, such a liberal approach could undermine the privilege of limited liability granted to companies.

4.1.3.1 The application of veil-piercing varies substantially across the country

One of the causes of the incoherence and inconsistency of veil-piercing in the U.S. is that this doctrine is perceived and applied differently by judges across the country. An example could be observed from the fiduciary duty law in the U.S., unlike the veil-piercing doctrine, which has become a coherent jurisprudence.[158] The fiduciary duty law is more coherent and clear because it is made by judges who have expertise in corporate law in Delaware.[159] As Delaware is the top choice for incorporation in the U.S., Delaware's Court of Chancery has built expertise and knowledge in corporate matters that no courts in other states can match.[160] These judges have opportunities to repeatedly hear and rule on fiduciary duty cases.

On the contrary, veil-piercing cases are judged by courts around the U.S. but some of these judges may not have specialized in corporate law. Moreover, since veil-piercing cases may appear in any court, this dilutes the possibility that one particular judge would encounter and rule on another veil-piercing case.[161] Without the repetition to create a coherent theory and consistent application, the doctrine of veil-piercing in the U.S. is therefore a product of hundreds of brilliant yet diverse rationales and judgments.

The inconsistent application and approach of veil-piercing, that is, each state takes on a different view about how and when to pierce the veil, can also be observed in Professor Oh's study. As a preferred state for incorporation,

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[158] *Thompson,* Connecticut Law Review 37(3) 2005, p. 626.
[159] *Ibid.,* p. 626.
[160] *Thompson,* Connecticut Law Review 37(3) 2005, p. 626.
[161] *Ibid.,* p. 626.

Delaware is expected to view limited liability as a principle that must be upheld; that is, it should take a restrictive attitude towards veil-piercing. Professor Oh's study confirms this expectation; Delaware courts pierced as low as 34.29% of the time.[162] Maryland courts took an even more conservative and restrictive approach when judging piercing cases. It was the most difficult jurisdiction for the plaintiff to successfully hold shareholders personally liable; Maryland pierced 25.81% of the time.[163] Delaware and Maryland made a piercing case harder to succeed because they required proof of fraud or evasion of a statutory obligation to pierce the corporate veil.[164]

On the contrary, North and South Dakota took a liberal attitude towards veil-piercing; they had the highest piercing rates. North Dakota pierced 85.71% and South Dakota pierced 83.33%.[165] These courts did not require proof of fraud; they merely asked for a showing of injustice or unfairness.[166] Moreover, undercapitalization was an important factor in these courts. Unlike other states where the undercapitalization factor alone would not be likely to cause a pierce, courts in North and South Dakota would hold shareholders personally liable based on undercapitalization alone.[167]

Because of the dispersed rulings delivered by courts across the country, the level of coherence and consistency of veil-piercing is unlikely to match that of fiduciary duty and will remain an issue for companies, market participants, and lawyers.

4.1.3.2 Piercing in cases where veil-piercing is not the best solution

As a result of the extensive coverage of the laundry lists and the inconsistent applications of veil-piecing, there is a large number of piercing cases in the U.S. However, it has been criticized that the approach taken is too liberal, subsequently resulting in piercing in situations where other areas of law could have been used to more effectively achieve the same result.[168] For instance, tort

[162] *Oh*, Texas Law Review 89(1), pp. 115-117. Delaware ranked 5th state with the lowest piercing rate, after Maryland 25.81%, Virginia 29.09%, New Hampshire 30.00%, and Arizona 33.33%.
[163] *Ibid.*, pp. 115-117.
[164] *Ibid.*, pp. 115-117.
[165] *Oh*, Texas Law Review 89(1), p. 118.
[166] *Ibid.*, p. 118.
[167] *Ibid.*, p. 118.
[168] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, pp. 163-169.

law could be used to imposing personal liability on the person or people responsible without undermining the principle of limited liability.

The first situation where veil-piercing is hard to justify is when courts pierce contract claims. Recall that contract creditors can factor in the company's default risk and reduce their bearing of such risk by negotiating for better guarantees. Against this background, from the theoretical point of view, contract claims should only be pierced when shareholders misled creditors into believing that the company is asset-sufficient when the facts show the contrary, this is, namely, misrepresentation.[169]

However, when comparing tort and contract claims, Professor Oh's study exhibits that contract claims were pierced 47.50% of the time while tort claims were pierced, only slightly higher than contract claims, 52.83% of the time.[170] Furthermore, surprisingly, its findings indicate that misrepresentation only accounted for 38.38% of the pierced contract cases. The top three reasons to cause courts to pierce were siphoning off funds (69.90%), domination (66.70%), and undercapitalization (62.88%).[171]

Even though the result affirms the argument that courts should pierce in order to compensate tort victims who involuntarily received the negative externalities and damages caused by limited liability, it remains puzzling and counterintuitive as to why courts pierce so much in contract claims where theoretically do not need remedy relief. Employing the doctrine of veil-piercing frequently, ignoring the fact that as an equitable remedy this doctrine should be used with caution, could threaten the use of limited liability companies as a vehicle to conduct business.

The second situation where veil-piercing is difficult to justify is when courts adopt a broad understanding of wrongdoing to pierce in cases where other areas of law should have applied. For instance, courts pierce in cases where wrongful termination could have been used instead of veil-piercing.[172] In *Gorill v. Icelandair/Flugleider*[173], the court pierced the veil because of the wrongful termination of employment. The scope of wrongdoing in the U.S. veil-piercing doctrine appears to be too broad, resulting in unnecessary use of veil-piercing.

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[169] *Bainbridge,* Journal of Corporation Law 26(3) 2001, p. 503.
[170] *Oh,* Texas Law Review 89(1), p. 125.
[171] *Ibid.,* pp. 142-143.
[172] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 164.
[173] *Gorill v. Icelandair/Flugleider,* 761 F.2d 847, 853 (2d Cir. 1985).

Even though it is a wrongdoing, this case could have been more effectively resolved by ruling it a breach of contract.[174] As an equitable remedy, if there is another remedy that can be offered by the laws, veil-piercing should not kick in.

The third situation involves piercing tort claims when veil-piercing is not the best solution. For instance, in *Parker v. Bell Asbestos Mines, Ltd*[175], the court pierced the corporate veil because the parent company hid behind the subsidiary company to avoid the liability incurred from harms done by Asbestos. [176] However, even if a business is conducted legally and diligently, some tort would inevitably arise. The privilege of limited liability enables company structure to be used as a vehicle to avoid potential liability when conducting business. [177]

In this case, other areas of laws are available to correct the negative externalities shifted to tort victims and the wrongs done by the companies. Since veil-piercing is limited to holding shareholders directly liable to creditors[178], tort law, for instance, may provide a better solution here to impose personal liability on persons who are responsible, irrespective of their roles in the company. [179] This way creditors are compensated without piercing through the corporate veil. And, the privilege of limited liability is still intact.

Finally, some factors included in the laundry list, for instance, the factor of lack of formalities, may not be relevant for veil-piercing. [180] Recall the economic justification for veil-piercing is to reverse the effect of shifting negative externalities to outside parties. Based on this analysis, a lack of corporate formalities alone is not entirely relevant to piercing because failure to keep a record of shareholder meeting minutes or to failure to use different office locations for affiliated entities does not impact a company's level of assets or ability to repay. Therefore, there is no shift of negative externalities. In the case of failure to follow corporate formalities, piercing could only be justified if shareholders deceive creditors by manipulating corporate formalities.[181]

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[174] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 164.
[175] *Parker v. Bell Asbestos Mines, Ltd.,* 607 F. Supp. 1397 (E.D. Pa. 1985).
[176] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, pp. 167-168.
[177] *Ibid.,* pp. 167-169.
[178] *Bainbridge*, Journal of Corporation Law 26(3) 2001, p. 515.
[179] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 169.
[180] *Bainbridge*, Journal of Corporation Law 26(3) 2001, p. 512.
[181] *Bainbridge*, Journal of Corporation Law 26(3) 2001, pp. 512-513.

4.1.4 Summation

In sum, the doctrine of veil-piercing in the U.S. contains an extensive scope. Not only does this overarching nature result from inconsistent application of the doctrine, but also enables piercing in cases where other legislation could have served as a superior solution – provide relief to the victims without undermining the privilege of limited liability to shareholders.

4.2 Veil-piercing in Germany

Germany, contrary to the U.S., rarely pierces the corporate veil[182]; courts are reluctant to undermine the privileges provided by the principle of limited liability and legal personality to companies. Currently, the only situation in which German courts would use veil-piercing is when shareholders commingling their assets with the company's assets.[183] When the corporate assets and shareholders' personal assets become indistinguishable, courts pierce the corporate veil and hold shareholders directly liable to the creditors. In cases of undercapitalization during the course of operation, German courts hold shareholders who committed the wrongdoing liable for tort and liable to the company, as supposed to creditors directly.[184] This is because German courts perceived that shareholders owe their duties and obligations to the company; creditors' losses are reflective of shareholders' wrongful conduct to the company.[185]

4.2.1 The minimum initial capital requirement and capital maintenance

German companies are governed by specific statutes. The German Limited Liability Company (*Gesellschaft mit beschränkter Haftung* or *GmbH*) is governed by the Limited Liability Company Act (*GmbHG*) and the Stock Corporation

[182] *Ito/ Watanabe,* in: *Siems/ Cabrelli* (eds.), Comparative Company Law: A Case-Based Approach, p. 219.
[183] *Schulz/ Wasmeier,* The law of business organizations: A concise overview of German corporate law, p. 106.
[184] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 181.
[185] *Ibid.,* p. 170.

(*Aktiengesellschaft* or *AG*) is regulated by the Corporation Act (*Aktiengesetz* or *AktG*).[186] Once established, GmbH and AG are legal persons separate from their shareholders and their shareholders enjoy the privilege of limited liability.[187] GmbH is a popular choice of company form, especially for medium-sized private companies.[188] It allows shareholders to have a strong influence over the management and they can give binding instructions regarding all matters concerning the company for directors to follow.[189]

Moreover, unlike the corporations in the U.S. where no statutory minimum initial contribution is required,[190] a GmbH is required to have a minimum of EUR 25,000 for its initial capital,[191] and an AG is required to have at least EUR 50,000 at the time of establishment[192]. The underlying reasons for having these requirements, as discussed in many German legal literatures, are to "establish integrity of the business that the founding members commit to"[193] and "prevent insolvencies at an early stage of a company's life"[194]. However, the minimum capital does not provide a guarantee or indication that the initial capital is adequate for business ventures that the company seeks to pursue.[195]

In addition to the initial capital requirement, German company statutes contain strict rules for capital maintenance.[196] Company assets that are necessary to maintain the statutory level of capital may not be distributed to shareholders.[197] When the company does not have sufficient assets but still made distributions, shareholders who received the payments must repay the company.[198] These

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[186] *Schulz/ Wasmeier,* The law of business organizations: A concise overview of German corporate law, p. 11.

[187] §1 AktG and §13 GmbHG.

[188] *Schulz/ Wasmeier,* The law of business organizations: A concise overview of German corporate law, p. 80.

[189] *Ibid.,* p. 92; *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p.171; §37(1) GmbHG and §46 GmbHG.

[190] *DLA Piper,* DLA Piper Guide to Going Global, 2020, p. 829, available at https://www.dlapiperintelligence.com/goingglobal/corporate/ (24 August 2020).

[191] § 5 GmbHG.

[192] § 7 AktG.

[193] *Tan/ Wang/ Hofmann,* Berkeley Business Law Journal 16(1) 2019, p. 174.

[194] *Ibid.,* p. 174.

[195] *Ibid.,* p. 175.

[196] *Cahn,* Working paper series / Johann-Wolfgang-Goethe-Universität, Institute for Law and Finance, February 2016, pp. 1-2, available at http://publikationen.ub.uni-frankfurt.de/frontdoor/index/index/docId/42328 (01 June, 2021).

[197] § 30 GmbHG.

[198] § 31 GmbHG.

rules of minimum initial capital and capital maintenance could help to understand why, in its new series of judgments, BGH finds that shareholders are liable towards the company and why BGH remains reluctant to pierce the corporate veil in cases where capital appears to be insufficient for the business ventures pursued.

4.2.2 The Trihotel judgment of BGH

In its 2007 landmark judgment, *Trihotel*,[199] BGH developed a new approach to hold shareholders liable for their wrongful conduct that resulted in company bankruptcy. Prior to *Trihotel*, BGH had created a subgroup of veil-piercing; BGH had held shareholders, who depleted the part of company assets that were supposed to be reserved to repay debts, directly liable to the company's creditors on the grounds of corporate form abuse.[200] This was changed in *Trihotel*. This new approach does not involve veil-piercing.[201] The liability of shareholders was henceforth to be understood as tortious liability based on section 826 BGB.[202]

In the *Trihotel* case, the Court considered that it needed to re-evaluate its former veil-piercing approach in the context where shareholders tamper with company assets and ultimately lead to the company's insolvency. The Court explained that the acts of tampering assets should be considered as a breach of shareholders' duties owed to the company, not directly to creditors.[203] Moreover, it would be wrong to assume that any depletion of the company's assets would immediately impact company's creditors.[204]

Following this analysis, the Court concluded that 'Existenzvernichtungshaftung', or 'liability arising from a withdrawal which destroys the economic basis of a company', was likely an internal liability.[205] Therefore, unlike the pre-*Trihotel*'s ruling of 'liability arising from a withdrawal which destroys the economic basis

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[199] Bundesgerichtshof [BGH] [German Federal Court of Justice] II ZR 3/04, Jul. 16, 2007 (*Trihotel*), 2007 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 2689.
[200] *Casper*, German Law Journal 9(9) 2008, p. 1133.
[201] *Qu, Charles Zhen/ Ahl, Björn,* Lowering the Corporate Veil in Germany : A case note on BGH 16 July 2007 (Trihotel), 2008, available at https://ouclf.law.ox.ac.uk/lowering-the-corporate-veil-in-germany-a-case-note-on-bgh-16-july-2007-trihotel/ (01 June 2021).
[202] *Casper*, German Law Journal 9(9) 2008, p. 1133.
[203] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 177.
[204] *Ibid.*, p. 176.
[205] *Casper*, German Law Journal 9(9) 2008, pp. 1132-1133.

of a company', the new concept no longer considered this liability as having a veil-piercing nature – creditors can hold shareholder directly liable.[206] Starting from *Trihotel*, 'liability arising from a withdrawal which destroys the economic basis of a company' is to be based on section 826 BGB under tort law, and shareholders are liable directly to the company.[207]

A shareholder is found liable when he intentionally harms the company and acts in bad faith as set out in section 826 BGB. To be held breaching section 826 BGB, it is not necessary to show that the shareholder has the intention to undermine the creditors' right; however, it would be sufficient to establish that he understands his actions could permanently impair the company's ability to fulfill its obligations to creditors.[208]

Under this new approach, which bases 'liability arising from a withdrawal which destroys the economic basis of a company' on section 826 BGB, disappointed creditors cannot sue shareholders directly for financial damages shareholders caused to the company. Since the tort is committed against the company, only the company can invoke tort law section 826 BGB and hold shareholders responsible. Therefore, creditors can only sue the company and no longer directly reach behind the corporate veil to hold shareholders liable.[209]

In this light, BGH takes a different approach, than the one adopted by the U.S., to tackle the issues when shareholders' wrongful conduct resulted in damages for the company and its creditors. Instead of directly piercing the corporate veil, German courts hold shareholders liable for their tortious actions for 'liability arising from a withdrawal which destroys the economic basis of a company' under tort law. To protect and uphold the privilege of limited liability granted to companies, German courts cautiously limit the application of veil-piercing.[210] Courts also limit themselves from piercing right through the corporate veil to hold shareholders directly liable to creditors. In cases where there is no doubt that the shareholders are responsible for their wrongful conduct that caused

[206] *Qu, Charles Zhen/ Ahl, Björn,* Lowering the Corporate Veil in Germany : A case note on BGH 16 July 2007 (Trihotel), 2008, available at https://ouclf.law.ox.ac.uk/lowering-the-corporate-veil-in-germany-a-case-note-on-bgh-16-july-2007-trihotel/ (01 June 2021).
[207] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 171.
[208] *Ibid.*, p. 178.
[209] *Qu, Charles Zhen/ Ahl, Björn,* Lowering the Corporate Veil in Germany : A case note on BGH 16 July 2007 (Trihotel), 2008, available at https://ouclf.law.ox.ac.uk/lowering-the-corporate-veil-in-germany-a-case-note-on-bgh-16-july-2007-trihotel/ (01 June 2021).
[210] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 177.

damages, courts find that they owe their duties to the company. Creditors could be compensated by enforcing claims on the company first, then request the claims to be assigned against the shareholder.[211]

4.2.3 The GAMMA judgment of the BGH

Shortly after *Trihotel*, *GAMMA*[212] provided BGH an opportunity to affirm and clarify its ruling in *Trihotel*.[213] In *GAMMA*, the court reaffirmed that shareholders are liable to the company; they do not owe their duties directly to creditors.[214] Moreover, the court emphasized that shareholders are obligated to satisfy the statutory minimum capital requirement at the time of establishment and ensure the company complies with the principle of capital maintenance, no distribution of dividends allowed if company assets are below a certain level as laid out in the company laws.[215] However, shareholders are not obligated to constantly inject more funds into the company for the company to satisfy its liabilities at all times.[216] Such an obligation would be incompatible with the principle of limited liability.[217] Therefore, shareholders are not liable for 'liability arising from a withdrawal which destroys the economic basis of a company' merely because the company does not have adequate assets to repay debts; they are liable when they intentionally deplete the company's assets causing the company to default on its debts.

4.2.4 Veil-piercing for commingling of assets

Commingling of assets is the only type of claim where BGH supports piercing the corporate veil.[218] Commingling of assets, as defined by BGH, is where corporate assets become indistinguishable from shareholders' assets.[219] BGH imposes

[211] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 177.
[212] Bundesgerichtshof [BGH] [German Federal Court of Justice] II ZR 264/06, Apr. 28, 2008 (*GAMMA*), 2008 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 2437.
[213] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 178.
[214] *Ibid.*, p. 179.
[215] *Ibid.*, p. 179.
[216] *Ibid.*, p. 179.
[217] *Ibid.*, p. 179.
[218] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 180.
[219] *Schulz/ Wasmeier,* The law of business organizations: A concise overview of German corporate law, p. 106.

personal liability on shareholders who deliberately commingle their assets with that of the company; they are liable directly to creditors.[220] Other shareholders who did not participate in this wrongdoing will not be held liable.

The legal basis for piercing the corporate veil in the commingling of assets situations is abuse of the corporate form.[221] When the abuse of the corporate form is evident, shareholders lose the privilege of limited liability. Then, section 128 Commercial Code, which holds all general partners of commercial partnerships personally liable, now applies to these shareholders.[222]

4.2.5 Shareholder liability in fraudulent cases

In other situations, where U.S. courts would pierce the veil, German courts apply other areas of law to impose personal liability on the person or people responsible for the situation. Here, shareholders are held liable not because of their role in the company, but merely because of their wrongful conduct. For instance, when a company is being used as part of a fraudulent scheme, such as tricking outside parties to contract with the company because these parties would not contract with the shareholders, the contracts signed would be found void pursuant to section 123 BGB.[223] Shareholders who commit deceit are liable for their tortious actions in the application of section 826 and 823(2) BGB; they are also subject to fraud sanctions provided by section 263 StGB.[224]

Additionally, shareholders deceiving others may be found liable for breaching the duties of care and diligence in their role as the legal representative of the company.[225] Under German Law, if contract creditors offer better contract terms as a result of trusting the shareholders and the deceiving information they provided, shareholders may be found liable for breaching sections 311(2), 241(2), and 280(1) BGB.[226]

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[220] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 181.
[221] *Ibid.*, p. 181.
[222] *Ibid.*, p. 181.
[223] *Ibid.*, p. 184.
[224] *Tan/ Wang/ Hofmann*, Berkeley Business Law Journal 16(1) 2019, p. 184.
[225] *Ibid.*, p. 184.
[226] *Ibid.*, p. 184.

4.2.6 Summation

In sum, Germany takes a more conservative approach when determining whether to disregard limited liability and separate legal personality of an entity. Commingling of company and private assets is presently the only situation where courts support the concept of piercing the corporate veil and hold the shareholders liable towards creditors. However, this is not to say that German courts provide no remedy for victims of company failures in other scenarios. In undercapitalization cases, courts hold the opinion that shareholders owe their duties to the company. Shareholders thus have to remedy the damages they caused to the company. In other scenarios where shareholders' actions through the company cause losses and injuries to outside parties, rather than piercing the corporate veil, courts hold the responsible person, regardless of his role in the company, liable for his wrongful conduct under tort.

4.3 Veil-piercing in Taiwan

Republic of China (R.O.C.), more commonly known as Taiwan, adopted the Civil Law system.[227] Chose to refer to the Swiss Civil Law structure, Taiwan decided not to separate its Civil Code and company legislation.[228] Taiwanese Company Act[229], as part of the Civil Code, came into effect on July 1st, 1927.[230] The Company Act was originally influenced by Germany's *AktG.*[231] However, through the amendments, some doctrines and practices from the U.S. company law were also transplanted to the Taiwanese Company Act.[232] Metaphorically speaking, the Taiwanese Company Act has the bone and body of Civil Law with the blood of U.S. principles. The doctrine of veil-piercing is an example of a common-law principle transplanted to Taiwan.

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[227] *Wang,* Corporate Law, p. 101.
[228] *Ibid.,* p. 101.
[229] Taiwanese Company Law available in English at https://law.moj.gov.tw/ENG/LawClass/LawAll.aspx?pcode=J0080001
[230] *Shao/ Tseng,* The Evolution of Taiwan Company Law: A Focus on the Blockholder-centric Model, June 2014, p. 2, available at http://www.law.ntu.edu.tw/aslea2014/file/Ching_ping_Shao_ASLEA%20Business%20Organization%20Law%20(Taiwan)-06102014.pdf (01 August 2020).
[231] *Chen,* Chungyuan Financial & Economic Law Review 2018, p. 25.
[232] *Wang,* Corporate Law, p. 205.

In the recent amendments in 2013 and 2018, the legislators aimed to tackle the issues that are frequently seen in family-owned businesses.[233] Family businesses are common in Taiwan and they suffer from shareholders abusing their power over management. What is often observed is that when a family-shareholder takes over the control, he or she or the family places their personal interests over the interest of the company.[234] If the decisions made and actions taken provide overall benefits to the company, corporate constituents are content and may choose not to challenge these family shareholders. However, if the abuse of shareholders' power results in the inability to fulfill the company's obligations, these shareholders could hide behind the corporate veil.

To prevent and avoid shareholders who have committed harmful acts escaping personal liability, the amendment in 2013 legally transplanted the principle of veil-piercing from U.S. law.[235] Company Act implemented Article 154 II which enables courts to hold the shareholders directly liable for the debts. This article states "if a shareholder abuses the company's status as a legal entity and thus causes the company to bear specific debts and to be apparently difficult for the company to pay such debts, and if such abuse is of a severe nature, the shareholder shall, if necessary, be liable for the debts". Taiwan first adopted this principle only for one type of company form - Company Limited by Shares.[236] The amendment in 2018 further ensures the protection of all limited-liability business constituents who have been wronged by shareholders; Article 99 II, with the same text from Article 154 II, was added for Limited Company.

4.3.1 Types of entities in Taiwan

There are four types of companies: Unlimited Company, Limited Company, Unlimited Company with Limited Liability Shareholders, Company Limited by Shares[237] (or Corporations). Shareholders of Limited Company and Corporations enjoy the privilege of limited liability; they are only liable up to the amount they invested in the company.[238] For the purpose of this veil-piercing discussion, the

[233] *Ibid.*, p. 48.
[234] *Ibid.*, p. 48.
[235] *Wang,* Corporate Law, p. 700.
[236] *Ibid.*, p. 205.
[237] Article 2 Taiwan Company Act.
[238] Article 99 II and Article 154 II Taiwan Company Act.

below section will only analyze the company forms that have statutory limited liability–Limited Company and Corporation.

4.3.1.1 Limited Company

The amendment in 2001 eliminated the requirement for a minimum number of founders.[239] One founder is all it needs to establish a Limited Company in Taiwan. This person can be a natural or legal person.[240] As a company structure that was designed for a small group of shareholders who maintain a trusting and close relationship with each other,[241] a Limited Company prohibits a transfer of shares before the approval of the majority of the fellow shareholders. Therefore, shares cannot be transferred freely.[242] Also, if new people want to invest in a Limited Company, the majority of the existing shareholders have to agree and approve the newcomers.[243] Shareholders, in this type of company, have equal rights. This is evident in the voting rights in shareholders' meetings; each shareholder has one vote, irrespective of how much he or she contributed to the capital of the company.[244]

A Limited Company must have at least one director who is authorized to execute the business operation and represent the company.[245] One company shall have at least one director but no more than three directors. They shall be elected from the shareholders and by the consent of at least two-thirds of them.[246] All directors have the competence to execute daily business operations. If the company only has one director, this person has the authority to both manage and represent the company. However, if there are multiple directors, all of them are empowered to represent the company. The multiple-director company can also designate one of the directors as a chairman of the board of directors to have the sole power to represent the company.[247]

To retain the flexibility and adaptability for small businesses, Limited Company does not require an establishment of a supervisory board or appointment of

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[239] *Wang,* Corporate Law, p. 261.
[240] *Ibid.,* p. 261.
[241] *Ibid.,* p. 270.
[242] Article 111 I Taiwan Company Act.
[243] Article 106 II Taiwan Company Act.
[244] Article 102 I Taiwan Company Act.
[245] *Wang,* Corporate Law, p. 274.
[246] Article 108 I Taiwan Company Act.
[247] *Wang,* Corporate Law, p. 281.

supervisors. Non-director shareholders assume the role of supervisors; they are granted the power of audit to review company financial statements.[248]

Based on this company structure, the statute empowers shareholders of Limited Company to influence and control every aspect of the business. In this light, the newly adopted principle of veil-piercing, if applied correctly with caution and precision, could help hold the persons, most likely to be the shareholders in this case, responsible for damages they caused to creditors.

4.3.1.2 Company Limited by Shares ('Corporation')

To establish a Corporation, founders of two or more natural persons are required. Or, a Corporation could be organized by a government or a legal person.[249] Same as Limited Company, the statute does not require a minimum initial capital for a Corporation.[250]

However, unlike a Limited Company, shares of a Corporation can be transferred or traded without the consent of other fellow shareholders.[251] Moreover, a shareholder's voting right depends on how many shares he owns. Each share represents one vote in shareholders' meetings.[252]

What is also different from a Limited Company is that the statute aims to establish a clearer separation between ownership and management for Corporations.[253] Shareholders of a Corporation were originally empowered with competence to influence the management of the company. Their power over management was diminished when directors' power was increased by the amendment in 2001.[254] A Corporation should have a board of directors consists of at least three directors; they do not have to be the shareholders of the company. After the amendment, under this new director supremacy regime,[255] shareholders retain the power to make decisions on 'big issues' that would affect

[248] Article 109 I Taiwan Company Act.
[249] Article 2 Taiwan Company Act.
[250] *DLA Piper*, DLA Piper Guide to Going Global, 2020, p. 723, available at https://www.dlapiperintelligence.com/goingglobal/corporate/ (24 August 2020).
[251] Article 163 Taiwan Company Act.
[252] Article 179 Taiwan Company Act.
[253] *Faung*, in *Faung* (ed.), The Changing Landscape of Company Law in Taiwan, p. 15.
[254] *Wang*, Corporate Law, p. 373.
[255] *Faung*, in *Faung* (ed.), The Changing Landscape of Company Law in Taiwan, p. 143.

the backbone of the company[256] while directors' increased power allows directors to make decisions on most of the daily operations and execute them.

However, it is observed that, despite the amendment's attempt to draw a clear distinction between ownership and management, in practice, shareholders, either intentionally gotten themselves elected as directors or merely serve as *de facto* directors, still maintain significant influence and control over management.[257]

In short, in the Corporation context, shareholders on many occasions still are responsible for determining the direction and making operational decisions for the business. If shareholders abuse their control or use the company for illegitimate purposes, the principle of veil-piercing enables courts to set aside the privilege of limited liability and find shareholders personally liable for debts and injuries caused.

4.3.2 The blockholder-centric situation in Taiwan

As observed above, regardless of the legislators' attempt to draw a clearer line between ownership and management, shareholders in practice still hold a significant control or influence over management. One would expect that this would not be an issue in larger or public companies. Public companies have a larger number of shareholders; thus, ownership and management could be easily diffused. However, in Taiwan, most companies, regardless of the size of the company and the number of shareholders, have concentrated corporate ownership.[258] As a result, blockholders[259] can insert their control over management by either elect some of their own as directors or nominate and elect non-shareholder directors whom they can easily manipulate or obtain influence over.[260]

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[256] Article 185 Taiwan Company Act.

[257] *Wang,* Corporate Law, p. 373.

[258] *Shao/ Tseng,* The Evolution of Taiwan Company Law: A Focus on the Blockholder-centric Model, June 2014, p. 21, available at http://www.law.ntu.edu.tw/aslea2014/file/Ching_ping_Shao_ASLEA%20Business%20Organization%20Law%20(Taiwan)-06102014.pdf (01 August 2020).

[259] Blockholders are shareholders who own a substantial portion of the company's share. They often are able to influence company's decisions through their voting rights. See https://www.investopedia.com/terms/b/blockholder.asp

[260] *Chen,* Chungyuan Financial & Economic Law Review 2018, p. 26.

In addition, the unclear role of managers does not make the separation of ownership and management clearer. The division of power between directors and managers is controversial. [261] The statute states that managerial personnel has the competence to manage daily business operations and contract with third parties on behalf of the company.[262] However, recall that directors also have the power to conduct business and represent the company.[263] Since an appointment of managers is not mandatory and directors have the competence to appoint and discharge managerial personnel if the company chooses to have managers,[264] it has been argued by commentators that managers are merely supporters of directors in conducting daily operations.[265]

In this light, if blockholders seek control of the company by occupying the role of directors, they subsequently also control the managerial positions. Thus, it is common to have one person wearing three huts: the major shareholder, director, and manager.[266] In Taiwan's scenario, where shareholders frequently involve themselves in the execution of business operations, it is essential to develop a doctrine that allows personal liability to be imposed upon shareholders who are responsible for the harms and losses caused.

4.3.3 Veil-piercing before the veil-piercing legislation and the Lehman case

Before the amendments that introduced the principle of veil-piercing, Taiwanese courts emphasized that veil-piercing was not legislated in Taiwanese law. Since Taiwan is Civil Law, courts could not rule a case base on the doctrine of veil-piercing.[267] In some cases, plaintiffs, who sought to hold shareholders personally liable for the injuries caused by companies, tried to refer to the principle of veil-piercing on the basis that Article 1 Civil Code allows the use of foreign concepts pursuant to the jurisprudence.[268] Article 1 Civil Code reads "if there is no applicable act for a civil case, the case shall be decided according to

[261] *Faung,* in *Faung* (ed.), The Changing Landscape of Company Law in Taiwan, p. 154.
[262] Article 31 II Taiwan Company Act.
[263] Article 193 Taiwan Company Act.
[264] Article 29 Taiwan Company Act.
[265] *Faung,* in *Faung* (ed.), The Changing Landscape of Company Law in Taiwan, p. 154.
[266] *Wang,* Corporate Law, pp. 49 & 55.
[267] *Lin,* NTU Law Journal 43 Special Issue 2014, p. 1305.
[268] *Hung/ Chu,* NTU Law Journal 43(3) 2014, p. 644.

customs. If there is no such custom, the case shall be decided according to the jurisprudence." However, the Supreme Court of Taiwan refused to import the concept of veil-piercing based on Article 1 Civil Code.[269]

The collapse of Lehman Brothers, during the 2008 financial crisis, triggered a series of discussions as to whether piercing the corporate veil is applicable in Taiwan. The series of litigations between Mega International Commercial Bank and Lehman Brothers Securities Co., Ltd., and these judgments provide illustrations.

The collapse of the Lehman Brothers Group caused extensive losses on the investments in structured notes. Many financial institutions, because of Lehman Brothers' default on investments, also went bankrupt. During that time, many investors sued banks and investment consultants for failure to fulfill their obligations as prudent administrators, as set forth in the Taiwanese Trust Law and Civil Code.[270] Some creditors also sought to pierce Lehman Brothers' corporate veil.

The most prominent case was when a Taiwanese bank, Mega International Commercial Bank (Mega Bank Taiwan), sought repayment of debts from Lehman Brothers Securities Co., Ltd. (Taiwan Lehman). Mega Bank Taiwan signed multiple contracts on Cross Currency Swap with Hong Kong-based Lehman Brothers Commercial Corporation Asia Limited (Lehman HK). When Lehman HK and its guarantor, Lehman Brothers Holdings, both declared bankruptcy, Mega Bank Taiwan decided to seek to pierce the corporate veil and hold Taiwan Lehman liable. The plaintiff argued that Taiwan Lehman and Lehman HK should be recognized as the same legal person.[271]

This case was first brought to the District Court[272] in Taipei.[273] The District Court rejected the argument that Taiwan Lehman and Lehman HK were one and the same. The District Court ruled that these two companies were two different and

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[269] *Ibid.,* p. 644.
[270] *Lin,* NTU Law Journal 43 Special Issue 2014, p. 1311.
[271] *Ibid.,* p. 1311.
[272] About the judicial system and courts in Taiwan: https://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1123&context=mscas p. 10.
[273] Taipei Taiwan District Court 2010 Civil Case No. 477. 臺灣臺北地方法院 99 年重訴字第 477 號民事判決。Available in Mandarin at: https://law.judicial.gov.tw/FJUD/data.aspx?ty=JD&id=TPDV,99%2c%e9%87%8d%e8%a8%b4%2c477%2c20101126%2c1

independent legal persons; they were only liable for their own duties and obligation. The judges emphasized that, at that time, the veil-piercing concept was not yet codified in the Taiwan Company Act, courts therefore would not be able to recognize the jurisprudence of veil-piercing. The applicability of the principle was thus denied.

In the *obiter dictum*, the court explained that this would not have been a successful piercing case under the U.S. veil-piercing concept. The reason being that this was a contract claim. The plaintiff had plenty of *ex ante* opportunities to review the creditability of Lehman HK and to factor in the risks of default at the time of negotiation. In order to have courts pierce the veil, there must be evidence proving the debtors have committed fraud. In this case, however, Lehman HK was not a shareholder of Lehman Taiwan and there was no evidence indicating that Taiwan Lehman was established to avoid legal duties and obligations. Thus, the corporate veil could not have been pierced.[274]

This case was appealed to the High Court.[275] It affirmed the reasoning and judgment of the District Court; it upheld that veil-piercing was not applicable since this was not yet part of the Taiwanese Company Act.[276] The High Court also took the opportunity to explain the principle of veil-piercing developed in the U.S. It stated that piercing claims in the U.S. make a distinction between voluntary and involuntary creditors. U.S. courts would not easily pierce the veil in voluntary cases, such as contract claims. By contrast, since involuntary creditors did not agree to bear the risk of company failure, U.S. courts would be more inclined to pierce the corporate veil. Although the High Court discussed the fundamental theory and application of the principle, it ruled that it cannot be applied here because there was no legal basis.

Mega Bank Taiwan was not to give up; it appealed the case to the Supreme Court.[277] However, the Supreme Court neither discussed the applicability of veil-

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[274] *Lin*, NTU Law Journal 43 Special Issue 2014, p. 1311.

[275] Taiwan High Court 2011 Civil Case No. 9. 臺灣高等法院 100 年重上字第 9 號民事判決。
Available in Mandarin at:
https://law.judicial.gov.tw/FJUD/data.aspx?ty=JD&id=TPHV,100%2c%e9%87%8d%e4%b8%8a%2c9%2c20110607%2c1

[276] *Lin*, NTU Law Journal 43 Special Issue 2014, p. 1312.

[277] Taiwan Supreme Court 2012 Civil Case No. 187. 最高法院 101 年台上字第 187 號民事判決。
Available in Mandarin at:
https://law.judicial.gov.tw/FJUD/data.aspx?ty=JD&id=TPSV,101%2c%e5%8f%b0%e4%b8%8a%2c187%2c20120210

piercing nor mentioned this principle. Instead, it ruled that the judgment of the High Court breached Article 469 VI Taiwan Code of Civil Procedure[278] and returned the case to the High Court.

The Supreme Court took the view that the High Court failed to observe the argument brought by the plaintiff. The plaintiff contended that Lehman Holding and Lehman HK were affiliated companies and Lehman Holding was a controlling company to Taiwan Lehman. Therefore, there was a link between Lehman HK and Taiwan Lehman. The Supreme Court pointed out that the High Court's ruling, that Lehman Taiwan and Lehman HK were independent legal persons, was decided without conducting thorough investigations regarding their relationship.[279]

The case was returned to the High Court.[280] Following the judgment of the Supreme Court, the High Court conducted investigations and reviewed the relationships between these Lehman companies. It was found that at the time when Mega Bank Taiwan signed the agreement with Lehman HK, Taiwan Lehman had not been established yet. Moreover, Taiwan Lehman only had one shareholder – Singapore-based Lehman Brothers Investments Pte. Ltd. Based on these findings, the High court reaffirmed that Taiwan Lehman and Lehman HK were not affiliated and should be recognized as two separate entities. Regarding veil-piercing, the High Court ruled that Article 1 Civil Code was not be used to bring in the concept in this case when, in a way, there was no veil to be pierced. Lehman Taiwan had no relations to Lehman HK, therefore, could not be held liable for Lehman HK's duties and obligations.

Although all these judgments ruled that the principle of veil-piercing was not applicable, the opinion of the High Court appeared to have accepted the idea of referring to the principle of veil-piercing based on Article 1 Civil Code.[281] It was argued by commentators that the High Court denied piercing because the situation at hand did not provide sufficient grounds for piercing, not because the

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[278] Article 469 VI Taiwan Code of Civil Procedure states "a judgment shall be automatically held in contravention of the laws and regulations in the following situations: ... 6. Where the judgment does not provide reasons or provides contradictory reasons".

[279] *Lin,* NTU Law Journal 43 Special Issue 2014, p. 1312.

[280] Taiwan High Court 2012 Civil Case No. 30. 臺灣高等法院 101 年重上更(一)字第 30 號民事判決。 Available in Mandarin: https://law.judicial.gov.tw/FJUD/data.aspx?ty=JD&id=TPHV,101%2c%e9%87%8d%e4%b8%8a%e6%9b%b4(%e4%b8%80)%2c30%2c20120828%2c1

[281] *Lin,* NTU Law Journal 43 Special Issue 2014, p. 1313.

principle was not legislated in the Company Act.[282] This is no longer an issue for debate since Article 154 II and Article 99 II now enable courts to apply the concept of veil-piercing to hold shareholders responsible.

4.3.4 Veil-piercing after the veil-piercing legislation and the RCA case

In 2018, the Supreme Court delivered a judgment on the highly anticipated corporate veil-piercing case based on Article 154 II.[283] Radio Corporation of America (RCA), a former American home appliance maker, set up manufacturing plants in Taiwan in 1967. At the time, it was a success story of American FDI in Taiwan.[284] In 1986, RCA was acquired by General Electronic (GE) who continued manufacturing electronic-related products and home appliances in Taiwan. Two years later, Thomson Consumer Electronics (TCE), a U.S. subsidiary of the French Technicolor S.A., acquired the property rights of one of the factories from GE. In 1991, TCE noticed that the hazardous chemicals from the production were not handled properly and contaminated the underground water and soil. A year later, TCE shut down the plant.[285]

However, employees were already exposed to the cancer-causing contaminations. The evidence showed that long-term exposure to hazardous chemicals resulted from the manufacturing process and the use of underground water contaminated by the dumping of toxic waste caused employees to develop cancer and other illnesses.[286]

These employee victims brought a class action against RCA, GE, TCE, and Technicolor seeking damages of NT$2.7 billion (US$92 million).[287] During the litigation, RCA transferred approximately US$100 million from the Taiwan company to its parent company abroad. RCA Taiwan thus was left with

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[282] *Ibid.*, p. 1313.
[283] Taiwan Supreme Court 2018 Civil Case No. 267. 最高法院 107 年台上字第 267 號民事判決。 Available in Mandarin: https://law.judicial.gov.tw/FJUD/data.aspx?ty=JD&id=TPSV,107%2c%e5%8f%b0%e4%b8%8a%2c267%2c20180816%2c1
[284] *Huang*, in *Faung* (ed.), The Changing Landscape of Company Law in Taiwan, p. 45.
[285] *The News Lens*, Taiwan's "Never Compromising" RCA Work-injury Case: after 20 years fighting for justice, damage of NT$ 500 million is finally awarded, August 2018, available in Mandarin at https://www.thenewslens.com/article/15429 (01 September 2020).
[286] *Shih*, Supreme Court sets precedents in RCA industrial pollution case, August 2018, available at https://focustaiwan.tw/news/201808160026 (01 September 2020).
[287] Ibid.

inadequate assets to pay for damages. The Supreme Court took the view that the principle of veil-piercing pursuant to Article 154 II was applicable in this case. The veil was pierced; GE, TCE, and Technicolor as the shareholders and the controlling companies of RCA were held liable for the tortious liability of RCA.

The Supreme Court emphasized that the veil-piercing doctrine is not to be used to completely disregard separate personality and limited liability. This principle is only applicable when controlling shareholders have dominance, commit fraud, fail to comply with company formalities, embezzle or siphon company assets, or illegitimately use the company to avoid tort and contract obligations causing injuries and losses to creditors of the company. In exceptional cases where equitable relief and remedies are needed, the separate legal personality of the company is to be set aside. This does not undermine the existence of limited liability companies or hinder the overall development of the economy.[288]

4.3.5 Summation

Taiwan is a relatively young country with a relatively new set of legislation. Aimed at legal transplanting and absorbing the best laws and concepts from other countries, the Taiwan Company Act, highly influenced by both German Civil Law and the U.S. Common Law, becomes a hybrid that still needs time to shape the transplanted laws into a set of rules that are best suited for its companies and market participants. As an example, Taiwan transplanted the principle of veil-piercing from the U.S. law to strengthen its corporate governance and tackle the issue of blockholder-overly-controlled companies. Article 154 II, which enables courts to hold shareholders liable for the company's debts, was first added to Company Act for Corporations in 2013. The principle was later extended to Limited Companies through Article 99 II in 2018. However, the wording of Article 154 II and 99 II are not unambiguous. Since they have only been transplanted in recent years, it remains to be seen as to how courts develop this concept and which, U.S., Germany, or other veil-piercing practices, Taiwanese judges will draw knowledge from.[289]

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[288] *Huang*, in *Faung* (ed.), The Changing Landscape of Company Law in Taiwan, p. 46.
[289] *Lin,* NTU Law Journal 43 Special Issue 2014, p. 1315.

5 Veil-piercing in the EU – harmonization required?

One of the four fundamental freedom of the EU, the freedom of establishment, opens the door for entrepreneurs and companies to choose a State of incorporation that is most advantageous for the business.[290] Article 50 TEFU further provides for the Union to legislate directives in most aspects of company law to the extent that is required to facilitate the functioning of the internal market.[291]

Given that each jurisdiction has developed various rules and applications for the concept of veil-piercing, a concern arises as to whether these national differences may operate as a hindrance to the freedom of establishment. However, as observed from the analyses above, it is impossible to standardize veil-piercing. This concept is heavily dependent on the juridical interpretations and facts in the case. In this light, national differences would not be eliminated, even if a harmonized provision is made in the EU law, and these differences could serve as an incentive to incorporate in a Member State other than the home State. Therefore, a harmonization of the piercing concept based on Article 50 TFEU is not justified or needed.

5.1 Freedom of establishment and the free choice of incorporation

Article 49 TFEU extends freedom of establishment to EU companies to facilitate the development of the internal market.[292] This provides businesses with a free choice of incorporation within the EU. Business planners undoubtedly would try to take advantage of this freedom to establish a company in a country that is most advantageous for the business; however, in the past, they faced a formidable obstacle, the real seat doctrine.[293]

[290] *Dammann/ Schündeln,* The Journal of Law, Economics, & Organization 27(1) 2011, p. 79.
[291] *Enriques,* International and Comparative Law Quarterly 66(3) 2017, p. 765.
[292] European Commission, Guide to The Case Law of the European Court of Justice on Articles 49 et seq. TFEU: FREEDOM OF ESTABLISHMENT, available at https://ec.europa.eu/docsroom/documents/22543/attachments/1/translations/en/renditions/native (20 June 2020).
[293] *Dammann*, Yale Journal of International Law 29(2) 2004, p. 479.

Traditionally, EU Member States have adopted either the real seat theory or the incorporation theory. [294] Under the incorporation theory, the applicable company law is the law of the jurisdiction where the company is incorporated, regardless of where its central administration or registered office is located.[295] In that light, companies incorporated in a Member State that follows the incorporation theory can relocate to any Member State, thus, taking advantage of the internal market.

By contrast, under the real seat theory, the applicable company law to the company is the law of the state in which the company's central administration (real seat) is located. [296] This theory also requires that, for formation and recognition purposes, the company's registered office has to be located in the same jurisdiction as its central administration.[297] Given this, it is unsurprising that it was questionable as to whether the real seat theory was compatible with the free movement of establishment.

In the landmark judgments, *Centros*[298] and *Überseering*[299], the ECJ ruled that the real seat theory is incompatible with the freedom of establishment.[300] These two decisions opened the door for the possibility to freely choose a State of incorporation within the EU. Member States now are required to allow companies registered in another Member State to relocate the registered office and/or central administration to their jurisdiction without losing the companies' legal personality and the privilege of limited liability.[301]

[294] *Lombardo,* Regulatory competition in European company law. Where do we stand twenty years after Centros?, May 2019, p. 7, available at https://ecgi.global/sites/default/files/working_papers/documents/finallombardo1.pdf (01 September 2020).
[295] *Van de Looverbosch,* Real Seat Theory v Incorporation Theory the Belgian Case for Reform, September 2016, p. 3, available at https://lirias.kuleuven.be/retrieve/540520 (07 September 2020).
[296] *Ibid.,* p. 3.
[297] *Lombardo,* Regulatory competition in European company law. Where do we stand twenty years after Centros?, May 2019, p. 7, available at https://ecgi.global/sites/default/files/working_papers/documents/finallombardo1.pdf (01 September 2020).
[298] Judgment in *Centros,* Case C-212/97, ECR, ECLI:EU:C:1999:126.
[299] Judgment in *Überseering,* Case C-208/00, ECR, ECLI:EU:C:2002:632.
[300] *Dammann,* Yale Journal of International Law 29(2) 2004, p. 477.
[301] *Gelter,* Journal of Corporate Law Studies 5(2) 2005, p. 248.

5.2 Article 50 TFEU- EU competence to harmonize company law

To ensure companies enjoy the mobility and freedom provided by the freedom of establishment, Article 50 TFEU provides the Union the competence to harmonize national laws to the extent required to facilitate the internal market.[302] Article 50(2)g TFEU is the basis for most of the directives in EU company law.[303] Article 50 TFEU has served as a legal basis for EU company law, starting from the First Company Directive adopted in 1968 (68/151) to the latest Company Directive 2017/1132.[304]

The approximation of company law can be justified when there is a link between the legislation adopted and the fostering of the freedom of establishment.[305] That is, the Union can lay down uniform rules for certain areas of company law as long as the abolishment of national differences has a beneficial effect on cross-border transactions.[306]

Currently, the EU directives do not provide for veil-piercing. Advocate General in case 81/09[307] took the view that the EU legislature leaves open for national legislation to define the concept of limited liability and the company's obligations. This indicates that decisions as to whether to adopt the veil-piercing concept and when to disregard separate personality are left for the Member States to decide.[308] The ECJ accepts the fact that the Member States employ an exception to limited liability and hold shareholders liable.[309] Therefore, piercing the corporate veil is lawful under Union law.[310]

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[302] Judgment in *Daihatsu*, Case C-97/96, ECR, ECLI:EU:C:1997:581, para. 18.
[303] *Andenas/ Wooldridge*, European Comparative Company Law, p. 8.
[304] *Mańko,* EU competence in private law, January 2015, p. 9, available at https://op.europa.eu/en/publication-detail/-/publication/9a845f1b-3821-42dd-8566-2b4a9c9cb3db (06 September 2020).
[305] *Andenas/ Wooldridge*, European Comparative Company Law, pp. 7-8.
[306] *Ibid.*, pp. 7-8.
[307] Opinion of Advocate General in Idryma Typou AE v Ypourgos Typou kai Meson Mazikis Enimerosis, ECR, ECLI:EU:C:2010:304.
[308] *Ntokmetzioglou,* Maastricht Journal of European and Comparative Law 21(3) 2014, pp. 522-523.
[309] *Ibid.*, p. 535.
[310] Opinion of Advocate General in *Idryma Typou AE v Ypourgos Typou kai Meson Mazikis Enimerosis*, ECR, ECLI:EU:C:2010:304, para. 55.

5.3 Veil-piercing in the EU Member States - examples from France and Poland

All EU Member States have developed their own approach to determining whether and when to hold shareholders liable for the company's debts and obligations.[311] In addition to the discussion about veil-piercing in Germany, this subsection provides brief analyses of veil-piercing in two other EU Member States: France and Poland.

In France, shareholders of limited liability companies are not liable for the debts of the company.[312] However, when the company is found to be fictive, courts disregard the separate legal personality and hold shareholders liable.[313] For instance, when a subsidiary is found to be established for the sole purpose of bearing all the liabilities of an affiliated group, courts may consider this subsidiary as a fictive debtor.[314] Fictiveness can also be found in situations where companies fail to maintain a distinct separation between the parent and the subsidiary.[315]

French courts also impose personal liability on individual or corporate shareholders when they discover that there is no separation between personal and company payments, namely commingling of accounts, and unusual transfers of assets or liabilities between two entities.[316]

Regarding tort liability, French courts hold that when shareholders commit a fault or negligence that caused layoffs or redundancies due to the deteriorating financial situation of the company, shareholders owe their duty to the employees.[317] In this case, the majority of shareholders are held liable to the employees based on general tort liability.[318]

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[311] *Karapanço/ Karapanço,* Academic Journal of Interdisciplinary Studies 2(9) 2013, p. 155.
[312] Article 223-1 French Commercial Code.
[313] *DLA Piper*, Corporate Personality: International Perspectives, 2020, p. 17, available at https://www.dlapiper.com/en/uk/insights/publications/2018/10/corporate-personality-international-perspectives-part-1/ (20 August 2020).
[314] *Ibid.,* p. 17.
[315] *Ibid.,* p. 17.
[316] *DLA Piper*, Corporate Personality: International Perspectives, 2020, p. 17, available at https://www.dlapiper.com/en/uk/insights/publications/2018/10/corporate-personality-international-perspectives-part-1/ (20 August 2020).
[317] *Ibid.,* p. 18.
[318] *Ibid.,* p. 18.

Shareholders of Polish limited liability companies also enjoy limited personal liability.[319] In general, Polish courts have been devoted to respecting and upholding the statutory guarantees of limited liability;[320] Polish jurisprudence has refused to pierce the corporate veil.[321] This is because Polish courts find no legal basis for veil-piercing in Polish law.[322]

However, if a company enters into a contract with a clear purpose of committing fraud, courts will disregard the rule of limited personal liability.[323] Furthermore, when fraud is committed by overusing or abusing the principle of limited liability and the damage is proven to have directly caused injuries to the company's creditors, courts in Poland will impose liability on the persons responsible. Creditors can seek remedy based on tortious liability against shareholders.[324]

Even though this subsection contains only a brief discussion about two of the EU Member States, together with the discussion about German's veil-piercing, one could observe that courts in continental Europe, in general, set a narrower scope of the concept. Moreover, regardless of their similarity in upholding limited liability, each of them employs different approaches when tackling the issue of abuse of limited liability by the shareholders.

5.4 National differences of veil-piercing concept facilitate free movement of establishment

The concept of veil-piercing or simply the concept of holding shareholders liable is perceived and applied differently across countries or even across jurisdictions and courts. This triggers a concern as to whether national differences in piercing concepts would hinder the free movement of establishment. As required by Article 50 TFEU, harmonization can only be justified if it is necessary to facilitate

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[319] Article 151 Polish Commercial Companies Code, available in English at https://supertrans2014.files.wordpress.com/2014/06/the-commercial-companies-code.pdf; *Rządkowski*, Comparative Law Review 20(2) 2015, p. 70.

[320] *Farat/ Michon,* Common Law Review 9(1) 2008, p. 25.

[321] *Rządkowski*, Comparative Law Review 20(2) 2015, p. 71.

[322] *DLA Piper*, Corporate Personality: International Perspectives, p. 30, available at https://www.dlapiper.com/en/uk/insights/publications/2018/10/corporate-personality-international-perspectives-part-1/ (20 August 2020).

[323] *Rządkowski*, Comparative Law Review 20(2) 2015, p. 77.

[324] *Rządkowski*, Comparative Law Review 20(2) 2015, p. 76.

cross-border incorporations. Since a harmonized EU provision on veil-piercing does not appear to facilitate the free movement of establishment, an approximation of law in this area is difficult to justify.

5.4.1 Veil-piercing could be a factor influencing incorporation decisions

When business planners are given the free choice of incorporation, they would make a list of pros and cons and evaluate factors, such as tax benefits, the quality of courts, the forms of companies available, the structure of corporate governance, shareholder liability, and director liability, to determine where to incorporate.[325] Although it would also be true that many firms tend to stay incorporated in the country where the founders reside and where the primary business is conducted, some business planners would consider establishing in a country that possesses business-friendly law and environment. In this light, the question is whether the different applications of veil-piercing and opinions on limited liability across the Member States would affect the planners' choice of incorporation.

Given that the U.S. enterprises have long had the freedom to choose which state they want to incorporate their company in, some observations can be drawn from the legal analyses and empirical studies about the U.S. company laws. At the first glance, however, the research on finding the factors that have significant impacts on the choice of a state of incorporation seems to indicate that veil-piercing law may be irrelevant to incorporation decisions. This is perhaps because, given the court-made-law nature and the lack of predictability and clarity, it is difficult for business planners to evaluate which state would be more prone to piercing the corporate veil than others.[326] After all, the veil-piercing is so fact-specific, the likelihood of a court pierces in another claim is unknown. The empirical studies discussed in the previous section would help shape the expectation for lawyers and shareholders; however, they do not provide the actual likelihood of piercing in a specific case.[327]

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[325] *Dammann/ Schündeln,* The Journal of Law, Economics, & Organization 27(1) 2011.

[326] *Ibid.,* p. 89.

[327] *Ibid.,* p. 89.

Nonetheless, the regression analysis conducted by Dammann and Schündeln[328] suggests that veil-piercing law does have some impact on the decision of where to incorporate for private companies in the U.S. The findings show that private companies in the U.S. are less likely to incorporate in the state where they conduct their primary business if this state has a higher piercing rate.[329] In this light, private companies would migrate to another jurisdiction where the perceived risk of the corporate veil being pierced is lower.[330]

Although this study only surveyed private companies in the U.S., it could serve as an indication as to what ordinary business owners consider when determining the state of incorporation. In this light, business planners in the EU are also likely to be influenced by the shareholder liability regime in a Member State when deciding where to incorporate. They would evaluate how protected a corporate veil is in the jurisdiction where they conduct business and they would prefer to reconsider the place of incorporation if the state of their choice is perceived to take a liberal approach towards piercing.

Since veil-piercing may play a factor in influencing the decision of where to incorporate, provided that other factors such as tax considerations and local business laws are not advantageous enough for the business planners to decide, the existence of national differences in the applications and interpretations of veil-piercing could facilitate the free movement establishment as it allows planners to take advantage of the different regimes.

5.4.2 Impossible to standardize the application of veil-piercing

One concern may arise as to if the national differences of veil-piercing remained unharmonized, it would develop into a messy and incoherent principle similar to the one in the U.S. Increased legal uncertainty and unpredictability would make business planners prefer to stay in their Member State where the company participants could more easily understand the actual, but confusing, application of the concept, avoid the problem of bias of judges when conducting

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[328] Professor *Dammann* and *Schündeln* conducted their analysis on 266,531 private companies in the U.S. whose information they extracted from Bureau van Dijk's ICARUS database in *Dammann/ Schündeln,* The Journal of Law, Economics, & Organization 27(1) 2011.

[329] *Dammann/ Schündeln,* The Journal of Law, Economics, & Organization 27(1) 2011, p. 95.

[330] *Ibid.,* p. 107.

burdensome litigations in another State[331], and communicate with lawyers effectively without cultural and language barriers. Diverse veil-piercing concepts thus could arguably hinder the freedom of establishment.

However, as observed from the veil-piercing discussion above, this doctrine is subject to the interpretation of each jurisdiction. Depending on how the law system wants to strike the balance between the limited liability and holding shareholders liable for their conduct, the applications will always be very different among jurisdictions. Moreover, regardless of how the harmonized provision is drafted, veil-piercing cases are very facts and case-specific. It would be difficult to develop a standard or pin down a definitive test across the Union.[332] The development of the doctrine of veil-piercing is likely to remain varied in the Member States, even if harmonization of some sort is put in place. Against this background, there is doubt that harmonization of veil-piercing would better enhance the freedom of establishment.

6 Conclusion

Given the privilege of limited liability, shareholders of a company bear no liability when the company defaults on its debts and obligations. This limitation on shareholder's liability encourages investments and facilitates the development of business because shareholders will not be punished for bad decisions made or the poor economic situation that caused the company to default on its debts. From an economic perspective, accepting limited liability as a default rule is a trade-off between business development facilitated by limited liability and negative externalities created by shifting the risk of default to parties outside of companies. As statutes allow the use of limited liability companies to avoid personal risks as a default rule, legislators perceive the benefits of limited liability outweigh negative externalities.

However, this privilege of limited liability could be abused by shareholders who use the vehicle of the company form to commit fraud and achieve illegitimate goals. In those cases, courts disregard the separate legal personality and pierce through the corporate veil to hold shareholders liable for debts incurred and

[331] *Dammann*, Yale Journal of International Law 29(2) 2004, pp. 492-502.
[332] *Hardee,* Washington Law Review 94(1) 2019, p. 259.

injuries caused by the company. Veil-piercing is an exception to limited liability and it is an equitable remedy. It should be applied infrequently and with much caution because if courts frequently impose personal liability on shareholders, it would undermine the statutory guarantee of limited liability and threaten the existence of limited liability companies.

This is no easy task to find the right approach and every country or jurisdiction has indeed developed various tests or approaches to determining when to pierce. For instance, the U.S. takes a liberal approach in applying the concept while continental Europe carefully limits the application of veil-piercing to claims where other areas of law could not provide sufficient protection or remedy.

Even though the discussions about the EU Member States in this paper are only limited to Germany, France, and Poland, it could still be observed that each jurisdiction takes a different view on how firmly limited liability should be upheld and in which circumstances limited liability should be disregarded.

Given that each jurisdiction has developed various rules and applications for the concept of veil-piercing, a concern arises as to whether these national differences may operate as a hindrance to the freedom of establishment. It is argued that since it is impossible to standardize veil-piercing, regardless of whether an EU provision is put in place, national differences would not be eliminated, and these differences could serve as an incentive to incorporate in a Member State other than the home State. Against this light, if each Member State has its own means to impose personal liability on shareholders responsible for the company's inability to repay its debts, harmonization of the piercing concept based on Article 50 TFEU is unnecessary and difficult to justify.

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