

Dance of the Corporate Veils: Shareholder Liability in the United States of America and in the Republic of Turkey

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The foundation of corporate law is the existence of a legal entity separate from its shareholders, thus shielding shareholders from liability for corporate obligations. Courts have rarely, and with trepidation, pierced through this corporate veil to impose liability on shareholders for corporate malfeasance. These instances have become more common in recent decades, suggesting that corporate investors and parent corporations acquiring subsidiaries need to be diligent to minimize their risk. In this article two academicians discuss the consequences of wrongdoing and mismanagement underlying the pros and cons of the systems adapted by both countries.

SHAREHOLDER LIABILITY IN THE UNITED STATES OF AMERICA

I. THE LIMITED LIABILITY OF SHAREHOLDERS

Many entrepreneurs incorporate their businesses primarily to limit their liability.¹ One court has acknowledged, “[t]he fundamental concept of a corporation is that it is a separate entity created under the law to enable a group of persons to limit their liability in a joint venture to the extent of their contributions to the capital stock.”² A federal court has referred to this principle of limited liability as “a pillar of corporate law.”³ The limited liability of shareholders is critical to encourage investment in corporations.⁴ There are exceptions to this limited liability, however, where the court will

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¹ See *Talaria Waste Management, Inc. v. Laidlaw Waste Systems, Inc.*, 827 F. Supp. 843, 847 (D. Mass. 1993).

² *Beale v. Kappa Alpha Order*, 192 Va. 382, 395, 64 S.E.2d 789, 796 (1951); see also *Higgins v. Smith*, 308 U.S. 473 (1940).

³ *United Electrical, Radio and Machine Workers of America v. 163 Pleasant Street Corporation*, 960 F.2d 1080, 1091 (1st Cir. 1992).

⁴ See *Cheatle v. Rudd's Swimming Pool Supply Co., Inc.*, 234 Va. 207, 360 S.E.2d 828 (1987).

pierce the corporate veil to find a shareholder liable.⁵ While the risk of personal liability is low for the average investor who buys a block of stock, the investor who is involved in the management and runs the company as his own should be aware of this risk. When the shareholder is a parent corporation, responsibility for the obligations of a subsidiary is similarly problematic. The possibility of acquiring unforeseen liability when subsidiaries are acquired has the potential to disrupt a significant sector of the U.S. and global economy and increase the costs of doing business, particularly in today's climate of intensified mergers and acquisitions activity.⁶

II. FEDERAL OR STATE LAWS

The liability of shareholders, like other corporate issues, is determined by state laws. In diversity cases, federal courts generally apply the laws of the relevant state.⁷ When a United States federal court has jurisdiction because a federal statute is involved, but the statute does not specify whether state corporate law is preempted, the courts have been inconsistent in their decision of whether to create a federal common law of veil piercing, or to apply the law of a particular state. Several courts have held that federal common law should decide whether the corporate veil should be pierced to find a parent corporation liable.⁸ The federal vs. state law determination impacts shareholders because it is more likely that a court will impose liability on a shareholder when federal rather than state laws control, as the following cases will illustrate. The factors that have been used by lower federal courts to determine whether to pierce a corporate veil under federal common law are:

“(1) inadequate capitalization in light of the purposes for which the corporation was organized; (2) extensive or pervasive control by the shareholder or shareholders; (3) intermingling of the corporation's properties or accounts with those of its owner; (4) failure to observe corporate formalities and separateness; (5) siphoning of funds from the corporation; (6) absence of corporate records; and (7) nonfunctioning officers and directors.”⁹

⁵ See *id.* For an excellent discussion on this topic, see Robert R. Berluti and Julie E. Bruce, A Massachusetts Guide to Preserving and Piercing the Corporate Veil, 78 Mass. Law Rev. 2, No. 1, March 1993.

⁶ The courts of the United States are not alone in their ability to impose liability on shareholders for corporate acts; China has recently enacted a veil piercing statute. See Mark Wu, “Piercing China's Corporate Veil: Open Questions from the New Company Law”, 117 Yale L.J. 329 (2007).

⁷ *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 684 (4th Cir. 1976.) For a discussion of when state law is applied, compared to when federal courts use federal common law, see *United States v. Bestfoods*, 524 U.S. 51, 63 n. 9 (1998).

⁸ *Town of Oyster Bay v. Occidental Chemical Corp.*, 987 F. Supp. 182, 199 (E.D.N.Y. 1997); *United States v. Nicolet, Inc.*, 712 F. Supp. 1193, 1201-1203 (E.D. Pa. 1989); *Idylwoods Assocs.*, 915 F. Supp. At 1305; *City of New York v. Exxon Corp.*, 112 B.R. 540, 552-553 (S.D.N.Y. 1990), *aff'd* in part 932 F.2d 1020 (2d Cir. 1991).

⁹ *Town of Oyster Bay*, 987 F. Supp at 203; quoting *In re Acushnet River and New Bedford Harbor Proceedings*, 675 F. Supp. 22, 33 (D. Mass. 1987).

In 1998, the U.S. Supreme Court attempted to limit federal common law in *United States v. Bestfoods*, stating that state corporation law should not be replaced by federal common law “simply because a plaintiff’s cause of action is based upon a federal statute.”¹⁰ The federal statute at issue was the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (“CERCLA”).¹¹ The issue was the derivative liability of a parent corporation for CERCLA response costs, because of the parent’s control of its subsidiary.¹² While the *Bestfoods* Court did not decide whether federal or state law would govern, the Court condemned federal courts using statutory gaps as an excuse to reject state corporate law principles.¹³

The Sixth Circuit acknowledged that application of federal law would be more likely to result in shareholder liability in *Carter-Jones Lumber Company v. LTV Steel Co.*¹⁴ Finding that the result would have been the same under federal common law as under Ohio law when applied to the facts at hand, the court applied Ohio law.¹⁵

The federal courts have applied a slightly different test to impose liability on shareholders in cases involving employee retirement plans.¹⁶ The court considers (1) whether the shareholder defendant respected the separate corporate entity; (2) the fraudulent intent of the defendant; and (3) the degree of injustice that would result if the veil were not pierced.¹⁷ Fraudulent intent is the threshold issue.¹⁸ The level of fraud required to pierce the corporate veil is less than the fraud needed for criminal or even civil fraud.¹⁹ In *Crane v. Green & Freedman Baking Co.*,²⁰ the court found that a reasonable jury could have concluded that two individuals, who were officers, directors, and shareholders of the corporation, were personally liable for the corporation’s failure to make the required contributions to the ERISA plan.²¹ The court was concerned that the shareholders caused the corporation to make payments to the shareholders and their relatives for “no apparent business justification,”²² at a time when the corporation was nearly insolvent. The shareholders used corporate funds to pay for personal vacations, at the same time making undocumented loans to the corporation.²³ A further justification for piercing

¹⁰ *United States v. Bestfoods*, 524 U.S. 51, 63 (1998).

¹¹ 42 U.S.C.A. § 9601 et seq.

¹² *Id.* at 64.

¹³ *Id.*

¹⁴ *Carter-Jones Lumber Co. v. LTV Steel Co.*, 237 F.3d 745, 747 (6th Cir. 2001).

¹⁵ *Id.*

¹⁶ *Crane v. Green & Freedman Baking Company, Inc.*, 134 F.3d 17, 22 (1st Cir. 1998).

¹⁷ *Id.* at 22, (citing *United Electric, Radio and Machine Workers v. 163 Pleasant Street Corp.*, 960 F.2d 1080, 1093 (1st Cir. 1992)).

¹⁸ *Crane*, 134 F.3d at 22.

¹⁹ *Id.* at 22.

²⁰ *Id.* at 22.

²¹ *Id.* at 23.

²² *Id.* at 24.

²³ 134 F.3d at 22.

the veil was falsified records of directors' meetings, which the shareholders admitted were altered to indicate the presence of the shareholder's wives, who were directors, but did not attend the meetings.²⁴

Although the federal common law rule for veil piercing is similar to the laws in many states, more specific state rules will be examined below.

III. FACTORS CONSIDERED TO IMPOSE LIABILITY ON SHAREHOLDERS

When state law applies in a veil piercing controversy, the standards of the various states have been substantially similar and all are hesitant to impose liability on shareholders. Massachusetts courts consistently state that shareholders will be held liable for corporate obligations only in "rare particular situations in order to prevent gross inequity."²⁵ Virginia courts agree, piercing the corporate veil only under extraordinary circumstances, when necessary to promote justice.²⁶ California courts similarly hold that even if unity of interest and ownership is proven, the corporate veil will be pierced only if "injustice would result from the recognition of separate corporate entities," and the inability to collect a debt or enforce a judgment does not satisfy the standard.²⁷ Delaware courts have noted that "[p]ersuading a Delaware court to disregard the corporate entity is a difficult task."²⁸ Delaware courts agree that a shareholder will be liable for the actions of the corporation only if the corporation is a sham and was created for fraudulent purposes.²⁹ It is worth noting, however, that many scholars agree that "[t]here is a consensus that the whole area of limited liability, and conversely of piercing the corporate veil, is among the most confusing in corporate law."³⁰

The First Circuit Court in the case of *Pepsi-Cola Metro. Bottling Co. v. Checkers, Inc.*, stated the Massachusetts twelve factor test to determine whether the corporate veil should be pierced, as follows:

1. insufficient capitalization
2. nonobservance of corporate formalities
3. nonpayment of dividends
4. insolvency of the corporation at the time of litigation

²⁴ *Id.*

²⁵ *My Bread Baking Co. v. Cumberland Farms, Inc.*, 353 Mass. 614, 620, 233 N.E.2d 748 (1968); *see also*, *Omni-Wave Electronics Corporation v. Marshall Industries*, 127 F.R.D. 644, 646 (D. Mass. 1989).

²⁶ *Dana v. 313 Freemason, A Condominium Association, Inc.*, 266 Va. 491, 500 (2003).

²⁷ *Virtualmagic Asia, Inc. v. Fil-Cartoons, Inc.*, 99 Cal. App. 4th 228, 245 (2002).

²⁸ *Wallace v. Wood*, 752 A.2d 1175, 1183 (Del. Ch. 1999).

²⁹ *Id.* at 1184.

³⁰ Frank H. Estabrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89, 89 (1985).

5. siphoning of corporate funds
6. nonfunctioning of corporate officers and directors
7. absence of corporate records
8. use of corporation for transactions of the dominant shareholder
9. fraud or injustice
10. confused intermingling of business activity
11. common ownership
12. pervasive control.³¹

West Virginia courts add the following factors:

13. use of the same office or business location by the corporation and its individual shareholders
14. employment of the same employees or attorney by the corporation and its shareholders
15. the formation and use of the corporation to assume the existing liabilities of another person or entity.³²

The above factors are weighed,³³ but no single factor is determinative,³⁴ with most courts requiring some evidence of misrepresentation or confusion of identity, proving the plaintiff was uncertain about whom they dealt with.³⁵ Some courts will refer to the “alter ego” doctrine, with a focus on the pervasive control of the corporation by the shareholder.³⁶

The factors used by the Virginia courts are not as clearly enumerated as in other jurisdictions, but most Virginia courts agree that the following issues are relevant:

1. The corporation was the alter ego, stooge, or dummy of the shareholder, which is determined by:
 - a. the shareholder commingled corporate and personal assets; or
 - b. the shareholder siphoned corporate assets; or
 - c. corporate formalities were not followed; and

³¹ Pepsi-Cola Metro. Bottling Co., Inc. v. Checkers, Inc., 754 F.2d 10, 16 (1st Cir. 1985); My Bread Baking Co., 353 Mass. at 620.

³² Laya v. Erin Homes, Inc., 352 S.E.2d 93 (W. Va. 1986).

³³ The George Hyman Construction Company v. Gateman, 16 F. Supp. 2d 129, 158 (1998).

³⁴ Virtualmagic, 99 Cal. App. 4th at 245.

³⁵ Evans v. Multicon Construction Corp., 30 Mass. App. Ct. 728, 736, 574 N.E.2d 395, 400 (1991).

³⁶ See, e.g., Crestmar Owners Association v. Stapakis, 157 Cal. App. 4th 1223 (2007)(piercing the corporate veil to find an individual shareholder liable).

2. the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime.³⁷

Virginia courts, and many other jurisdictions, also consider deliberate undercapitalization, where the corporation was unable to pay its costs of doing business from its inception.³⁸

Georgia courts, similar to Virginia courts, avoid a long list of factors, instead piercing the corporate veil only if there is “abuse of the corporate form”, evidenced by commingling or confusing the properties, records, or control of the two entities.”³⁹

The majority of jurisdictions do not require proof of fraud to pierce the corporate veil.⁴⁰ The D.C. Circuit Court of Appeals is in the minority of courts that still requires evidence of fraud, although the fraud need not be directly related to the plaintiff’s claim.⁴¹ Delaware courts require fraud, but consider undercapitalization and lack of corporate formalities to be elements of fraud.⁴² Although fraud is one of the more common reasons for piercing the corporate veil, inadequate capital is often used as the reason for shareholder liability.⁴³ Some courts require evidence of misrepresentation or confusion of identity, proving the plaintiff was uncertain about which person or entity they dealt with.⁴⁴ Other courts impose liability on officers or directors who participate in the tortious conduct, whether fraud or otherwise.⁴⁵

A. Liability of a Parent Corporation for the Obligations of its Subsidiary: Dominion and Control

Parent, or holding, corporations and their subsidiaries are regarded as separate entities, so that a parent corporation is not usually liable for the torts

³⁷ *Cheatle*, 234 Va. at 212, 360 S.E.2d at 831.

³⁸ *Dana*, 266 Va. at 501; *DeWitt Truck Brothers, Inc., v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 685 (4th Cir. 1976); *See also* Mark W. Kelley, “Piercing the Corporate Veil: Collecting Judgments When the Corporation is Defunct,” 2000 ATLA CLE 1659 (2000).

³⁹ *Pazur v. Belcher*, --S.E.2d ---, 2008 WL 747797 at *4 (Ga. App. 2008).

⁴⁰ *DeWitt Truck Brothers, Inc.*, 540 F.2d at 684 and cases cited therein.

⁴¹ *Jackson v. Loews Washington Cinemas, Inc.*, ---A.2d---, 2008 WL 793617 (D.C. Cir. 2008) (“The fraud, however, need not directly taint the obligation on which the plaintiff is suing”).

⁴² *Petrich v. MCY Music World Inc.*, 371 Ill App. 3d 332, 334, 862 N.E. 2d 1171 (Ill. App. I Dist. 2007).

⁴³ *See, e.g.*, *Anderson v. Abbott*, 321 U.S. 349 (1944).

⁴⁴ *Evans v. Multicon Construction Corp.*, 30 Mass. App. Ct. 728, 736, 574 N.E.2d 395, 400 (1991).

⁴⁵ *Itofka, Inc. v. Hellhake*, 8 F.3d 1202 (7th Cir. 1993). A Virginia court used this reasoning in *N.S. Gumenick v. Ferebee*, 192 Va. 174, 63 S.E.2d 767 (1951).

or liabilities of the subsidiary.⁴⁶ Liability may be imposed on the parent corporation, as a shareholder, if the parent pervasively controls the subsidiary, so that the subsidiary is an agent or instrumentality of the parent, or if the corporations are engaged in a joint venture.⁴⁷

A Massachusetts court held a corporate defendant responsible for the actions of other corporations with a common shareholder, although the corporate defendant was not a shareholder in any of the related corporations.⁴⁸ The court based its decision on agency and causation principals, because a manager of the corporate defendant had instructed each of the other corporations to wrongfully retain the plaintiff's property.⁴⁹

Also relying on agency principles, the U. S. District Court in *Devlin v. WSI Corporation*⁵⁰ decided an employee who was wrongfully terminated based on age discrimination was allowed to sue both the corporation that employed him, and its parent corporation. Because the plaintiff's immediate supervisor, and the two people to whom that supervisor reported, were employees of the parent corporation, the court deemed the subsidiary to be the agent of the parent corporation, and therefore any claim against the subsidiary could also be asserted against the parent corporation.⁵¹

A Bankruptcy court relied less on agency theories and more on the misleading of the plaintiff when it pierced the corporate veil in *In re Plantation Realty Trust*.⁵² A member of a golf course, who was owed a refund of membership dues, was permitted to file a proof of claim against the bankrupt owner of the real estate on which the golf course was located.⁵³ The member's contract was with a subsidiary of the bankrupt corporation.⁵⁴ The court noted the common ownership and pervasive control by one individual and the lack of corporate formalities.⁵⁵ Although there was no commingling or under-capitalization, the representations made to the plaintiff were "confusing, and perhaps misleading."⁵⁶ Also, the individual who represented the golf course to the plaintiff failed to clearly indicate in which capacity he was acting.⁵⁷ The bankrupt corporation owned all real estate on which the

⁴⁶ *Dorn v. Astra USA, Inc.*, 1997 WL 25891 at *2, 74 Fair Empl. Prac. Case. 689 (D. Mass. 1997).

⁴⁷ *Id.*; *Gurry v. Cumberland Farms*, 406 Mass. 615, 550 N.E.2d 127 (1990); see also *Wallace v. Wood*, 752 A.2d 1175, 1184 (Del. Ch. 1999) (refusing to pierce the veil of a subsidiary without sufficient facts to indicate that the parent corporation's complete dominion and control of the subsidiary.).

⁴⁸ *My Bread Baking Co.*, 353 Mass. at 616.

⁴⁹ *Id.*

⁵⁰ *Devlin v. WSI Corporation*, 833 F. Supp. 69 (D. Mass. 1993).

⁵¹ *Id.* at 74.

⁵² *In re Plantation Realty Trust*, 232 B.R. 279 (D. Mass. Bankr. 1999)

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Plantation Realty Trust*, 232 B.R. at 283.

⁵⁶ *Id.* at 283.

⁵⁷ *Id.*

golf course was located.⁵⁸ The plaintiff's membership agreement misleadingly stated that his membership fees would be secured by a mortgage on real estate owned by the golf course operator.⁵⁹ This deceit persuaded the court to pierce the veil of the corporate operator to place liability with the real estate owner.⁶⁰

The Fourth Circuit imposed liability on a parent corporation that created a wholly owned subsidiary to operate a West Virginia steelmaking facility.⁶¹ The parent's control of the subsidiary was dominant, with the parent required to approve all proposals and expenditures of the subsidiary.⁶² When the subsidiary was liquidated in bankruptcy, the parent sold its assets and retained the nine million dollars in proceeds.⁶³ The court found this sufficient unfairness to pierce the corporate veil, stating that the dominance alone may have been sufficient reason to pierce.⁶⁴

Absent evidence of fraud, a mere unity of ownership between a parent and wholly owned subsidiary was not sufficient for a D.C. Circuit Court to impose liability on the parent, where separate corporate records were maintained.⁶⁵

As the preceding cases indicate, scrupulous maintenance of separate corporate records is critical for a parent corporation to avoid liability for the actions of its wholly owned subsidiaries.

B. Liability of Individual Shareholders: Lack of Corporate Formalities

Although courts were reluctant in the past to find an individual personally liable for the contract or tort liability of a corporation, more recent decisions are contrary.⁶⁶ In 1985, the First Circuit found individuals liable for the contract obligations of the corporation in *Pepsi-Cola Metro Bottling Co. v. Checkers, Inc.*⁶⁷ A husband and wife were held personally liable for the obligations of several corporations in which they owned stock.⁶⁸ The husband owned all of the stock of one corporation, the wife all of the stock of a second

⁵⁸ *Id.*

⁵⁹ 232 B.R. at 284.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.* at 65.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Jackson v. Loew's Washington Cinemas Inc.*, --A.2d--, 2008 WL 793617 (D.C. Cir. 2008).

⁶⁶ See, generally, Wendy B. Davis, The failure of the federal courts to support Virginia's reluctance to pierce the corporate veil, 5 J. of Small and Emerging Bus. L. 203, 207 (2001) ("No recently published Virginia court decision pierced the veil of a Virginia corporation to find a corporate or individual shareholder liable for a corporate obligation."); but see *Dana v. 313 Freemason*, 266 Va. 491, 587 S.E.2d 548 (2003) (piercing the corporate veil to find an individual shareholder liable for corporate obligations.)

⁶⁷ *Pepsi-Cola Metro Bottling Co., Inc.* 754 F.2d at 10.

⁶⁸ 754 F.2d at 12-13.

corporation, and the wife and others owned shares in a third corporation.⁶⁹ Even though these individuals were not the sole shareholders, they were held liable for the actions of the three corporations, because the court reasoned “[w]here the principal shareholders of a close corporation fail to observe with care the corporation’s existence, a court will not later heed their requests to do so.”⁷⁰ The reasons for the court’s decision were (1) the use of corporate funds for personal expenses of the officers, (2) lack of a corporate telephone listing, (3) operation of the corporation out of the home of the officers, and (4) no records of shareholder meetings or major corporate transactions.⁷¹ The court found that the shareholders used the corporation for their personal transactions.⁷²

Following the *Pepsi* decision, the Federal District Court in *Talaria Waste Management, Inc. v. Laidlaw Waste Systems, Inc.*,⁷³ denied a motion for summary judgment brought by a shareholder, refusing to shield the shareholder from liability for a corporate debt.⁷⁴ Although the court could have reached this same conclusion on the grounds that the individual was also the promoter of the corporation and the contract with the plaintiff was entered into before the corporation’s existence, the court stated that “two separate grounds support this conclusion.”⁷⁵ The court found that the corporate form was a sham because the individual defendant was the sole shareholder and officer, and the corporation had filed no tax returns, maintained no corporate records, and paid no salary to the shareholder.⁷⁶ The shareholder also admitted that he used the corporate checking account to pay personal expenses.⁷⁷

More recently, Massachusetts courts have imposed personal liability for both contract and tort liability.⁷⁸

The lack of corporate formalities caused another Massachusetts Court to pierce the corporate veil of a construction company in *Strong v. Hegarty*.⁷⁹ The shareholder never used the full name of the corporation, Hegarty Constructon Co., Inc., in letterhead, advertisements, invoices, or when answering the telephone.⁸⁰ The shareholder always used the name Hegarty Construction, which the plaintiffs believed, and the jury agreed, was a trade

⁶⁹ *Id.*

⁷⁰ *Id.* at 16.

⁷¹ *Id.* at 14.

⁷² 754 F.2d at 16.

⁷³ *Talaria Waste Management, Inc. v. Laidlaw Waste Systems, Inc.*, 827 F. Supp. 843, 847 (D. Mass. 1993).

⁷⁴ *Id.*

⁷⁵ *Id.* at 845.

⁷⁶ *Id.*

⁷⁷ *Id.* at 847.

⁷⁸ *Dujon v. Williams*, No. Civ. A. 91-1278-B, 5 Mass. Law Rptr 456, 1996 WL 402344 (1996).

⁷⁹ *Strong v. Hegarty*, 1997 WL 317016, 6 Mass. Law Rptr. 703 (Mass. Super. Ct. June 5, 1997).

⁸⁰ *Id.* at *1

name used by the shareholder individually.⁸¹ The court's decision was also supported by the lack of shareholder or director meetings, lack of wages paid, and because the worker's compensation insurance was subscribed by the shareholder individually.⁸²

The Fourth Circuit found a sole shareholder liable for the debts of a corporation because there was a lack of corporate formalities and undercapitalization, in *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*⁸³ The *DeWitt* court noted that, although fraud was not required under South Carolina law, there must be some "element of injustice or fundamental unfairness."⁸⁴ Although fraud may not have been deemed a requirement, the facts of *DeWitt* indicate a clear example of fraud. The corporation acted as an agent for fruit growers.⁸⁵ The dominant shareholder told the fruit growers that he had paid the plaintiff the funds due for transportation, which were then deducted from the net proceeds delivered to the growers.⁸⁶ This statement was not true, because the amount owed for transportation was pocketed by the shareholder, and the plaintiff remained unpaid, hence this suit to collect transportation costs.⁸⁷ The corporation had never had a shareholder or directors' meeting, and there was conflicting testimony regarding the identity of its officers.⁸⁸ The corporation was insolvent and paid no dividends.⁸⁹ Although *DeWitt* is often cited for the proposition that fraud is not required, in fact fraud was evident in this case.

As the above cases indicate, strict adherence to corporate procedures, such as shareholder and director meetings, minutes of those meetings, separate bank accounts, and corporate letterhead, is critical to avoiding shareholder liability. At the end of this article are suggestions for corporate procedures to minimize the risk of shareholder liability.

C. Liability of Individual Shareholders: Dissolution of Corporation

When a corporation dissolves with some obligations outstanding, shareholders may be held responsible for paying those obligations, as the following cases illustrate. The shareholder's fraud and deceit convinced a Massachusetts Court to impose liability on a shareholder who was the president, clerk, and director of nine corporations, in *Dujon v. Williams*.⁹⁰

⁸¹ *Id.*

⁸² *Strong*, 1996 WL 376778 at *2.

⁸³ *Id.*

⁸⁴ 540 F.2d at 687.

⁸⁵ *Id.* at 688.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 687.

⁸⁹ *Id.*

⁹⁰ *Dujon*, 1996 WL 402344 at *2. Several unpublished decisions will be relied on in the article. According to the Eighth Circuit, in *Anastoff v. United States*, No. 99-3917 EM, 2000 WL 1182813 at *1 (August 22, 2000) (vacated on other grounds, 235 F.3d 1054 (8th Cir. 2000), unpublished decisions have the same precedential effect as published decisions.

The corporations operated taxi services, and a taxi owned by one of the corporations injured the plaintiff.⁹¹ The shareholder caused the dissolution of one corporation after the plaintiff filed her complaint, although the shareholder continued to draw funds from the “dissolved” corporation’s account.⁹² Other transfers of assets were made to newly formed corporations, the stock of which was owned by the shareholder’s wife, daughter, and a long-time employee.⁹³ The court held the shareholder liable even though the capitalization of the new corporation was sufficient, there were some corporate records, all corporations were solvent at the time of litigation, and corporate funds were not used to pay the personal expenses of the shareholders.⁹⁴ The court noted the non-observance of most corporate formalities and lack of significant records, siphoning of assets by the individual, and non-functioning of other officers.⁹⁵ The shareholder’s pervasive control of all the related corporations, and his actions in transferring assets to new entities to avoid paying the plaintiff, helped to persuade the court.⁹⁶ The court also noted the shareholder’s attempts to persuade the plaintiff that her only remedy was a small insurance policy.⁹⁷

An individual shareholder who dissolved the corporate debtor was found liable for a corporate debt in *Maury Kusinitz Insurance Agency, Inc. v. Medical Devices of Fall River, Inc.*⁹⁸ The shareholder owned, at relevant times, between 45 and 51% of the shares of a corporation that made medical instruments.⁹⁹ The corporation became insolvent and all assets were sold at auction to an acquaintance of the shareholder.¹⁰⁰ The shareholder continued to be involved in a medical instrument business operated at the same location with the same equipment, under a different name.¹⁰¹ Insurance premiums were owed to the plaintiff by the predecessor corporation, which the shareholder refused to pay.¹⁰² The court ordered the shareholder to pay the cost of the premiums to the plaintiff, because of his pervasive control of the corporation.¹⁰³ The court noted that other officers did not function in their intended roles, there was a lack of corporate formalities, and no dividends

⁹¹ *Dujon*, 1996 WL 402344 at *2.

⁹² *Id.* at *6.

⁹³ *Id.* at *8.

⁹⁴ *Id.* at *11.

⁹⁵ 1996 WL 402344 at *11.

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Maury Kusinitz Insurance Agency, Inc. v. Medical Devices of Fall River, Inc.*, No. Civ. A. C94-01422, 7 Mass. Law Rptr. 205, 1997 WL 426970 (July 23, 1997).

⁹⁹ *Id.* at *1.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ 1997 WL 426970 at *1.

had been paid.¹⁰⁴ The auction of assets to an acquaintance also supported a disregard of the corporate form.¹⁰⁵

In a similar case also involving a dissolved corporation, the court pierced the corporate veil to impose liability on the two individual shareholders in *Mount v. Baypark Development, Inc.*¹⁰⁶ The corporation constructed the plaintiff's home, with a two year warranty for a dry basement.¹⁰⁷ As soon as the plaintiff's closing occurred, the shareholders dissolved the corporation, closing the corporate account and distributing all assets to themselves.¹⁰⁸ This unjust action, combined with the lack of any corporate formalities such as dividends, meetings, or annual reports, convinced the court to pierce the veil.¹⁰⁹

To avoid personal liability, shareholders should make certain that proceeds of corporate assets of a dissolving corporation are used to pay corporate debts. Assets should be appraised or sold at public auction to avoid the appearance of impropriety.

D. Liability of Individual Shareholders: Inadequate Capitalization

A recent Virginia decision found individual shareholders liable for the actions of a close corporation, where the corporation was significantly undercapitalized and created for the sole purpose of avoiding liability.¹¹⁰ The corporation had no liquid assets and all revenue of the corporation was deposited in the personal checking account of the shareholder.¹¹¹ The shareholder was aware that the condominium units sold to the plaintiffs had significant structural defects, and the formation of the corporation was for the sole purpose of avoiding personal liability for such defects.¹¹² The court found that injustice could be avoided only by finding the shareholder personally liable.¹¹³ This is a departure from many earlier Virginia decisions that refused to pierce the corporate veil under even more compelling circumstances, and may indicate a trend. In a 1971 decision, the Virginia Supreme Court of Appeals refused to pierce the veil of an insolvent corporation, disregarding the presence of most of the factors commonly used as reasons to pierce, in *Garrett v. Ancarrow Marine, Inc.*¹¹⁴ A husband was the sole stockholder and president, his wife the secretary, of a boat building

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at *4.

¹⁰⁶ *Mount v. Baypark Development, Inc.*, No. 1083, 1998 WL 31524 (Mass. App. Div. Jan. 26, 1998).

¹⁰⁷ *Id.* at *2

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Dana v. 313 Freemason*, 266 Va. 491 (2003).

¹¹¹ *Id.* at 497.

¹¹² *Id.* at 499.

¹¹³ *Id.* at 501.

¹¹⁴ *Garrett v. Ancarrow Marine, Inc.*, 211 Va. 755, 180 S.E.2d 668 (1971).

corporation operated out of their home pursuant to an oral lease.¹¹⁵ The corporation was insolvent, but continued operations with substantial loans from the couple.¹¹⁶ The Plaintiff contractor agreed to build a launching ramp and slip for the corporation on a cost- plus basis.¹¹⁷ The corporation paid the contractor \$115,000, but failed to pay the remaining \$85,464 owed.¹¹⁸ Although the corporation was insolvent at the time of the contract, and the plaintiff was not informed of this fact, the court found the husband and wife's silence did not amount to fraud and denied any personal liability of the couple.¹¹⁹ The court did not analyze the factors traditionally used for piercing the veil, but refused to pierce based on the lack of any action to defraud.¹²⁰ Many other jurisdictions would impose liability on shareholders based on inadequate capitalization.¹²¹

In a recent California decision, a court found an individual shareholder liable for a corporate obligation where the individual dominated the company, paid corporate taxes from his personal account, and conveyed corporate assets to himself without compensating the corporation.¹²²

E. Liability of Individual Shareholders: Fraud

Applying Virginia law, the Fourth Circuit Court found fraud sufficient to impose liability on an individual shareholder in *National Carloading Corp. v. Astro Van Lines, Inc.*¹²³ The individual defendant had converted the only corporate asset for his personal use by encumbering the asset with a lien.¹²⁴ The court stated that "in holding [the individual shareholder] liable it is not necessary to disregard the corporate entity of Astro or Van Lines."¹²⁵ Van Lines' main asset was an I.C.C. motor common carrier certificate.¹²⁶ The shareholder transferred this certificate to Astro, for which Astro assumed the encumbrances, including a \$373,000 security interest for a bank loan, which loan was later paid by the shareholder.¹²⁷ The court found that Astro purchased the only asset of Van Lines while Van Lines was insolvent.¹²⁸ This was known to the sole shareholder of both corporations.¹²⁹ The court found this transfer to be fraudulent, because the effect of the transfer to Astro was

¹¹⁵ *Id.* at 756, 180 S.E.2d at 669.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *See, e.g.,* *Anderson v. Abbott*, 321 U.S. 349 (1944).

¹²² *Crestmar Owners Assoc. v. Stapakis*, 157 Cal. App. 4th 1223, 1232 (2007).

¹²³ *National Carloading Corp. v. Astro Van Lines, Inc.*, 593 F.2d 559 (4th Cir. 1979).

¹²⁴ *Id.*

¹²⁵ *Id.* at 562.

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

the inability of the creditors of Van lines to collect their debts.¹³⁰ This was a fraudulent conveyance according to Virginia Code s. 55-80.¹³¹ Even if the debt owed to the shareholder for paying off the bank loan was valid, the court would have deemed the transfer fraudulent.¹³² The court found that the shareholder had participated in the wrongdoing, and was therefore personally liable.¹³³

Commingling and misrepresentation were sufficient for the Fourth Circuit, applying Virginia law, to find a shareholder liable in *Cancun Adventure Tours, Inc. v. Underwater Designer Company*.¹³⁴ The court noted that its power to impose liability on a shareholder should be exercised with “extreme circumspection”, however, “the corporate veil is not sacrosanct.”¹³⁵ The plaintiff purchased an air compressor for filling scuba diving tanks from the defendant’s corporation.¹³⁶ The compressor continually overheated, but the defendant was unwilling or unable to fix the problem.¹³⁷ The individual shareholder regularly commingled corporate and personal assets.¹³⁸ The corporation operated out of the shareholder’s home, with the real estate inconsistently being listed as a personal or corporate asset on tax returns.¹³⁹ Although the plaintiff alleged fraudulent misrepresentations of the capabilities of the compressor, the court did not find fraud, instead basing the recovery on breach of warranty.¹⁴⁰ The court awarded punitive and compensatory damages against both the corporation and its sole shareholder.¹⁴¹

Even the Federal courts have been unable to pierce the corporate veil in cases where the plaintiff was unable to produce any evidence of fraud. The Bankruptcy Court for the Eastern District of Virginia did not pierce the corporate veil in a case where domination of the corporation was the only factor proven, in *In re Criswell*.¹⁴² There was no evidence of fraud, undercapitalization, or any factors other than dominance by the shareholder.¹⁴³

¹³⁰ *Id.* at 562.

¹³¹ *Id.*

¹³² *Id.* at 563.

¹³³ *Id.* at 564.

¹³⁴ *Cancun Adventure Tours, Inc. v. Underwater Designer Company*, 862 F.2d 1044 (4th Cir. 1988).

¹³⁵ *Id.* at 1047.

¹³⁶ *Id.* at 1045, 46.

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.* at 1048.

¹⁴⁰ *Id.* at 1049.

¹⁴¹ *Id.* at 1046.

¹⁴² *In re Criswell*, 52 B.R. 184 (E.D. Va. 1985).

¹⁴³ *Id.*

IV. NOTWITHSTANDING RECENT TRENDS, MANY COURTS STILL REFUSE TO IMPOSE LIABILITY ON SHAREHOLDERS FOR CORPORATE LIABILITIES

Although the trend is toward disregarding the corporate form, many courts remain hesitant to impose liability on shareholders.¹⁴⁴ In a recent First Circuit case, *In re Strangie*,¹⁴⁵ the court refused to pierce the veil, even though many factors weighed in favor of shareholder liability.¹⁴⁶ The court noted that the shareholder did not sign corporate checks and did not knowingly or directly participate in any diversion of funds.¹⁴⁷

Although a plaintiff presented evidence of confused intermingling of activity between a parent and subsidiary, the court refused to pierce the veil in *Omni-Wave Electronics Corporation v. Marshall Industries*.¹⁴⁸ The subsidiary was adequately capitalized to compensate the plaintiff, therefore no fraud or gross inequity would result from a failure to pierce the corporate veil.¹⁴⁹ Similarly, the court found no fraud or injustice sufficient to pierce the veil in *In re Computer Engineering Associates, Inc.*¹⁵⁰ Pervasive control was lacking, because one of the individual defendants only owned 55% of the stock, while the other was merely an officer, not a shareholder, and it appeared that officers were functioning.¹⁵¹ The court refused to find evidence of fraud, when the defendant corporation was merely seeking payment for services provided.¹⁵²

A lack of evidence of pervasive control, under-capitalization, or fraud, similar to the situation in *Computer Engineering*, lead the court to refuse to pierce the corporate veil in *United Electrical, Radio and Machine Workers of America v. 163 Pleasant Street Corporation*.¹⁵³

¹⁴⁴ See, e.g., . *The George Hyman Constr. Co. v. Gateman*, 16 F. Supp. 2d 129 (D. Mass. 1998); *Hiller Cranberry Products, Inc., v. Koplovsky*, 165 F.3d 1 (1st Cir. 1999); *Evans v. Multicon Constr. Corp.*, 30 Mass. App. Ct. 728, 574 N.E.2d 395 (1991); *Birbara v. Locke*, 99 F.3d 1233 (1st Cir. 1996).; *Dorn v. Astra USA, Inc.*, 1997 WL 25891 at *2, 74 Fair Empl. Prac. Case. 689 (D. Mass. 1997).

¹⁴⁵ *In re Strangie*, 192 F.3d 192 (1st Cir. 1999).

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 196; see *Pepsi-Cola Metro. Bottling Co., Inc. v. Checkers, Inc.*, 754 F.2d 10 (1st Cir. 1985).

¹⁴⁸ *Omni-Wave Electronics Corporation v. Marshall Industries*, 127 F.R.D. 644, 647 (D. Mass. 1989).

¹⁴⁹ *Id.*

¹⁵⁰ *In re Computer Engineering Associates, Inc.*, 2000 WL 1199928 at *18 (Bankr. D. Mass. 2000).

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *United Electrical, Radio and Machine Workers of America v. 163 Pleasant Street Corporation*, 960 F.2d 1080, 1903 (1st Cir. 1992).

A Virginia court in *Cheatle v. Rudd's Swimming Pool Supply Co., Inc.* also refused to pierce the corporate veil.¹⁵⁴ Rudd's Swimming Pool Supply Co., Inc. ("Supply") serviced swimming pools.¹⁵⁵ An employee of Supply purchased the right to use the Rudd name, and incorporated a new business as Rudd's Swimming Pool Management and Service Company, Inc. ("Management").¹⁵⁶ The purchase was paid for by promissory notes signed by Management payable to Supply.¹⁵⁷ Supply filed for bankruptcy protection.¹⁵⁸ Management transferred all its assets and liabilities to a new corporation, Regency.¹⁵⁹ Regency operated the same business as Management, with the same employees, location, and customers.¹⁶⁰ The plaintiff, a 50% shareholder in Supply, brought this action to recover the balance on the promissory notes from the individual shareholders as well as Regency, as the successor corporation.¹⁶¹ After Regency filed bankruptcy, the claim against Regency was abandoned.¹⁶² The court noted that "a corporation is a legal entity entirely separate and distinct from the shareholders or members who compose it. This immunity of stockholders is a basic provision of statutory and common law and supports a vital economic policy underlying the whole corporate concept."¹⁶³ The plaintiffs must prove that the corporation was the "alter ego, alias, stooge, or dummy" of the individual stockholders.¹⁶⁴ Even if the transfer of all assets was done with the intent to hinder, delay, or defraud the plaintiff, the court found this insufficient to pierce the veil of Regency.¹⁶⁵ The court noted that corporate formalities were followed, and there was a valid purpose for the reorganization: the need for a new image after the bankruptcy of Supply.¹⁶⁶ This negated any inference that Regency was the alter ego of the shareholders.¹⁶⁷ The court also found insufficient evidence of fraud, because there was no evidence that the individuals made a knowing misrepresentation to the plaintiff, and there was no evidence that the shareholders personally benefited from the transfer from Management to Regency.¹⁶⁸ The court downplayed the benefit the shareholder received when

¹⁵⁴ *Cheatle v. Rudd's Swimming Pool Supply Co., Inc.*, 234 Va. 207, 360 S.E.2d 828 (1987).

¹⁵⁵ *Id.* at 209, 360 S.E.2d at 829.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ 234 Va. at 210, 360 S.E.2d at 830.

¹⁶⁰ *Id.* at 211, 360 S.E.2d at 830.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.* at 212, 360 S.E.2d at 831.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 213, 360 S.E.2d at 831.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

the stock in Regency was not encumbered with the debt of Management, finding this benefit to be tenuous and indirect.¹⁶⁹

In one of the first Virginia cases to use language that reduced the level of fraud required to pierce, the court in *O'Hazza v. Executive Credit Corporation*, stated that a shareholder could be liable if he used the corporation to "evade a personal obligation."¹⁷⁰ Although this language appears to signal an increased willingness to impose liability on shareholders, the court again refused to pierce the corporate veil, finding insufficient evidence of fraud.¹⁷¹ The Executive Credit Corporation had agreed to advance money to Sounds You See, Inc., ("Sounds") for the installation of a sound system in a hotel.¹⁷² The president of Sounds had informed Executive Credit Corporation of the cash flow problems of Sounds.¹⁷³ The President of Executive Credit Corporation testified that he believed that the parents of the president of Sounds, who were its shareholders, would "stand behind these deals."¹⁷⁴ The hotel backed out of the deal, after Executive Credit Corporation had advanced \$35,000, which Sounds was unable to repay.¹⁷⁵ Sounds was dissolved for failure to pay the annual license fee, and minimally capitalized by the parents as a way to provide income for their son.¹⁷⁶ The court did not allow Executive Credit Corporation to reach the assets of the shareholder parents, notwithstanding that the parents had made significant loans to Sounds in the past to keep it afloat.¹⁷⁷ The court held that Executive Credit Corporation was not the victim of fraud, because it had been informed of the financial difficulties of Sounds.¹⁷⁸

Recognizing that many shareholders use the corporate structure to limit their liability to their initial investment, a Virginia court refused to find that a shareholder used a corporation to "evade a personal obligation" in *Greenberg v. Commonwealth*.¹⁷⁹ The Commonwealth brought charges against the defendant corporation for making usurious loans.¹⁸⁰ Pursuant to a statute prohibiting actions by a "lender", the trial court imposed liability against the corporation as well as its individual shareholder, although this individual was

¹⁶⁹ *Id.* at 214, 360 S.E.2d at 832.

¹⁷⁰ *O'Hazza v. Executive Credit Corporation*, 246 Va. 111, 431 S.E.2d 318 (1993).

¹⁷¹ *Id.* In a case decided months before *O'Hazza*, the Supreme Court of Virginia used an even weaker standard, stating that the corporate veil could be pierced "when necessary to secure justice." *Nedrich v. Jones*, 245 Va. 465, 429 S.E.2d 201 (1993). The *Nedrich* court did not decide to pierce the veil, instead deciding only that the claim was objectively reasonable and therefore sanctions against the plaintiff's attorney were not warranted. *Id.*

¹⁷² *O'Hazza*, 431 S.E.2d at 320.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 322.

¹⁷⁸ *Id.* at 323.

¹⁷⁹ *Greenberg v. Commonwealth*, 255 Va. 594, 499 S.E.2d 266 (1998).

¹⁸⁰ *Id.* at 598.

not involved in the day to day operations.¹⁸¹ The appellate court did not reach the issue of whether the corporation was an alter ego of the shareholder, finding sufficient reason to reverse the trial court's piercing.¹⁸² Although there was no evidence that the individual shareholder was not aware that the corporation was violating a statute, the court found that the corporation was not formed to "perpetrate or disguise illegal activities."¹⁸³

The trial courts of Virginia are in accord with the appellate courts, refusing to pierce the veil in a majority of cases, finding insufficient evidence of fraud.¹⁸⁴

The Fourth Circuit showed an unusual deference to the Virginia courts when deciding that a lack of fraud prevented shareholder liability in *Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.*¹⁸⁵ The defendant was an Illinois corporation formed for entering into real estate joint ventures.¹⁸⁶

When condominium purchasers sued for breach of warranty, the defendant's joint venturor paid the full amount of their claim, because the profits earned by the defendant had been distributed to its shareholders, leaving no capital.¹⁸⁷ The joint venturor sought to pierce the veil to find the individual shareholder liable.¹⁸⁸ Factors considered by the court in its decision of whether there was dominion and control were corporate records, payment of dividends, and whether other officers and directors existed.¹⁸⁹ Following the *Cheatle* decision, the court held that mere domination is not enough, but the plaintiff must prove that "the corporation was a device or sham to disguise wrongs, obscure fraud, or conceal crime."¹⁹⁰ "The fact that limited liability might yield results that seem 'unfair' to jurors unfamiliar with the function of the corporate form cannot provide a basis for piercing the corporate veil. Virginia law requires proof of some legal wrong before it undermines this basic assumption of corporate existence."¹⁹¹ Because no fraud was involved, the court refused to find the shareholder liable.¹⁹²

¹⁸¹ *Id.* at 599, 602.

¹⁸² *Id.* at 605, n.10.

¹⁸³ *Id.* at 605.

¹⁸⁴ *See, e.g.* *Ell v. Moss*, Chancery No. 131226, 31 Va. Cir. 8, 39 Va. Cir. 8, 1995 WL 1055919 (Va. Cir. Ct. July 10, 1995); *Richmond Homes Management Corp. v. Raintree, Inc.*, Civ. A. No. 930047, 1994 WL 147767 (W.D. Va. April 6, 1994); *Kirkpatrick v. First American title Insurance Company*, No. 61548, 59820, 16 Va. Cir. 534, 1985 WL 306765 (Va. Cir. Ct. Feb. 25, 1985); *Papile v. Batman Co., Inc.*, No. 138351, 38 Va. Cir. 127, 1995 WL 1055961 (Va. Cir. Ct. August 18, 1995). Each of these courts refused to pierce the corporate veil.

¹⁸⁵ *Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.*, 974 F.2d 545 (4th Cir. 1992).

¹⁸⁶ *Id.* at 545.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.* at 548.

¹⁹⁰ *Id.* at 548 (quoting *Cheatle*, 360 S.E.2d at 831).

¹⁹¹ *Id.* at 548-49.

¹⁹² *Id.* at 551.

The Fourth Circuit did not pierce the veil in *United States Fire Insurance Company v. Allied Towing Corp.*,¹⁹³ because the court found a lack of evidence of any factors other than an identity of officers and directors in the two corporations at issue.¹⁹⁴ There was no evidence of fraud.¹⁹⁵

A lack of fraud also resulted in the Fourth Circuit's refusal to find shareholder liability in *Ost-West-Handel Bruno Bischoff GMBH v. Project Asia Line*.¹⁹⁶ Following the rule of law of *Dewitt*, the court found no evidence of fraud, although they stated that injustice or unfairness would have been sufficient, and there was no evidence of under-capitalization, insolvency, or any other cause for piercing.¹⁹⁷

The Virginia courts recognize that shareholders often incorporate for the purpose of limiting personal liability,¹⁹⁸ which should not be deemed a sufficient evasion of personal obligations to impose liability on the shareholders.

A Georgia court stated that sole ownership of a corporation by one person, acting as sole director and officer, was not sufficient to hold that person liable for a corporate action.¹⁹⁹ Absent evidence of abuse of the corporate form, such as commingling of assets or a lack of records, the court did not pierce the veil, even where the shareholder had both borrowed and loaned money to the corporation, because such loans were adequately documented in the corporate records.²⁰⁰

A recent Delaware decision did not pierce the corporate veil because of a lack of fraud, notwithstanding that the court defined fraud broadly to include undercapitalization or a lack of corporate formalities.²⁰¹

Texas courts are similarly hesitant to find a shareholder liable, unless "the subsidiary is being used as a sham to perpetrate a fraud, to avoid liability, to avoid the effect of a statute, or in other exceptional circumstances."²⁰² A court did not impose liability on the parent because of a lack of exceptional evidence of fraud or unfairness to the plaintiff.²⁰³

Investors should be aware that even without evidence of fraud, some courts will impose liability on shareholders for corporate obligations if there is

¹⁹³ *United States Fire Insurance Company v. Allied Towing Corp.*, 966 F.2d 820 (4th Cir. 1992).

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 829.

¹⁹⁶ *Ost-West-Handel Bruno Bischoff GMBH v. Project Asia Line, Inc.*, 160 F.3d 170 (4th Cir. 1998).

¹⁹⁷ *Id.*

¹⁹⁸ *Greenberg*, 255 Va. at 594, 499 S.E.2d at 266.

¹⁹⁹ *Pazur v. Belcher*, --- S.E.2d ---, 2008 WL 747797 at *4 (Ga. App. 2008).

²⁰⁰ *Id.*

²⁰¹ *Petrich v. MCY Music World Inc.*, 371 Ill App. 3d 332, 334, 862 N.E. 2d 1171 (Ill. App. I Dist. 2007).

²⁰² *Town Hall Estates Whitney Inc. v. Winters*, 220 S.W. 3d 71, 86 (Tex. App. Waco 2007).

²⁰³ *Id.*

insufficient capitalization of the corporation, corporate procedures are not followed, or where the corporation is controlled by one person or parent corporation.

CONCLUSION

The Courts of the various United States are consistent in their hesitancy to impose liability on shareholders for corporate obligations; however, where a plaintiff can prove fraudulent conduct by the shareholder, liability is more likely. Virginia protects the limited liability of shareholders to a greater extent than other jurisdictions, although such protection has diminished in recent years. The Fourth Circuit and other Federal courts have demonstrated more willingness to find fraud sufficient to pierce a corporate veil, even in situations where the state courts would likely fail to find sufficient evidence of wrongdoing. Both state and federal courts have become increasingly willing to impose liability on a shareholder for an obligation of their corporation, therefore investors and parent corporations need to be more diligent in maintaining the separate existence of the corporate entity.

Business owners who incorporate to limit their liability should scrupulously maintain corporate records, accounts, and other formalities. Customers and others who deal with the corporation must be made aware that they are dealing with the corporation, not any individual shareholder or subsidiary. Even these precautions will not protect the shareholder if a court finds evidence of fraud or injustice.

The following suggestions may help to protect a shareholder from personal liability:

- Although one individual can be the sole director and hold all offices in some states, it may be preferable to avoid this situation. Consider electing the corporate accountant as the Treasurer, and assign an active role to this person. If there is no corporate accountant, consider retaining one. Avoid inactive officers, such as relatives or friends, who draw a salary without performing actual services.
- Document the purposes of the corporation other than limiting the liability of the shareholders. Suggestions include attracting investors, liquidity of investment, management options, professional image, public relations, authority to do business in other regions.
- Stationery with the complete corporate name should be used for all business communications. This should include Inc., Corp., Ltd., or other such designations if included in the articles of organization filed with the secretary of state. Avoid trade names, initials, or shortened forms.
- Signatures on corporate documents and correspondence must include the complete corporate name above the signature, with the name and title of the signer beneath their signature.

- Use the full name of the business in all advertising, signs, directories, telephone listings, and when answering the telephone. This should be considered when choosing a corporate name; simple, short, and easy to pronounce is preferable. Sales personnel should be trained to use the correct corporate name at all times and avoid using personal pronouns such as “I”, “me” or “we”.
- Establish accounting records and bank accounts in the corporate name.
- All income and expenses from the corporation should go through the corporate account. Never deposit personal funds of the shareholder in this account or pay personal expenses from this account. Be sure to document the funds transfer, as well as its legitimate business purpose, in the corporate records.
- If the corporation uses a shareholder’s equipment, a signed bill of sale or lease should be signed and retained.
- Hold shareholder and director meetings on time and keep accurate minutes.
- Pay all corporate, employment and withholding taxes when due. Retain a competent corporate accountant.
- Contact an attorney at least annually to file annual reports and review corporate records.
- Maintain sufficient capitalization for business purposes, and insurance for liabilities.
- After dissolving the corporation, do not maintain any accounts or draw a salary. Ensure that funds from the liquidation of assets are used to pay corporate debt promptly.
- Subsidiaries should not operate out of the same office as a parent corporation, and avoid having identical employees, officers, or directors as the parent.
- Avoid fraud, or even the appearance of fraud.

SHAREHOLDER LIABILITY IN THE REPUBLIC OF TURKEY

I- PRINCIPLE OF LIMITED LIABILITY

A. Overview

The corporate body came into being as a result of various needs of real bodies. In this respect, person and property communities are formed so as to achieve a objective which real bodies cannot by themselves accomplish since it exceeds their lifetime or limited opportunities.²⁰⁴ When such person or property community is recognized by the law as a unit independent from the persons and properties making it up, it is a “*corporate body*.”²⁰⁵ This independence is expressed as “the principle of separation;” the rights and debts that result of the activities the corporate body is engaged in through its organs belong directly to the corporate body, not its members²⁰⁶.

As an extension to this rule, the corporate body called the corporation, as a legal person, is responsible for the debts of the company under the Trade Law, with the exception of the provisions concerning liability of the managers (eg. Article 336 and 339 of Turkish Commercial Code). In this respect, company managers, partners and representatives are not liable to creditors of the company (Article 269/2, 503 and 532 of Turkish Commercial Code). As stated before, their liability concerning company debts is in the name of the “*corporate body of the corporation, confined to the amount of capital they committed but failed to bring de facto to the company*.” In this case, it is the principle of limited liability which arises.

B. Historical Information

The principle of limited liability has been accepted and implemented for more than a century. In this respect, the principle was introduced in the middle of the 19th century (between 1820 and 1870) into the legal system of the European states and the USA.²⁰⁷ Before these dates, the generally held opinion was that the real body partnering with a commercial company should be unlimitedly liable; it was believed that whoever gained power and profit should manage the partnership and compensate for any losses, because the activities and structures of the companies were quite simple at that time and there was trust in the financial power and honesty of the liable partner of the company²⁰⁸. However, the principle of limited liability became an

²⁰⁴ Yanlı, V.: Anonim Ortaklıklarda Tüzel Kişilik Perdesinin Kaldırılması ve Pay Sahiplerinin Ortaklık Alacaklılarına Karşı Sorumlu Kılınması, İstanbul 2000, p. 9.

²⁰⁵ Akınal, T.: Türk Medenî Hukukunda Tüzel kişiler, İstanbul 1995, p. 3.

²⁰⁶ Tekinalp, G./Tekinalp, Ü.: “Perdeyi Kaldırma Teorisi”, A Tribute to Prof. Dr. Reha Poroy, İstanbul 1995, s. 387; Yanlı, p. 10 and more.

²⁰⁷ Atabarut, İ. S.: İngiliz ve Amerikan Hukukunda Tüzel Kişilik Örtüsünün Aralanması Teorisi ve Uygulama Alanlarından Dava Örnekleri, Prof. Dr. Nuri Çelik’e Armağan, C. I, İstanbul 2001, p. 486; Yanlı, p. 76.

²⁰⁸ Atabarut, p. 487.

indispensable element of corporate law as commercial relations and social structure changed over time.²⁰⁹

C. Main Reasons for the Adoption of the Principle of Limited Liability

In general terms, the principle of limited liability serves the entrepreneurs who wish engage in commercial activities, yet aim to limit liability to creditors. In this way, the entrepreneur will know the highest possible debt risk will be as a result of the principle of limited liability and conduct commercial activities in comfort based on this knowledge.²¹⁰ This principle encourages the commercial activity of the entrepreneur.²¹¹

The principle of limited liability mainly depends on two principles. One is that the association of the capital and the partners of these associations (corporations) are totally independent bodies. In this sense, a corporation is a body separated from those who conduct its activities via its constituent organs and its managers. Also, the principle of “personalisation of debt relation” is valid for the corporation. Therefore, as separate entities, each person is responsible only for his/her own debt and is not bound to be affected personally from the relationships between the corporation and its creditors.²¹²

Second is that the associations of capital, especially the corporate bodies having a large number of shareholders, do not give active roles to these shareholders in the management of the company. In an ordinary general partnership, the general partners and limited partners are unlimitedly liable to the creditors to the second degree (Article 178/1 and 258 of the Turkish Commercial Code) because these partners are given the broad opportunity to participate in the management, representation and assets of the company and have the power of saving (association of persons). However in associations of capital, partners do not have a very active role in company decision-making. The goals of the shareholders here is to make profit. Therefore, it was found unjust to assign unlimited liability to people, who do not play an active role in the management of company unlimited liability, against creditors for the debts of company.²¹³

²⁰⁹ *Antunés, J. E.: Liability of Corporate Groups, Boston 1994, p. 122; Easterbrook, F. H./Fischel, D. R.: Limited Liability and the Corporation, The University of Chicago Law Review, Y. 1985, C. LII, p. 88.*

²¹⁰ *Hacıoğlu Reva, Z.: “Anonim Şirketlerde Tek Borç İlkesi ve Türk Ticaret Kanunu Tasarısı Çerçevesinde Değerlendirilmesi”, Y. 2005, İstanbul Barosu Dergisi, C. LXXIX, S. 5, p. 1552; Easterbrook/ Fischel, p. 91; Yanlı, p. 75- 76; Atabarut, p. 486.*

²¹¹ *Atabarut, p. 487; Hacıoğlu Reva, p. 1555.*

²¹² *Antunés, p. 127-128; Yanlı, p. 77; Hacıoğlu Reva, p. 1555.*

²¹³ *Ocaktan, H.: Anonim Şirketlerde Sınırlı Sorumluluk İlkesi Karşısında Şirket Alacaklılarının Korunması, Ankara 2000, p. 5 (Unpublished Master Thesis); Yanlı, p. 78;*

II- “THE PRINCIPLE OF LIFTING THE CORPORATE VEIL” AS A PRINCIPLE OF LIMITED LIABILITY

A. Overview

Associations of capital were regarded as “a product of economic needs” when they first emerged, while the principle of limited liability was regarded as an outcome of the features of this type of organization. However, since the beginning of the last century, the principle of limited liability has become the main reason why such corporations have been preferred.²¹⁴

However, the lawmaker has not envisaged any limitation for this particular preference. In other words, it is not against law to aim solely for the limitation of liability in the preference of partners for associations of capital.²¹⁵ On the other hand, the legal system is not supposed to make it possible for the partners to hide behind the corporate body of the company if they aim to deceive others by misusing legal limited liability through the establishment of associations of capital or weakening the financial standing of the company due to the fault of managers of the company, where as a result creditors have a loss when they can not collect on their loans.²¹⁶

The solution of “the principle of lifting the corporate veil”²¹⁷ aims to improve the partners’ and managers’ sense of responsibility and to avoid unlawful situations, which in turn helps protect the rights of the creditors of the company^{218 219}. Here the particular objective is not to allow the misuse of the

²¹⁴ Hirsch, R. E.: “Ticaret Hukukunda Mahdut Mesuliyet”, Adalet Dergisi, Y. 1938, S. 47, s. 1023. (Directly from Battal, A.: “Bir Alan Araştırması Işığında Sermaye Şirketlerinin Sorumluluğu Konusundaki Hukukî Bilgi Eksikliğinin Olumsuz Sonuçları ve Perdenin Kaldırılması Teorisi Yardımıyla Giderilmesi” Yargıtay Dergisi, Y. 1998, C. XXIV, S. 1-2, p. 657); Tekil, F.: Anonim Şirketler Hukuku, İstanbul 1998, s. 52.

²¹⁵ Battal, p. 657.

²¹⁶ Hirsch describes his opinion as “if the outcome is for an interest, fraud should be blocked through taking formalities of companies as liability.” (Directly from Battal, p. 657). Also see. Dural, M.: “Tüzel Kişilik Perdesinin Aralanması”, Sermaye Piyasası Hukuku 15. yıl Sempozyumu, Ankara 17-18 Ocak 1997, p. 103.

²¹⁷ Despite the absence of a uniformity in German and Swedish law to clarify this principle, in English and American law mostly the concepts “Lifting The Corporate Veil” or “Piercing The Corporate Veil” are used. Also, the principle is also named as “Disregard of Legal Entity” or “Disregarding The Corporate Entity”. In Turkish law this principle is named as “Lifting the Disguise”, “Lifting the Corporate Body Disguise” or “Clarifying Principle”. In this study, the term of “Lifting the Corporate Veil” term will be used, inspired by “Piercing The Corporate Veil”. (See Poroy [Tekinalp/Çamoğlu] for its use in Turkish law, p. 97; Yanlı, p. 13 and more.

²¹⁸ Lackey, E. A.: Piercing the Veil of Limited Liability in the Non-Corporate Setting, Arkansas Law Review, Y. 2003, C. LV, p. 561; Seven, V./ Göksoy, C.: Ticaret Şirketlerinde Tüzel Kişilik Perdesinin Kaldırılması, İstanbul Barosu Dergisi, Y. 2006, C. LXXX, S. 6, p.2459; Battal, p. 658.

²¹⁹ Another principle functioning to protect creditors of the partnership against the principle of limited liability is the principle to protect company assets. In this respect, in the registry of company, as well as full commitment of the whole capital [Art 285/1 of Turkish Commercial Code] and no bonding for less than its nominal value [TArt. 286/1 of Turkish Commercial Code] and other measures for adequate assets, the failure of the company to transfer or pledge its own shares in principle [Art. 329 of Turkish Commercial Code] and special measures on condition that the assets decrease [Article 324 of of Turkish Commercial Code] and provisions the like

legal separation of the corporate body and its partners under the disguise of the strict rules of the principle of limited liability, but to mitigate this strict principle.²²⁰ For instance, if (H) is a bond owner and (H) submits to (D), who develops it within time, the bill, he takes it for granted that (D) is his creditor and can put forward this situation as a “personal exception.” If (H) endorses the bill to a corporate body, whose majority of company shares is on his account, just to overcome this legal obstacle²²¹ and wishes to obtain his credit from (D) through a new holder company instead, this is regarded as a “misuse of the corporate body” and it does not matter if the corporate body who transfers the bill and the corporate body who owns it are different bodies or not.²²² Thus, (D) should be able to put forward the personal exceptions against the corporate body holding the bill as well as the endorser (H) in accordance with the “principle of lifting the corporate veil.”²²³

For associations of capital, the principle of lifting the corporate veil means, in accordance with the “liability law,” the expansion of the areas of liability so as to include the partners of the company as well who owe a debt of the corporate body to his creditors because of his own assets.²²⁴ This principle abolishes the rule that the liability of the partners is limited to the capital share they commit to the company and opens the path for the creditors of the corporate body to attach the personal assets of the partners in order to satisfy debts.²²⁵

B. The Principle of Lifting the Corporate Veil within Turkish Law

1- Legislation Perspective

It is possible to find regulations in the legislation of Turkish Law on lifting the corporate veil through delegating the liabilities of the corporate body to the partners or managers. In this respect, Articles 179, 180 and 192 of the Turkish Trade Law which allow creditors to apply for the personal liability of the partners to be held accountable for the debt of collective companies,

include the principles which protect the assets of the company for the sake of the creditors of the partnership and prevent any unwanted outcomes of the principle of limited liability. See *Ansay*, T.: Anonim Şirketler Hukuku Nereye Gidiyor, Ankara 2005, p. 41; *Yanlı*, p. 82.

²²⁰ *Tekinalp/Tekinalp*, p. 387.

²²¹ Here the important issue is that the bill has been transferred by (H) with an “assignment endorsement” to an incorporated body, instead of a collection endorsement. Because, the debtor can claim the pleas he has against collection endorser also against plea endorser in any asset document transferred in this way. (TTL art. 600/2). In this case, it is clear that there is no need to apply the principle of lifting disguise of the corporate body.

²²² *Tekinalp/Tekinalp*, p. 387.

²²³ This was explained by Poroy and Tekinalp as follows; “Pursuant to the principle of lifting the disguise, in the case of endorsement of a promissory note to a single body partnership or endorsement of the bill from such partnership to single partnership, pleas against partnership or the partner can be put forward to the transferee as well. In the case of plural partners to a partnership if they are not real partners (dummy partners assumption), there is single partnership”. Poroy, R./ Tekinalp, Ü.: Kıymetli Evrak Hukuku Esasları, 16th Ed, İstanbul 2005, p. 84.

²²⁴ *Yanlı*, p. 37.

²²⁵ *Atabarut*, p. 482; *Yanlı*, p. 37.

Article 435 of Turkish Commercial Code which suggests that “straw men” are not acceptable in corporate bodies, Article 35 of the Law 6183 on Procedures concerning the Collection of the Public Credits, which allows creditors to apply for the partners of the debtor companies to be held accountable for uncollected public credits²²⁶ and Article 10 of the Tax Procedure Law, entitled “Tasks of the Legal Representatives,” which authorizes the collection of partially- or totally-uncollected tax from the assets of a company and the resultant credits from the assets of those who represent the company are examples of this principle in legislation.²²⁷ Also, Articles 110 and 134 of Banking Law 5411²²⁸ do not totally eliminate the legal disguise of personal separation of legal bodies before the law, yet constitute another example of this principle, since they set aside the personal separation of the bank and the dominant partners, and that between other companies in the community, on the condition of compensating the losses of the banks transferred to the Savings Account Insurance Fund and the bank credits which become Fund credits from those liable in accordance with the Law.

2- Court Decisions Perspective

It has been observed that court decisions have been made with respect to the principle of lifting the corporate veil, which is included in the legislation indicated above. The first one of such decisions is the decision by the 19th Legal Chamber of the Supreme Court of Appeals on 02.11.2000 (Basis No: 2000/5828, Decision No: 2000/7383). The decision and resultant text of the verdict suggests; “**DECISION:** *The attorney of the claimant claimed and sued on the grounds that the defendant was the sole guarantor of the credit contract between client’s bank and out-case B.... Automative Co., there was no positive outcome of the notice issued due to the failure of payment of the credit debt, the prosecution started with confiscation against the defendant, who was turned to bankruptcy, the defendant objected to prosecution, and the decision was to claim the bankruptcy of the defendant on grounds that the objections are not right. The defendant’s attorney asked for the rejection of the case, stating that his client is not a tradesman, therefore his bankruptcy cannot be requested since being a partner does not provide the position of tradesman to real bodies. The bankruptcy verdict was appealed by the defendant’s attorney on grounds that bankruptcy conditions were attained for the defendant who failed to pay despite the stock order who was founder member for various companies and who was chairman of MUSIAD from 1990 to 1999. RESULT:* *Since there is no inconsistency about the verdict and the fact that the defendant who was the partner and manager of Kağit*

²²⁶ RG: 28.07.1953 - 8469.

²²⁷ Bahtiyar, M.: Ortaklıklar Hukuku, 2nd Ed, İstanbul 2006, s. 7; Poroy [Tekinalp/Çamoğlu], p. 97 - 98. In accordance with this provision, all shareholders in a private limited company are liable for the public debt of the company from the first level and unlimitedly. However, there is no clarity in Act No. 6183 concerning the liability of partners of the company for the debts of the company other than these. *Kumkale*, R.: Sermaye Şirketleri, Ankara 2003, p. 243.

²²⁸ RG: 01.11.2005 - 25983.

*Inc, P... Inc, P... Inc., B... Inc., F... Inc., L... Food Inc., A... Chemistry Inc.,... Chemistry Inc, B... Automative Inc, O... Automotive Inc., B... Automative Inc on the grounds of the evidence on which the decision is based and, even though the defendant does not have a personal registry in the trade registers and who is the manager of the Istanbul Chamber of Commerce which is bound to MUSİAD as an industrialist, all objection demands of the defendant attorney are rejected and the verdict is unanimously approved on 2.11.2000.*²²⁹ In this decision, although he was not registered in the trade registry as a tradesman, he is registered in the trade and navy trade chambers and professional committees and has a large share in large companies, it was stated that the decision was a good model for practising the principle of lifting the corporate veil in court.²³⁰ However, this decision caused some confusion in terms of relation between the principle and decision since the reasons were not clearly understood from the decision²³¹.

Another decision, which was another model for the principle of lifting the corporate veil, resulted from a case before the Izmir 4th Trade Court of First Instance on 17.02.2005 (Basis No: 2002/843, Decision No: 2005/64) and the Supreme Court of Appeals 19th Legal Chamber decision on 15.05.2006 (Basis No: 2005/8774, Decision No: 2006/5232) which approved this decision.²³² In the conflict, the claimant company concluded a sales contract with the defendant companies (Ege Limited Co. and Ege Inc.) concerning the sales of goods. In accordance with this contract, two orders of goods were sold to the defendant companies at different prices and amounts; two invoices were prepared and one was submitted to Ege Limited Co., and the other to Ege Inc. After a while, following the contract, Ege Limited Co. partners transferred their shares to third bodies. The claimant company fulfilled its responsibilities under the sales contract yet sales prices failed to be paid by the defendant companies. So the claimant company sued the defendant companies for the joint and in solide collection of the total price of both contracts from the defendant companies. Following this, defendant Ege Inc, attempted to avoid payment on the grounds that the invoices were developed differently and it cannot be liable for the debt of Ege Limited Co. and that the liability for payment on his account concerning the sales cost under the invoice was transferred to the other defendant by its own will, so therefore he was exempt from the relevant debt in accordance with the Articles 173/1 and 174/1 of Debts Law. The local court stated in his decision with reason that “... although there are different legal bodies from the legal aspect under the “theory of lifting the corporate veil,” both defendant companies have the

²²⁹ www.kazanci.com.tr (23.04.2007)

²³⁰ *Seven/Göksoy*, p. 2459.

²³¹ Poroy, Tekinalp and Çamoğlu, most probably and rightfully, criticized the decision since it was not possible to understand if the decision was based on the registry of the relevant person as tradesman in the chambers or his large share in various companies. *Poroy [Tekinalp/Çamoğlu]*, p. 98 - 99.

²³² For detailed analysis of the decision see *Seven/Göksoy*, p. 2455 - 2470.

*identical properties due to sister company relations.*²³³ Defendant Ege Inc has only the argument that the other defendant is liable for the debt since they are separate legal bodies. This argument is the misuse of the right in accordance with the Article 2 of the Civil Law... The phenomenon of separate legal bodies cannot be taken into consideration in form. It should be considered under the conflict between the parties, honesty principles and equality criteria. The attempts of the defendant Ege Inc. to leave the debt to the other defendant (Ege Ltd. Co.) which does not have the capability to pay and is a separate corporate body is not acceptable. Therefore the decision is that both companies are in *solido* liable for the debt.” The decision by the local court was approved by the Supreme Court of Appeals and High Court decision included the phrase “... it is not appropriate to find both defendants liable by lifting the corporate veil ...” and the principle of lifting the corporate veil was clearly approved for the first time²³⁴.

In agreement with the approaches and decisions by the local court and Supreme Court of Appeals in the particular case, we would also like to note that there are further considerations that are particularly important. The principle of lifting the corporate veil is to avoid the misuse of the principle of limited liability and to detect the real liable parties under the disguise. Therefore it should be considered “how far” the corporate body was misused. In this respect, in the particular case, it is necessary to go beyond the principle of limited liability which is brought by the corporate body of incorporation and reach the real persons on condition that Ege Inc. partners misused not only the legal personality of Ege Limited Co. but also that of Ege Inc. as against the principle of honesty in accordance with Article 2 of Turkish Civil Law.

3- Doctrine Perspective

The principle of lifting the corporate veil has been the subject of comprehensive studies in Turkish legal doctrine for the recent 15 years now.²³⁵ It has been suggested that the relevant principle is of particular importance for our legal system, especially in the situation of starting large businesses with inadequate capital and when the capital of company falls short of that needed for the operation of the company in time, it hurts the financial trust in the company; therefore it is necessary to find those responsible under the concept of lifting the corporate veil.²³⁶

²³³ The local court based this identical situation in this particular case on the fact that the same persons were the partners and managers of the defendant companies on the date when the contract was concluded and the person who concluded the contract with the claimant on behalf of the defendants, who received the good and issued the containership letter of credit was the joint representative of both companies. Also, the fact that Ege Limited Co. partners transferred their shares does not disturb the identical situation in the particular case; even so, it has been stated in the decision with reason. *Seven/Göksoy*, p. 2456.

²³⁴ *Seven/Göksoy*, p. 2469.

²³⁵ *Tekinalp/Tekinalp*, p. 387-404; *Atabarut*, p. 481 - 498; *Seven/Göksoy*, p. 2451-2470; *Battal*, p. 645-662.

²³⁶ *Ansay*, p. 55.

The first issue considered regarding the principle of lifting the corporate veil in Turkish legal doctrine is whether a specific intent must be found in order to apply this principle. One view in literature suggests that “a deliberate misuse” is required for applying this principle while the other holds, as we also agree, that it should be practiced “even in the absence of deliberation.”²³⁷

Whichever approach is adopted, it is unanimously held that the principle of “lifting the corporate veil” in Turkish legal system is based on the principle of honesty and the prohibition of misuse of rights contained in Article 2 of the Turkish Civil Code.²³⁸ Therefore, the legal system shall not protect the misuse of rights born by the corporate body through the establishment of a corporate body, making use of an existing corporate body or hiding behind the corporate body in an attempt to violate a liability born by law or an agreement to hurt any third party²³⁹.

On the other hand it has been expressed that lifting the corporate veil is not only covered under conditions of misuse of the principle of limited liability but also some other situations. In this respect, Articles 180 and 182 of the Turkish Commercial Code are not related to the principle of limited liability; and the relevant articles can be models for the principle of lifting the corporate veil where it concerns general and limited partnerships²⁴⁰.

The final point here is that the approach in theory and practice is that the principle of separation is a rule and the principle of lifting the corporate veil is an exception.²⁴¹ Therefore, creditors of a company are required to apply to the corporate body first for satisfaction of a debt even if there is something contrary to the principle of honesty under Article 2 of Turkish Civil Code.²⁴² On the other hand, in the presence of special provisions which allow for lifting the corporate veil, at the same time making it possible to reach the personal liabilities of the partners of the company in law – since the principle of lifting the corporate veil is not directly regulated in law – the provision present in law will have the priority. In this case, for instance on conditions of *culpa in contrahendo* liability of the partners of the company, the principle of lifting the corporate veil shall not apply.²⁴³ However, there is no need to apply the principle to reach the liability of the partner of the company who is the in personal guarantor of the debt of company.²⁴⁴

CONCLUSION

The principle of limited liability, which has become an indispensable element in corporate law in the last century, has assumed the role of “promoting”

²³⁷ For details see. *Tekinalp/Tekinalp*, p. 391 and more; *Battal*, p. 658-661.

²³⁸ Bkz. *Tekinalp/Tekinalp*, p. 386; *Dural*, p. 103; *Battal*, p. 660; *Akünel*, p. 16-18.

²³⁹ *Ocaktan*, p. 109.

²⁴⁰ *Tekinalp/Tekinalp*, p. 398.

²⁴¹ *Poroy* [*Tekinalp/Çamoğlu*], p. 98; *Tekinalp/Tekinalp*, p. 394; *Dural*, 98.

²⁴² *Lackey*, p. 561; *Yanlı*, p. 85.

²⁴³ *Yanlı*, p. 86.

²⁴⁴ *Lackey*, p. 560.

entrepreneurs in commercial life. Thus, the entrepreneur who is a partner to an association of capital can both take part in activities beyond the capacity of this capital and he can keep his liability at a particular level, which ensures the “trust” which is indispensable for trade.

The principle of limited liability is based on the idea that the partner who did not take part in management owing to the organization of the association of capital; and mostly who did not attempt it, shall not be affected by any negative outcome (from debt of the company) of the mismanagement of a company in which he did not have a role in managing. Since this is the main principle, recently it has been observed that the “principle of lifting the corporate veil” has been accepted in legal systems as an element to balance the conditions of misuse of limited liability in time and the losses of the creditors of the company.

Despite the regulation of the principle of limited liability and the presence of some provisions to prevent misuse of this principle in Turkish law, it has been criticized that the principle of “lifting the corporate veil” has not overtly been bound to a provision in law and that this gap has been attempted to be closed by the principle of honesty contained in Article 2 of the Turkish Civil Code. We hold the opinion that the relevant principle should be taken into the scope of a provision so as to decrease misuse of the principle to a minimum, in line with the needs of the rapidly developing commercial sector.