

# Piercing the Corporate Veil: a Comparative Analysis

C. Jocelyne Kokaz\*

## I. The United States Approach

### A. *Balancing the Disadvantages of Limited Liability*

Insulation from corporate liability, a means to limit the personal financial liability to a shareholder's capital investment, has been a debated subject among recognized legal scholars. Limited liability was criticized since shareholders do not bear the full costs of doing business by entering the protective shield of limited liability. Taking into account this disadvantage resulting from the limited liability regime, there has even been a proposal that if corporate limited liability is eliminated totally from the capital market on behalf of tort creditors, the consequences therefrom would not be so severe.<sup>1</sup>

One way to balance the disadvantages of limited liability has been piercing the corporate veil, an equitable remedy in nature. The courts can refuse to disregard the corporate entity if the complaining party can be adequately compensated with money damages.<sup>2</sup> "Courts have allowed creditors in some situations to reach the assets of shareholders... The cases may be understood, at least roughly, as attempts to balance the benefits of limited liability against its costs. Courts are more likely to allow creditors to reach the assets of shareholders where limited liability provides minimal gains from improved liquidity and diversification, while creating a high probability that a firm will engage in a socially excessive level of risk taking."<sup>3</sup>

The law allows the incorporation of a business for the very purpose of enabling its proprietors to escape personal liability... but... the courts will disregard the corporate form, or, to use accepted terminology, "pierce the corporate veil, "whenever necessary to prevent fraud or to achieve equity."<sup>4</sup> If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a

\* Attorney at law, Istanbul.

1 Henry Hansmann and Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 Yale L. J., 1879, 1934 (1991); see also Phillip Blumberg, *The Law of Corporate Groups: Tort, Contract, and Other Common Law Problems in The Substantive Law of Parent and Subsidiary Corporations* 50 (1987); E. Merrick Dodd, *The Evolution of Limited Liability in American Industry: Massachusetts*, 61 Harv. L. Rev. 1351 (1948).

2 William M. Fletcher, *Fletcher Cyclopedia of Corporations* 1 (perm ed. rev. vol. 1990).

3 Frank H. Easterbrook and Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985).

4 Choper Coffee Morris, *Cases and Materials on Corporations* 148 (3d ed. 1989).

general rule, and until sufficient reason to the contrary appears;<sup>5</sup> but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.<sup>6</sup> In other words, two dominant requirements must be met – there must be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist, and circumstances must indicate that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice.<sup>7</sup>

The “veil” of the “corporate fiction” or the “artificial personality” of the corporation, is “pierced”<sup>8</sup> and the individual or corporate shareholder exposed to personal or corporate liability, as the case may be, when a court determines that the debt in question is not really a debt of the corporation, but ought, in fairness to be viewed as a debt of the individual or corporate shareholder or shareholders.<sup>9</sup> Even a nonprofit organization can be subject to this doctrine.<sup>10</sup> Apparently these explanations do not provide a clear-cut rule for piercing the corporate veil. No precise formula is available to predict when a court should disregard the corporate entity, each case being *sui generis*.<sup>11</sup>

### B. Checklist of Main Factors Used by Courts

Courts usually look for the existence of some specific fact pattern before proceeding with piercing the corporate veil. There is consensus in the legal community as to the factors constructing these specific fact patterns. However, the factors relied upon in disregarding the corporate entity should not be treated as conclusive but they should be regarded as guidelines.

The presence of one factor will not suffice to disregard the corporate veil. In most cases factors will overlap. Usually when an overlap occurs and there are several factors that show corporate abuse courts will pierce the corporate veil. It is crucial to emphasize once more that the major reason for incorporating is to limit liability and the power to pierce the corporate veil is to be exercised “reluctantly” and “cautiously.”<sup>12</sup> Certainly courts have had a tendency to pierce the veil of subsidiary corporations more often than in other cases<sup>13</sup> but by whatever means the conclusion to disregard the corporate entity is arrived at, it essentially means that under

5 Easterbrook & Fischel, *supra* note 3 at, 603.

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

7 Fletcher, *supra* note 2, at 662.

8 I. Maurice Wormser, *Piercing the Veil of the Corporate Entity*, 12 Colum. L. Rev 496 (1912).

9 Stephen B. Presser, *Piercing The Corporate Veil* § 1.01-1.06 (1994 ed).

10 Fletcher, *supra* note 2, at 711.

11 *Id.* at 661.

12 *Id.* at 662.

13 Easterbrook and Fischel, *supra* note 3, at 103-109.

the facts of the case the person or corporation in control is liable for the acts and omissions of the corporation.<sup>14</sup> A checklist comprising of factors considered most often by courts before proceeding with piercing the corporate veil is as follows:

### 1. Inadequate Capitalization (Undercapitalization)

The basic idea behind the "undercapitalization" or "inadequate capitalization" theory is that if the shareholder or shareholders deliberately incorporate with initial capital they know to be inadequate to meet the expected liabilities of the business they intend to be doing, they are engaging in an abuse of the corporate form, and ought to be individually liable when those liabilities actually occur.<sup>15</sup> If a corporation is organized and carries on a business without substantial capital so that the corporation is likely to have insufficient assets available to meet its debts, it is inequitable that the stockholders should set up such a flimsy organization to escape personal liability.<sup>16</sup> A corporation is undercapitalized when the magnitude and the nature of the company require more capital than the capital already invested.

Inadequate capitalization is especially a key factor where the claimant is an "involuntary creditor"<sup>17</sup> who cannot be said to have willingly accepted the risk of inadequate capitalization. A contract creditor on the other hand will have to show that he had no opportunity to ascertain that the corporation did not have reasonable capital for its foreseeable business.<sup>18</sup>

In bankruptcy cases, a parent will be given inferior position compared to other claimants if management improprieties or undercapitalization is evident. The deep rock doctrine that covers bankruptcy and reorganization proceedings of corporations whose sole or controlling shareholder (usually a parent corporation) seeks to enforce claims against it as a general or secured creditor provides the legal justification to arrive at this conclusion.<sup>19</sup> A party seeking to pierce the corporate veil must show that the financial setup of the corporation is a sham and causes injustice; mere proof that the corporation is now insolvent is insufficient.<sup>20</sup> The fact that a

14 *Solomon v. Klein*, 770 F2d 352 (CA3 1985); *People v. Clauson*, 231 Cal App 2d 374, 41 Cal Rptr 691; *Unijax, Inc. v. Factory Ins. Ass'n*, 328 So 2d 448 (Fla App); *Condensor Service & Engineering Co., Inc. v. Brunswick Port Authority*, 87 Ga App 469, 74 SE2d 398; *Burger Man, Inc. v. Jordan Paper Products, Inc.*, 170 Ind App 295, 352 NE2d 821; *Hunt v. Jefferson Arms Apartment Co.*, 679 SW2d 875 (Mo App.); *Hideca Petroleum Corp. v. Tampipex Oil International Ltd.*, 740 SW2d 838 (Tex App Houston 1987); *Miles v. CEC Homes Inc.*, 753 P2d 1021 (Wyo 1988).

15 *Presser*, *supra* note 9.

16 *Fletcher*, *supra* note 2, at 811.

17 *See also*, § I, D.

18 Steven Emanuel, *Emanuel Law Outlines* 27 (2d Ed. 1992-93).

19 Posner and Landers, *Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy* 43 U. CHI. L. REV. 527 (1976).

20 *Fletcher*, *supra* note 2, at 731.

corporation operates at a loss in and of itself is not enough to warrant disregarding the corporate entity.<sup>21</sup>

## 2. Failure to Issue Stock

While the fact that a corporation remains inchoate without stockholders or stock is not by itself determinative of an alter ego relationship<sup>22</sup>, nevertheless it does indicate that the corporation may exist merely to serve the interests of another – a corporation or an individual.

## 3. Siphoning of Funds of the Corporation by the Dominant Stockholder

When a shareholder drains out all of the profits and/or capital while the company still functions whether this takes place as salaries, dividends, loans or anything similar courts refer to siphoning of funds. The dominant shareholder will have used the corporation as a facade for its operations.

## 4. Commingling of Corporate and Personal Assets

Evidence that shareholders used corporate funds for personal purposes, mixed corporate and personal accounts, or commingled assets so that the ownership interests were indistinguishable will be weighed, along with other factors, when a disregard of corporate separateness is urged.<sup>23</sup> The "fraudulent conveyance" explanation of the Dean of the Harvard Law School, Robert Clark, Provides a very good basis in enlightening piercing the corporate veil cases in this context.<sup>24</sup>

## 5. Failure to Follow Corporate Formalities

Absence of corporate records, nonpayment of dividends, nonfunctioning of other corporate officers and directors, not holding the shareholders and directors' meetings are all examples of failure to follow corporate formalities. If creditors are injured by the corporation's conduct then courts are more willing to pierce the corporate veil.<sup>25</sup>

## 6. Use of the Same Office or Business Location by the Corporation and its Individual Stockholders

This is a strong indication that the parent exercises control over the subsidiary. Where the corporation is a wholly owned subsidiary with identical principle corporate officers, these facts alone might provide sufficient evidence for piercing the corporate veil.

<sup>21</sup> *Id.*

<sup>22</sup> *See*, alter ego, § I., 2.

<sup>23</sup> Fletcher, *supra* note 2, at 700.

<sup>24</sup> *See*, particularly the analysis under *Walkovszky v. Carlton* in Presser, *supra* note 9.

<sup>25</sup> Fletcher, *supra* note 2, at 767.

## 7. Use of the Corporate Entity to Promote Fraud or Injustice

Where the corporate form of organization is adopted or a corporate entity is asserted in an endeavor to evade a statute or to modify its intent, courts will disregard the corporation or its entity and look at the substance and reality of the matter.<sup>26</sup> Courts have two viable alternatives: They can either disregard the corporate entity or they can establish its responsibility and render judgment against it.

### *C. Types of Corporation where Piercing the Veil Occurs Most Often*

#### 1. Close Corporations

Some courts have suggested that close corporations are subject to greater scrutiny with regard to piercing the corporate veil because of the small number of stockholders and their frequent occupancy of positions as officers, directors, and employees<sup>27</sup> of the corporation. It is particularly important for close corporations to have been adequately capitalized because this is regarded as a very important factor in this context. Meanwhile, the violation of corporate formalities is not regarded as a grave abuse in close corporations.

A recent empirical study<sup>28</sup> suggested that piercing the corporate veil is a doctrine exclusively directed at close corporations and corporate groups. The data showed Delaware as having produced very few piercing cases. At first glance this seemed to be contradictory to the proposition since Delaware has been by far the most dominant state in corporate law. However, this contradiction lost its validity in the light of the traditional focus of Delaware. To state it more clearly, Delaware's traditional focus has always been on large, publicly held corporations and the proposition states that piercing the corporate veil is a doctrine exclusively directed at close corporations. From these it logically follows that Delaware does not have the potential to produce piercing the veil cases.

#### 2. Parent-Subsidiary Companies and Affiliates

The terminology used to hold a parent liable for the acts of its subsidiary can vary. The terms "instrumentality," "alter ego" and "agent" are sometimes deemed equivalent and interchangeable.<sup>29</sup> The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor.<sup>30</sup> There is no litmus test

<sup>26</sup> *Id.* at 820.

<sup>27</sup> *Id.* at 709.

<sup>28</sup> Robert B. Thompson, *Piercing the corporate veil: An Empirical Study*, 76 Cornell L. Rev. 1047-1053 (1991).

<sup>29</sup> Fletcher, *supra* note 2, at 729.

<sup>30</sup> quoting famous Justice Cardozo from *Berkey v. Third Avenue R. R. Co.*, 244 N.Y. 84, 94, 155 N.E. 58, 61 (N. Y. 1926).

for determining whether a subsidiary is the alter ego of the parent.<sup>31</sup> Because veil piercing determinations are highly fact-specific, courts look to the totality of circumstances and apply traditional veil-piercing analysis on a case-by-case basis.<sup>32</sup>

Generally, without fraud or bad faith, a corporation won't be liable for exercising domination and control over its subsidiary. There is a presumption of separateness<sup>33</sup> the plaintiff must overcome to establish liability by showing that the parent is employing the subsidiary to perpetrate a fraud and that this was the proximate cause of the plaintiff's injury. Once the veil is pierced any claim against the subsidiary if substantiated can be attributed to the owner who would have to bear final responsibility for providing the "deep pocket" to satisfy the judgment award.<sup>34</sup>

Under the "alter ego" doctrine the court merely disregards corporate entity and holds individual responsible for acts knowingly and intentionally done in the name of the corporation.<sup>35</sup> To establish the "alter ego" doctrine, it must be shown that the stockholders disregarded the entity of the corporation, made corporation a mere conduit for the transaction of their own private business, and that the separate individualities of the corporation and its stockholders in fact ceased to exist.<sup>36</sup>

The factors taken into consideration when determining the alter ego status of a company are whether:

1. the parent and subsidiary have common stock ownership;
2. the parent and subsidiary have common directors or officers;
3. the parent and the subsidiary have common business departments;
4. the parent and the subsidiary file consolidated financial statements and tax returns;
5. the parent finances the subsidiary;
6. the parent caused the incorporation of the subsidiary;
7. the subsidiary operates with grossly inadequate capital;
8. the parent pays the salaries and other expenses of the subsidiary;
9. the subsidiary receives no business except that given to it by the parent;
10. the parent uses the subsidiary's property as its own;
11. the daily operations of the two corporations are not kept separate;
12. the subsidiary observes the basic corporate formalities, such as keeping separate books and records and holding shareholder and board meetings.

Affiliated companies (sister-brother companies) are within the scope of

31 *United States v. Jon-T Chemicals, Inc.*, 768F. 2d (5th Cir. 1985, pp. 686-694).

32 *Id.*

33 *Fletcher*, *supra* note 2, at 729.

34 Thomas J. Smith, Susan L. Walker, and Kelly L. Murray Wildman, Harrold, Allen & Dixon, *Foreign Parent Corporation Liability for United States Subsidiaries*, 1993 *Compl. L. Y. B. Int'l. Bus.* 299, 301.

35 *Black's Law Dictionary* 77 (6th ed. 1990).

36 *Id.*

the same rules with parent-subsidary companies. Affiliate companies are in U.S. law branches, divisions or subsidiaries. Under the Investment Company Act (15 U.S.C.A.), a company in which there is ownership (direct or indirect) of 5 percent or more of the voting stock is described as an affiliated company.

In the business world it is a well-known fact that business transactions are carried between parent and subsidiaries and among sister companies while preserving the separate legal entity of each complex. Accordingly, even where sister corporations are closely related from an economic standpoint in that the economic health of one is vitally important to the continued vitality of the other, and both are dominated by a single shareholder, so long as such domination is exerted upon each corporation as a separate concern, one corporation's grant of credit to the other, without more, is not grounds for applying the doctrine of corporate disregard in action to satisfy judgment against one sister corporation by action against the other. On the other hand, if the dominion and control of the parent company prevents the sister company from fulfilling its obligations, then the theory of separate existence won't be applied even in the absence of fraud and the parent company will be held liable.

Agency theory can also be used to hold the parent liable of the subsidiary's actions. The subsidiary will be viewed as the agent and consequently the parent as the principal. The parent may wittingly or unwittingly have led a plaintiff to believe that it stands behind or considers itself liable for the obligations of its subsidiary, and a creditor who acts to his detriment in reliance on those representations may recover, not only by use of the agency theory, but also on grounds of estoppel, from the parent.<sup>37</sup> There are also rare instances where piercing the corporate veil doctrine can be applied to hold the subsidiary responsible for the acts of the parent.<sup>38</sup>

#### a. State v. Federal Courts

There is a distinctively different approach in the parent-subsidary context among federal and state courts. Federal courts focus on the regulatory purpose of the statute at issue instead of merely looking at factors of control or dominance in determining whether the corporate form should be protected or disregarded. This is done to enhance congressional policies and to promote federal statutes. For example, the federal courts have tried to formulate a more liberal standard<sup>39</sup> with regard to the cases concerning the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), known also as the superfund, which holds responsible parties liable for the cost of cleaning up hazardous waste sites. By relaxing the standards for veil-piercing when a federal statute is

<sup>37</sup> *Liability of a Corporation for Acts of a Subsidiary or Affiliate*, 71 HARV. L. REV. 1122, 1123 (1958).

<sup>38</sup> *FMC Finance Corp. v. Murphree*, 632 F2d 413 (CA5 1980); *Kingston Dry Dock Co. v. Lake Champlain Transp. Co.*, 31 F2d 265.

<sup>39</sup> 6 Computer & High Tech. L. J., p. 4

involved, more parent corporations will be held liable for the acts of their subsidiaries under CERCLA and other federal statutory regulations.<sup>40</sup> Parent corporations cannot safely assume that the traditional "corporate veil" will insulate them from jurisdiction or liability.<sup>41</sup>

#### D. Comparison of Tort and Contract Creditors

Courts usually would more easily pierce the corporate veil in contract cases compared to tort cases.<sup>42</sup> This is because the party seeking relief in a contract case is presumed to have voluntarily and knowingly entered into an agreement with a corporate entity, and is expected to suffer the consequences of the limited liability associated with the corporate business form.<sup>43</sup> It is alleged that this is not the situation in tort cases where the involuntary creditor did not have the chance to select the corporate entity. Posner argued that since voluntary creditors are easily able to investigate the capitalization and other measures for reducing risk undertaken by those to whom they lend they can adjust their rates of interest accordingly, and thus protect themselves against any increased risk they assume because of the rule of limited liability. In other words, contract creditors can investigate the standing of the party contracted.<sup>44</sup> However, whether a contractual relationship is truly one in which a creditor had the opportunity to investigate the capital structure of a debtor and knowingly failed to exercise a right to investigate before extending credit, such that the creditor should be precluded from piercing the corporate veil, should be decided with respect to the particular facts of each case, rather than by the denial to all contract creditors who resort to this equitable remedy by a presumption of the assumption of risk.<sup>45</sup> The answers given as to the sort of contract involved and the nature of the activity complained of— is it something of which the plaintiff can be considered to have assumed the risk—constitute significance in reaching a conclusion with regard to piercing the corporate veil in the case of contract creditors.<sup>46</sup>

Even in the setting of innocent tort victims suffering from the disadvantages of limited liability, Dean Clark asserted the probable

40 Thomas J. Smith, *supra* note 34.

41 10 VA. ENVTL. L. J., p. 12 (1991).

42 See however the empirical study (R. B. Thompson, *supra* note 28) which shows that the corporate veil is pierced less often in tort cases in contrast to contract cases. But the author also emphasizes what an empirical study can and cannot do especially given the fact that the results of his study are based only on filed and reported cases. (most cases are settled and many cases are not reported).

43 Fletcher, *supra* note 2 at 712.

44 Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 503 (1976). But see Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 620 (1975) and Landers, *Another Word on Parents and Affiliates in Bankruptcy*, 43 U. CHI. L. REV. 527-540 (1976).

45 Fletcher, *supra* note 2, at 813.

46 *Id.* at 712.

adoption of better solutions to the problem rather than piercing the corporate veil. These solutions include the imposition of higher capital requirements by state legislators; the requirement of greater amounts of mandatory insurance, revision of federal insolvency laws and the establishment of compensation schemes by states.

### *E. Criticism of U.S. Piercing the Corporate Veil Approach*

In U.S.A. there are a lot of court decisions on piercing the corporate veil. However, it is quite difficult to draw a bright line rule on when the courts would pierce the corporate veil and when they would reject to do so. There seems to be no escaping from the paradox posed by American law's dual wish to aid entrepreneurs of modest means by offering limited liability, and at the same time avoid the burden of imposing unforeseen liability on corporate creditors, particularly involuntary ones.<sup>47</sup> The courts use the equitable doctrine of piercing the corporate veil to achieve justice despite the cost of creating a high level of legal unpredictability. The various factors and lists in cases and commentary create more confusion than clarity as to when disregard of the corporate entity is appropriate.<sup>48</sup>

The law strived to end the illegal, fraudulent interference of the parent to the subsidiary and this required courts to find some form which would be applied identically. This wasn't possible with all the different factual situations courts had to face; thus courts had to overstretch the standards. The trend of increase in disregard of the corporate entity, especially in the area of toxic torts and particularly by federal courts is alarming with regard to the future of limited liability.<sup>49</sup> Courts start with the presumption of limited liability and when none of the usual "suspects" can be found, that presumption continues.<sup>50</sup> If this presumption is going to change, it would be appropriate if it is changed by the legislators instead of the judiciary so that a more understandable and consistent body of law is created. Even innocent tort victims can be provided with adequate protection as suggested above by referring to legislative measures<sup>51</sup> which will be enacted by the classical policy articulates, the organs of the state and federal legislatures. A comment that might be going too far states "Before the American corporation dies an ignoble and untimely death, or at least before the attractiveness of investments in American corporations dangerously erodes, there ought at least to be a real and robust public debate weighing and comparing the advantages of limited liability's incentive value and other policy goals."<sup>52</sup>

---

47 Presser, *supra* note 9.

48 Thompson, *supra* note 28.

49 M. Horwitz, *The Transformation of American Law* (1977); Presser *supra* note 9.

50 Thompson, *supra* note 28.

51 See *supra* § I, D.

52 Presser, *supra* note 9.

## II. Different Perspectives

### A. The Approach of Argentina and France

#### 1. Fraud Analysis

Most of the decisions rendered by French and Argentina courts as for remedies related with abuses of corporate personality mention the notion of fraud. Nevertheless the meaning of "fraud" used by these courts is not the same as the meaning of "fraud" used by U.S. and English courts. In common law a judge can make a finding of fraud without necessarily establishing malice or intent. "Fraud" is divided into different categories in civil law the remedies of which differ. The three different types of fraud which will be illustrated below are: simulation, dolus and actio Pauliana.

##### a. Simulation

Simulation<sup>53</sup> leads to the same results as piercing the veil. The results achieved by simulation are strongly criticized because they overrule limited liability by providing a judicial declaration of nullity which is observed as an excessive remedy.

##### aa. Simulation in Argentina

Simulation in sham or fictitious companies in France and in Argentina are treated somewhat differently. In Argentina statute law does not allow one man companies. Therefore, it is not common to have one man companies in Argentina and in any event if courts meet these types of companies they treat them as fictitious. In Argentina the abuse of corporate personality usually appears in parent-subsidiary context and the doctrine of "economic unity"<sup>54</sup> is used to provide remedy.

---

53 As cited in Juan M. Dobson, *Lifting the veil in four countries: Argentina, England, France and the United States*, 35 INTL & COMP. L. Q. 839-863 (1986) "Simulation is an operation through which an apparent legal situation, different from the real legal situation is created. According to Argentina Civil Code art. 955 an act of the parties will be deemed to be simulated whenever its legal character is shown to have been disguised to look like another transaction, or whenever a deed contains false dates or provisions that are insincere, where a conveyance is made to someone who is a third party's stooge. There has to be a contrast between the exterior facade put up by the parties and their real object. Whenever the parties have used a contract to create an illusion, this is a fictif transaction, which is one of the varieties of simulation. Normally the fictitious transaction will be entered to evade the normal consequences of the law applying to the real transaction."

54 "Since 1973 Argentina courts have used this doctrine under which insolvency proceedings may be extended from one company to another person (corporate or individual) where there has been a legal unity among them. The prerequisites of this unity are not clear but the *Suprema Corte de Justecca de la Nacion* has held that fraud must be shown for this remedy to become available.

### ab. Simulation in France

In France the enacted statute of 1985 allows the one-man company<sup>55</sup> – the *entreprise unipersonnelle a responsabilite limitee* (EURL). This company was designed to allow individuals to limit their liability but it does not follow from this statute that the one man company can never be treated as fictitious.<sup>56</sup> France has made extensive use of the doctrine of simulation starting from as early as 1908.<sup>57</sup>

### b. Dolus in Argentina and France

Another type of fraud and perhaps the most common one is *dolus* referring to acts performed by a person actively appreciating the unlawful consequences of his actions especially with intent. Whenever a party shows that he would not have entered the contract had it not been for the deceit (*dolus*), the principle of error and its resulting nullity will become applicable.<sup>58</sup> Ergo if a court concludes that the contract was entered into as a result of the intentional fraud of one party, the innocent party may claim nullity of the contract and third parties may claim damages if they have been prejudiced. The concept of *dolus* can be of assistance in providing remedies where the corporate entity is used to escape contractual obligations or to injure third parties. In these cases the corporate veil would be lifted.

### c. Actio Paulina

*Actio Pauliana*, the roots of which lie in Roman Law, is used in civil law countries. Both in France and in Argentina this action is recongized. A typical scenario where it is convenient to use Actio Pauliana is where the debtor enters a transaction with a third party who had knowledge of the debtor's insolvency at the time of the transaction. The debtor will have to provide adequate remedies for the transactions which will prejudice the rights of individual creditors. If the debtor has received consideration from the transaction then three elements<sup>59</sup> will have to be proved:

1. prejudice to a creditor causing or aggravating insolvency;
2. the obligation to the creditor must predate the transaction;
3. fraudulent connivance of the debtor and the third

problems related to internal loans made by company members. However, Actio Pauliana has been criticized because it does not

55 EURL loi No. 85-697, 11.7.85, 0.1985, 394.

56 Surlooten, *L'entreprise unipersonnelle a responsabilite limitee*, D. 1985, 187.

57 A director who had gone into business personally under a company's cloak could be made personally bankrupt because he had identified himself with the company, see, e.g., *Mary Baynaud v. Maillard*, 29.6.1908, D. 1910, 233, note Percerou.

58 COD. CIV. art. s 931, 932 (Ar.); C. CIV. art. 1116 (Fr.)

59 Dobson, *supra* note 53, at 844.

distinguish between transactions made in good faith and ones made in bad faith. A member of the company may be discouraged from lending money to the company since his knowledge of the company's feeble financial situation increases his chance of being challenged as a creditor.

## 2. The Agency Analysis

In U. S. law, agency related terms are commonly used in piercing the corporate veil. The rationale for this lies in the content of agency principles: English and American law, assigns full liability to the undisclosed principal *vis-a-vis* third parties for authorized acts performed by his agent acting within his authority. When the existence of the principal is not made known to a party at the time of contracting the third party has the choice of starting an action against either the agent or the undisclosed principal.<sup>60</sup>

The elements of control are combined with the agency analysis to render it effective. To verify the presence of control the plaintiff must show:

1. control, not merely majority or complete stock control but complete domination, not only of the finance, but of policy and business practice in respect to the transaction so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and

2. such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of the statutory or other positive legal duty, or dishonest and unjust act in contravention of the plaintiff's legal rights; and

3. the aforesaid control and breach of duty must proximately cause the injury or unjust loss.<sup>61</sup>

The time when control is exercised is very important. Control must be shown at the time the acts complained of took place<sup>62</sup> but the time frame to provide evidence is more flexible.

In contrast, agency law known as the law of representation does not play such an important role in France and Argentina because the law of agency has a narrower scope. An undisclosed principal is not liable to third parties for contractual obligations incurred by his agent; there is no direct action that a third party may initiate against an undisclosed principal.<sup>63</sup> In summary, neither fraud nor agency constitutes an appropriate basis for company abuse especially in the parent-subsidiary context where the need to pierce the corporate veil arises more frequently than other situations.

60 *Watteau v. Fenwick* [1893] 1 Q.B. 346; *Kendall v. Hamilton* [1879] A.C. 504, 514; Henn, Agency-Partnership 105 (1977); Markesins and Munday, An Outline of The Law of Agency 130 (1979).

61 Fletcher, *supra* note 2, at 612.

62 *Id.* at 758.

63 Fontanarrosa, Derecho Comercial Argentino 260, 454 (1967); art. 1929, Argentina civil code; art. 223, Argentina Commercial Code; art. 1997, French Civil Code; Req. 10.2.36, D.P. 1937, 1.92, report M. Conseiller Pilon.

### 3. Other Equivalents to Piercing The Corporate Veil in France and Argentina

#### a. Abuse of Rights Theory

France and Argentina have developed the abuse of rights theory, a combination of the fraud and agency analysis, which is evaluated together with the "the interests of the company." Abuse can be conducted either by the majority shareholders against the minority shareholders or it can be committed by the company against third parties. Internal control of a company meaning that there is a dominant majority holding control over a dissenting minority can be abusive depending on the circumstances. As long as the majority uses its controlling power in accordance with the company's interests there is no question of abuse. The external control of a company meaning that the decisions of a company are determined by an outside economic power not owning the shares is always abusive.

A strong and consistent line of cases has established the existence and application of the theory in French law<sup>64</sup> but the limits are not quite clear.<sup>65</sup> Control of a company by itself does not provide sufficient foundation for the application of the abuse of rights theory; the control must be abusive for this theory to apply.

#### b. French Approach in the Parent-Subsidiary Context

The French approach in the parent-subsidiary liability context is based on partial adjustments on its bankruptcy and labor laws.

##### ba. Insolvency Law

As noted by Professor Blumberg "French law sets forth in the greatest detail the procedure for the extension of the subsidiary's bankruptcy proceedings to include the parent."<sup>66</sup> Two categories of cases have to be treated separately in French law.

The first category includes cases of commingling of assets.<sup>67</sup> Where the assets and affairs of a parent and subsidiary corporation have been so closely intertwined that the latter is to be considered a mere instrumentality<sup>68</sup> of the former<sup>69</sup> substantive consolidation is provided for. These cases are similar to the piercing of the corporate veil cases which are used in the U.S.A.

---

<sup>64</sup> As cited in Dobson, *supra* note 53, at 845; Ghestin, Goubeaux, *Traite de droit civil, introduction generale* (2nd ed., 1983), p. 617, n. 697; Paris, 13.4.82, *Gaz. Pal.* 1983 obs. Dupichot, [1984] *Rev. trim. dr. comm.* 102.3. There is some overlapping in French theory of fraud. (*Encyl. Dalloz, Abus des droit, Antoine Pirovono*, n. 169).

<sup>65</sup> Dobson, *supra* note 53, at 858.

<sup>66</sup> Philip Blumberg, *The Law of Corporate Groups, Procedural Law* 27-37 (1983).

<sup>67</sup> *Confusion de patrimoines*.

<sup>68</sup> *Societe de facade*.

<sup>69</sup> Maurice Cozian and Alain Viandier, *Droit Des Societes* 440 (1987).

The second category of cases concern statutory consolidation cases functioning when a parent company has been acting like a director of a subsidiary. In these cases the subsidiary's bankruptcy extends to the parent company where the parent company as a director:

1. disposed of the assets of the subsidiary as if they were its own;
2. used the subsidiary as a mask to achieve its own interests;
3. used the assets and loans from the subsidiary in a way that impaired the latter's interests;
4. exploited the subsidiary in a way that had lead to bankruptcy;
5. destroyed documents or failed to keep proper accountability of the subsidiary's affairs; or
6. fraudulently depleted the subsidiary of its assets.<sup>70</sup>

A parent becomes a "de facto director"<sup>71</sup> if it involves itself in the subsidiary's day to day management without having been formally elected as a director. Although liability of the parent can be established on this basis it is rather difficult to make use of this concept. Plaintiffs are faced with several difficulties. First of all claimants have to establish the status of the parent company as a director, then they have to show that there was a breach of the fiduciary duties to the subsidiary<sup>72</sup> and finally it must be proven that the damages to the subsidiary are a proximate cause of the parent's action or inaction.<sup>73</sup>

#### bb. Labor Law

France has an interesting approach in establishing parent liability where employee claims are concerned. It attaches parent liability whenever a parent has involved itself in the relationship between a subsidiary and its employees, the rationale being that employees are small and weak creditors and the size of their claims would mostly not justify participation in risky and expensive litigation against the parent.<sup>74</sup>

### B. German Approach

#### 1. Inadequate Capitalization as a Severe Problem Resulting from the Structure of the German Economy

Inadequate capitalization is a much bigger problem in the German economy than the U.S. economy because the percentage of equity capital is more than twice as high in comparable German enterprises.<sup>75</sup> German legislators set capital requirements to cope with this problem. Nonetheless,

<sup>70</sup> *Id.* at 441; *Action en extension*, loi du 25 janvier 1985, Art. 182; Michel Jeantin, *Droit Commercial* 685-689 (1988).

<sup>71</sup> *Dirigeant de fait*.

<sup>72</sup> *Faut de gestion*.

<sup>73</sup> Jeantin, *supra* note 70, at 681-682.

<sup>74</sup> Karl Hofstetter, *Parent Responsibility for Subsidiary Corporations: Evaluating European Trends*, 39 INT. & COMP. L.Q. 586 (1990).

<sup>75</sup> Maximilian Schiessl, *The Liability of Corporations and Shareholders for the Capitali-*

the German courts refused to disregard the corporate entity where they faced substantial undercapitalization. In *Typenhaus*<sup>76</sup>, the second panel of the German Federal Court (Bundesgerichtshof) did not hold the parent company liable for inadequate capitalization. The parent company was at the same time the majority shareholder of the subsidiary company. In this case, the defendant being the parent corporation, was engaged in manufacturing prefabric houses. After the manufacturing had been completed the parent incorporated a subsidiary which would continue this process while the parent itself took over the process of distribution of the houses. The subsidiary was not only undercapitalized but completely dominated by the parent which owned the equipment of the subsidiary.<sup>77</sup> After the holding of this case the eighth panel of the Bundesgerichtshof which is the more competent panel in issues related with corporations criticized this decision and gave the impression that the result could be otherwise if they had been competent in lieu of the second panel. However, seven years later when the eighth panel encountered a similar issue, the shareholders were not held liable for the inadequate capitalization.<sup>78</sup>

## 2. Equivalents to Piercing the Veil in Germany

### a. Personal Liability without Disregarding the Corporate Entity

#### aa. Tort Liability

Courts have used article 826 of the German Civil Code (Bürgerliches Gesetzbuch, "BGB") to hold shareholders liable in cases where the allocation of risk extremely disfavor the creditors. The Bundesgerichtshof concluded that article 826 of the BGB is violated if "a close corporate entity is abused by the sole shareholder in order to continue the business operations though the shareholder is aware that the corporation is unable to satisfy its obligations."<sup>79</sup> BGB, article 826 is entitled as "Wilful damage contrary to public policy" and it states that "A person who wilfully causes damage to another in a manner contrary to public policy is bound to

---

*zation and Obligations of Subsidiaries under German Law*, 7 Nw. J. INTL L.&BUS. 480-506 (1986).

76 Judgment of May 4, 1977, Bundesgerichtshof, W. Ger., 68 BGHZ 312, 314 ("Typenhaus").

77 *Id.*

78 In the judgment of Mar. 26, 1984, Bundesgerichtshof, W. Ger., 90 BGHZ 381, 388-89 ("Beton-und Monierbau I") the eighth panel held: "the responsibility of a shareholder for a proper financing does not oblige him to make a subsequent payment during a crisis of the enterprise but prevents him from placing the creditors at a disadvantage by avoiding an objectively required increase in equity capital and turning to a less risky form of financing."

79 Judgment of Nov. 26, 1957, Bundesgerichtshof, W. Ger., 1957 WM 460, 462.

compensate the other for the damage."<sup>80</sup>

The wilfulness requirement in this article is met only if the shareholder is well aware of all the facts, including the possibility of damages to the creditors.<sup>81</sup> It is cumbersome to meet the wilfulness requirement for plaintiffs and it aggravates enforcement problems.

The *Architekten* is a case where the limited partnership which had a close corporation as the only general partner, sold to the limited partners of the partnership at the same time shareholders of the close corporation, constructed buildings well below the market price. Both companies were undercapitalized. An architect had a claim against the limited partners of the partnership but the sham structure of the companies were organized in a way that enabled the defendants to reap off all the profits while the undercapitalized companies bore all the liabilities. Therefore, the *Bundesgerichtshof* held the defendants liable in tort.

#### ab. The *Culpa in Contrahendo* Doctrine

According to this doctrine "the stage of contractual negotiations, even when they do not lead to the conclusion of a contract, engender a relationship of trust between the parties similar to that arising from a contract, so that the parties are required to observe the customary standards of care."<sup>82</sup> Hence, if these standards of care are not met the violating party will have to compensate the damages of the relying party.

If a parent corporation is involved in negotiations between its subsidiary and a third party, the parent may be held liable on the basis of acting as the agent of the subsidiary, either if the parent has a strong business interest in the negotiated contract or if the third party puts its trust in the parent to a great extent. This interpretation is extremely different from the U. S. approach where the parent is held responsible as the principal while the subsidiary is regarded as the agent.

#### b. Konzernrecht

The core of the German parent liability from the subsidiary system lies on concern law ("*Konzernrecht*") supported by functional equivalents of contract law, tort law and bankruptcy law.<sup>83</sup> A literal translation of *konzernrecht* would be law of group of companies. The protection of minority shareholders, including their protection from existing factual or contractual influence or control of a major shareholder of the stock corporation is regulated by *konzernrecht*.<sup>84</sup>

*Konzernrecht* comes into play when the parent company directly or indirectly exerts a controlling influence.

80 German Civil Code, Revised ed. as amended to Jan. 1, 1992, 153, translated by Simon L. Goren (1994).

81 BGHZ, 1979 NJW 2104, 2105 (1978).

82 Schiessl, *supra* note 75, at 494.

83 *Id.*

84 *See supra* note 76.

The basic requirement for the application of the law of affiliated enterprises is that the parent is an "enterprise", i.e., it has entrepreneurial interests outside the subsidiary for which it might sacrifice the subsidiary's interest. This is seen as more dangerous to the corporation compared to the conduct of a majority shareholder interest which is the case in the parent-subsidiary context.

The German system differentiates the corporations within the limits of the German Stock Corporation Act<sup>85</sup> and the corporate groups which are outside the reach of this act. Compared to other industrialized economies, Germany has a relatively small number of stock corporations of which no more than quarter are listed on the stock exchange.<sup>86</sup>

#### ba. Liability under the German Stock Corporate Act

Statutory provisions regarding affiliated enterprises only exist in the AktG (Stock Corporation Act.)<sup>87</sup> The scope of this act covers solely the parent or the subsidiary if they are established in the form of an Aktiengesellschaft ("AG") (stock corporation) or in the form of a Kommanditgesellschaft auf Aktien ("KGaA") (an association limited by shares). However, there are also provisions in the Stock Corporation Act which apply to all companies regardless of their forms.<sup>88</sup> The Act divides corporate groups into integration concerns, contract concerns and de facto concerns.

In integration concerns where a parent holds between 95 to 100 percent of the stock of a subsidiary, the two companies can agree to integrate formally and when integration occurs the parent basically acquires unlimited power to direct its subsidiary. The corollary of this authority is the joint and several co-liability of the parent company for all existing and future creditor claims against the subsidiary.<sup>89</sup>

Contract concerns<sup>90</sup> are qualified (centralized) concerns formed specifically by domination agreements (beherrschungsvertrag) granting the parent the right to use broad directing powers *vis-a-vis* its subsidiary.<sup>91</sup> A qualified concern can also be described as a corporate group structure in which the parent, as a mere shareholder, exerts a long-standing and pervasive control pattern over the (daily) affairs of its subsidiary.<sup>92</sup> A qualified concern is lawful only if there is a domination agreement and the parent is liable to the creditors and the minority shareholders. A domination agreement submits the subsidiary's management to the absolute control of

85 Aktiengesetz (AktG).

86 *Germany: Can friendly takeovers really exist*, Euromoney Supplement, Jan. 26, 1991.

87 Schiessl, *supra* note 75, at 496.

88 AktG § 15-19.

89 AktG, s. 322.

90 *Vertragskonzern*, AktG, ss. 291-310.

91 Hofstetter, *supra* note 74, at 580.

92 See Schiessl, *supra* note 75, at 505 (the definition of the qualified concern is still relatively open and awaits more detailed delineations by the courts).

the parent and as long as the management of the subsidiary follows the instructions of the parent no matter how destructive they may be to the subsidiary, itself, the management can not be held liable for damages resulting from their actions or from an alleged violation of their fiduciary duties.<sup>93</sup> Practically the parent can practice use this power to the detriment of the subsidiary; since the subsidiary is left without discretion whatsoever. However, the parent would refrain from acting to the detriment of the subsidiary since the parent is obliged to compensate the subsidiary for all (annual) deficits occurring during the contract period.<sup>94</sup> This is not the only protection of the creditors under a domination agreement. In the event of the termination of the domination agreement, the controlling company must provide security to the creditors of the controlled company for claims brought prior to the publication of the entry of the termination in the trade register with the condition that the creditor has notified the controlling company within a period of six months.<sup>95</sup>

Despite the absence of a domination agreement between the parent and the subsidiary if the parent exercises influence over the subsidiary's management this is when a *de facto* Konzern is established. "*De facto* Konzern"<sup>96</sup> is also described in German law as the situation where dependence is taken advantage of by the parent through uniform control,<sup>97</sup> i.e. interference in the subsidiary's management. As long as the parent compensates the subsidiary in the end of each business year, the subsidiary is not entitled to any claim. If the parent does not compensate the subsidiary thereafter the subsidiary earns a claim for consequential damages and also creditors can enforce this claim by way of instituting derivative actions.<sup>98</sup> The *de facto* concern could not be used effectively in Germany. In fact, successful actions for damages under these provisions are apparently unknown.<sup>99</sup> Courts require a specific allegation of disadvantage caused by a transaction<sup>100</sup> and the proof of detrimental interference on a transaction by transaction basis. This is very difficult to establish where the businesses of the parent and subsidiary corporations have been highly interconnected.<sup>101</sup>

#### bb. Liability under the Corporate Group Law Outside the Reach of the Stock Corporation Act

The German Stock Corporation Act does not cover subsidiaries in the form of partnership or close corporations (GmbH)<sup>102</sup> which are quite

93 AktG, s. 308 (1), s. 310 (3).

94 AktG, s. 302.

95 AktG, s. 303 (1), See also Schiessl, *supra* note 75, at 498.

96 *De facto Konzern*, AktG, ss. 311.318.

97 *Einheitliche Leitung*, AktG, s. 18.

98 AktG, s. 317 (1), s. 317 (4).

99 Schiessl, *supra* note 75, at 501.

100 *Id.*

101 Emmerich/Sonnenchein, *Konzernrecht* 355 (1989).

102 *Gesellschaft mit beschränkter Haftung*.

common in Germany. There isn't any codification of concern law on these aspects. Therefore, the German courts stepped in and developed an approach similar to the Stock Corporation Act for these cases.<sup>103</sup>

In the *Autokran*<sup>104</sup> case and in the *Tiefbau*<sup>105</sup> case confirming the rationale of the *Autokran*<sup>106</sup> case, the German Federal Court held that where a parent company was "permanently and extensively" involved in the management of a now bankrupt subsidiary, a rebuttable presumption exists that the parent did not show sufficient consideration for the subsidiary's best interests. The court in *Autokran* stated that if the controlling company is "permanently and extensively involved in the management" and is the sole shareholder of the subsidiary, this control is enough to hold the company as a qualified de facto konzern.<sup>107</sup> Unless the parent is able to defend itself successfully, it is directly liable to the subsidiary's creditors for the subsidiary's obligations. The parent would be successful if it can show that the director of an independent company who abides by its fiduciary duty would not have run the business in a different way. In other words, insofar as the parent company is able to prove that the losses of the subsidiary are not caused by the konzern relationship but by an external factor, such as a nationwide crisis, the parent company will not be held liable by the court.<sup>108</sup>

To summarize, the German Court used two tactics to get around the problems regarding enforcement difficulties:

1. It shifted the burden of proof to the parent.
2. It granted a direct claim to the subsidiary's creditors against the parent and at the same time it restricted the parents defense to situations in which the subsidiary's "losses were caused by circumstances outside the parent's managerial control."<sup>109</sup>

On 23 September 1991, the German court rendered the "Video" judgment (BGHZ 115, 187) which was interpreted as making the sole or majority shareholder of the GmbH personally liable if he is also its managing director and, in addition to this, runs another, non-corporate business of his own and/or participaties in other companies. This decision was criticized as going too far in depriving a GmbH from the principal of limited liability whereby a company is liable to its creditors only to the extent of its assets.

The German court's one of the most recent decisions, of 29 March 1993

103 Emmerich/Sonnenchein, *supra* note 100, at 359-396 and Emmerich, *Der Heutige Stand Der Lehre Vom GmbH Konzernrecht, Die Aktiengesellschaft* 1-7 (1987).

104 95 BGHZ 330 (1985).

105 BGH ZIP 1989, 440z; NJW 1800 (1989).

106 Defendant, being the only member and the chief executive, of the seven close corporations he incorporated carried on intertwined activities. The subsidiaries were unable to achieve financial independence by creating equities. This was a qualified de facto konzern situation.

107 Schiessl, *supra* note 75, at 505.

108 *Id.*

109 Hofstetter, *supra* note 74.

is said to be a restrictive interpretation of its "Video" judgment. In this judgment the Bundesgerichtshof, following the doctrine of "qualified GmbH-group", treated the controlling shareholder of the GmbH as the dominant enterprise, in a group of companies under the statute regulating the external and internal relations of groups of companies.<sup>110</sup> The German court limited the personal liability of such a controlling shareholder to situations when, in the pursuit of this other business interests, he has failed to take proper care of the interests of the company he controls and, in particular, if he has failed to ensure that it can pay its debts.<sup>111</sup> Although in the "Video" judgment the burden of proof was on the controlling shareholder to show that the losses were not caused by his acts, the German court shifted the burden of proof to the creditors in this recent decision. Controlling shareholders are required to supply all the essential information to the creditors, but the creditors are obliged to prove that the controlling shareholder caused the loss and insolvency by causing the company disadvantage in favor of his other businesses.

### C. The European Community Approach to Piercing the Corporate Veil

#### 1. The Parent-Subsidiary Context

European Community law by its ninth directive<sup>112</sup> attempted to legislate about parent company liability. The ninth directive being widely influenced by German and French law adopts the notion of a *de facto* director from the latter while it goes further than the German Corporate Stock Act when it establishes direct (presumptive) parent liability to subsidiary creditors without requiring the need of a compensation scheme. The *de facto* director notion<sup>113</sup> of the European countries treat managing partners as if they were formal directors of the subsidiary.

The proposed ninth directive contains measures that would sweep away the long-accepted business and international legal practice of limiting a company's liability to its equity value and instead subject board members of a non-EC parent company to unlimited personal liability damages if they make a decision harmful to the interests of an EC subsidiary.<sup>114</sup> This attempt of the European Community faced strong opposition by U.S. interests<sup>115</sup>, the Union of Community Industries,

110 *BGH Eases Unlimited Liability Rules*, The Financial Times Limited Business Law Brief, Apr. 1993.

111 *Id.*

112 Text of proposal in (1985) ZGR 446-465.

113 The *de facto* director notion also exists in Swiss Corporation Law and European Community's ninth directive.

114 *Proposed EC Directive Limits Power of Foreign Firms over EC Subsidiaries*, 18, No: 15 The Bureau of National Affairs, Inc., International Trade Reporter, Jan. 18, 1983, at 599.

115 *Id.* cited as "If this thing comes out of the EC Council without some important changes," an American diplomat said, "we'll have a fire storm," ... the Ameri-

representing West European industry and the British Banking Association. The EC wanted to make use of the ninth directive to protect the shareholders, creditors, and employees of subsidiaries operating in the EC. If accepted, the ninth directive would mandate EC members to shape their national law at least according to the norms stated in the directive, though countries would have the option to set higher standards if they want to act so. It seems unlikely that this directive will be legislated.<sup>116</sup>

## 2. Tort Liability

In the Belgian case of *SA Pasquay v. Cosmair Incorporated and SA L'oreal*, decided in 1988, the *tribunal de commerce* (commercial court) held that the parent company L'oreal was jointly responsible with its subsidiary Cosmair. The action comprised of request for damages from the subsidiary resulting from breach of contract and action for tort against both the subsidiary as the first defendant and the parent as the second defendant. Here, I will only try to focus on the court's rationale with regard to second defendant L'oreal's liability resulting from tort. The facts can be summarized as follows: SA Pasquay entered into negotiations to become the exclusive distributor of Warner. The negotiations were advancing very well and in fact they were in the stage of completion "...when, on 17 January 1984, Warner informed the plaintiff that it had been undertaken by Cosmair Inc, which held the Lancome and L'oreal licence for the United States, it stated that it would act as Cosmair's independent subsidiary and did not envisage any change in its relationship with the plaintiff in the near future. The relationship continued normally in the manner described above until the time when Warner notified the plaintiff, by letter of 23 April, of its decision to terminate 'negotiations... concerning signature of the agreement,' without stating a reason."<sup>117</sup>

The plaintiff alleges that the reason why Cosmair ended the negotiations for an exclusive distributorship agreement was L'oreal's directives of tortious nature. The plaintiff bases its allegation on two arguments. Firstly, that there was an agreement formed under "third party complicity" and alternatively that the second defendant was liable due to culpa in contrahendo. The court rejects the first argument because plaintiff could not establish the existence of an agreement. The only remaining issue is whether L'oreal is liable for its conduct by which it decided that Cosmair would end the negotiations of the distributorship agreement with SA Pasquay. In fact, defendant does not deny that it instructed Cosmair to end the advanced negotiations of the distributorship agreement with SA Pasquay. In fact, defendant does not deny that it instructed Cosmair to end the advanced negotiations with plaintiff but it states that since it did not

---

can Chamber of Commerce in Belgium, representing U.S. business interests, has expressed its concern in a series of highly secret meetings with EC officials, including the commissioner responsible for the measure,..."

<sup>116</sup> Hofstetter, *supra* note 74, at 587-591.

<sup>117</sup> *SA Pasquay v. Cosmair Incorporated and SA L'oreal*, (1989) ECC 508, (Belgium).

take part in the negotiations directly it could not be held liable for that.

The Commercial Court found that the termination of the negotiations did not take place as described by defendant. There was a letter written by Warner/Cosmair to the plaintiff on 10 April, 1984 indicating that the General Director of Perfumes and Beauty of L'oreal's, namely Mr. Claude Galinier-Warrain, was responsible to give the decision of the distribution of Warner products in the Belgian and Luxembourg markets. In this same letter, Mr. Claude Galinier -Warrain had also expressed his interest for meeting the plaintiff and discussing the future of the Warner market. Although this letter and the termination letter which was sent 13 days later was brought to the attention of Mr. Claude Galinier-Warrain, he did not contact the plaintiff by any means. "Taken together, these facts show that it was the second defendant who took the initiative in breaking off the negotiations. Therefore there was common guilt on its and the first defendant's part in contributing knowingly to cause injury to the plaintiff and the second defendant is liable for such fault."<sup>118</sup>

The court also explains that the right of group of companies is unknown in Belgium but in specific areas such as accounting legislation and tax law the subsidiary can be controlled by placing it within the context of a "holding" company. Also, in European competition law the behavior of subsidiary companies whose policy is dictated by a parent company may be attributed to the parent and justifies fines imposed on it to sanction the subsidiary's behavior.<sup>119</sup> "As the common and tortious liability on the defendants' part has been the cause of injury, they are jointly and severally liable to make amends to the party suffering the injury."<sup>120</sup>

### III. CONCLUSIONS

In general terms it is quite clear that the US approach to piercing the corporate veil differs greatly from the other approaches explained above. However, the fascinating observation in this aspect is that despite the enormously different legal rules and doctrines applied in France, Argentina, Germany and the EC the results achieved in the end are more or less similar to the U.S.

A brief overview of the major differences in these systems can be summarized as follows:

In France and Argentina there are three different nuances of fraud and the remedies connected to each one vary. These nuances do not exist in the U.S. and the remedy is always the same if liability incurs. Agency rules are completely vice versa in these countries. In the U.S. the parent is held liable as the principal while in France and Argentina liability is imposed on the parent as the agent. Argentina has used the doctrine of economic unity by

<sup>118</sup> *Id.*

<sup>119</sup> *cf* as cited in *supra* note 117, h van ryn and p van ommeslaghe, "examen de jurisprudence-les societes commerciales", (19810 rcjb 261 and 262 no. 27).

<sup>120</sup> *Supra* note 117.

which the insolvency proceedings can be extended from one company to another person or company. France has also made use of its elaborate bankruptcy laws in granting relief to plaintiffs. Moreover France's labor law, which ties a direct presumption of liability to the parent, is noteworthy. But France's real innovation is the notion of the "de factor director" which is a part of its detailed bankruptcy laws, which have proven to be very useful.

The general trend in Germany has been to be reluctant on piercing the veil of corporations but instead to use other means to hold the shareholders liable for the obligations of the parent. Germany holds the shareholders directly liable in special circumstances arising from tort and also uses the *culpa in contrahendo* doctrine. However, *konzernrecht* is the drastic difference between the U.S. and German system. In U.S. the affiliated enterprise doctrine is viewed as a subcategory of the piercing the corporate veil doctrine<sup>121</sup> and the rules applied to parent-subsidary companies and to affiliated enterprises are the same. In comparison, piercing the corporate veil rules can be applied to the parent-subsidary companies but the rules related to affiliated enterprises (*konzernrecht*) are totally different in Germany. Under the Konzern doctrine, focusing particularly on affiliated enterprises, a parent company may be held liable for its subsidiary's losses and obligations if the parent company is shown to have exercised a certain degree of control over the subsidiary.<sup>122</sup>

The EC did not legislate the issue yet but the ninth directive, which is on the agenda of the EC, offers a combination of the European approaches to piercing the veil cases. As explained above, it has selected the "de facto" director notion from France and it has adopted the tactic of the German Federal court by assuming direct liability of the parent against the creditors of its subsidiary. In European systems as a whole limited liability of subsidiary corporations is not pierced *per se*. Proof of violation of duties to the subsidiary or chance to the parent to defend itself is given first.<sup>123</sup>

Which system is more apt to solve the problems related to piercing the corporate veil, by rendering justice more effectively, is a hard question to answer and it is not the topic of this Article. The success and the failures of the different perspectives have to be taken into careful consideration and the new trends have to be developed accordingly. The legal arena desperately needs help to accomplish this difficult task. In the final analysis, the aim of every legal system is the same: To achieve the delicate balance between the scales of justice.

---

121 *Id.* 482.

122 Schiessl, *supra* note 75, at 506.

123 Hofstetter, *supra* note 74.