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Paweł Słup*

PIERCING THE CORPORATE VEIL– A COMMON PATTERN?

Abstract

The aim of this article is to present a comparative perspective of the doctrine of piercing the corporate veil in three major jurisdictions: Germany, the United States, and England in the light of the appropriate legal rules and recent case law. The concept of piercing the veil is still undeveloped in Poland, yet it has already drawn some attention from both the judiciary and legal scholars. It will be argued that despite the fact that the three aforementioned jurisdictions belong to different legal traditions, both the cases in which courts decided to pierce the veil and the nature of veil-piercing are similar among the jurisdictions. However, the study shows growing hostility to the doctrine, especially in continental jurisdictions. The arguments for restricting the scope of veil-piercing formulated under the laws of Germany, United States, and England should be taken into consideration in Polish jurisprudence as well.

Keywords

corporate veil – veil-piercing – Durchgriffshaftung – abuse of legal personality – lifting the veil

I. Introduction

Conducting a business activity in the form of a company has many positives. Members of the company can take advantage of the corporate

* The author is a student of the University of Warsaw, Faculty of Law and Administration and the Warsaw School of Economics.

personality and decide which part of their own assets they would like to put on risk. The structure of the company's bodies allows them to devolve management of the day to day business along with the responsibility to directors, persons who do not have to be involved in a corporate relationship; the devolution, however, does not deprive members of their right to gain profit from the company's business. Furthermore, the corporate structure provides its members with a certain degree of anonymity, as their personal data is generally not disclosed to the public[1].

The advantages of the corporate form may, however, threaten other entities such as creditors of the company[2]. In recent years, along with the discussion on the diminishing role of share capital, the topic of shareholder's liability is becoming more and more popular in the Polish company law literature[3]. Following foreign literature and judicature, a danger in using the corporate form contrary to the aims for which it had been established has been noticed. This was named as abuse of corporate form[4],

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[1] See exemptions to this rule in the Polish law [in:] art. 38 p. 8) items c) i d) and art. 38 p. 9) item h) National Court Register Act from 20 August 1997 (Polish Journal of Laws 1997, No 12, item 769 as amended) and art. 69 s. 1 p. 1 Act of 29 July 2005 on Public Offering, the Conditions Governing the Introduction of Financial Instruments to Organized Trading, and on Public Companies (Journal of Laws from 2009, No 185, item 1439).

[2] Members are also creditors to their company, but the paper is focused on creditors remaining outside corporate structure and the term „creditor" will be further used to describe only the latter type of creditor. See on different types of creditors: F. H. Easterbrook, D. R. Fischel, *Limited Liability and the Corporation*, "The University of Chicago Law Review" 1985, vol. 52, pp. 104–109.

[3] See on the role of share capital in Polish literature: A. Opalski, *Kapitał zakładowy i akcje [Share capital and shares]* [in:] *System prawa prywatnego. Tom 16. Spółki kapitałowe [System of Private Law. Volume 16. Companies]*, (ed) S. Sołtysiński, Warszawa: CH Beck, 2016, p. 108–122; A. Radwan, *Sens i nonsens kapitału zakładowego [Sense and nonsense of share capital]* [in:] *Europejskie prawo spółek. Tom 2 [European Company Law. Volume 2]* (ed) M. Cejmer, J. Napierała, T. Sójka, Kraków: Zakamycze, 2005, p. 25–99.

[4] M. Litwińska-Werner, *Nadużycie formy spółki [Abuse of corporate form]* „Studia Prawa Prywatnego", Issue 3, 2007, p. 85; A. W. Wiśniewski, *Prawo o spółkach. Podręcznik praktyczny. Tom 1. Wiadomości ogólne. Spółka cywilna [Law of Companies. Practical handbook. Volume 1. General information. Civil Partnership]*, Warszawa: Twigger 1998, p. 56–59; S. Sołtysiński, *Komentarz do art. 301 [Commentary to art. 301]* [in:] *Kodeks spółek handlowych. Tom III. Komentarz do art. 301–490 [Code of Commercial Companies and Partnerships. Volume III. Commentary to art. 301–490]*, ed. S. Sołtysiński, A. Szajkowski, A. Szumański, J. Szwaja, Warszawa: CH Beck 2013, para 33.

abuse of legal personhood[5], or even abuse of the right to use a legal person[6].

It was submitted that Polish law is relatively unprepared to combat the abuses of corporate form[7]. Some authors claim that the undermining of separate legal personality is a solution to that problem[8]. Although this undermining has a rather restricted scope in Polish law *de lege lata*, authors and the judicature[9] focus on the foreign concept of "piercing the corporate veil", known also as "lifting the veil" or "Durchgriff" (in German jurisdiction). The analysis of the concept in foreign legal systems allows the authors to seek inspiration for similar solutions on the ground of Polish law[10].

The aim of this paper is to present a brief characteristic of the concept of piercing the corporate veil as a judicial device used to protect creditors of a company by presenting types of cases in which courts have

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[5] T. Targosz, *Nadużycie osobowości prawnej [Abuse of legal personality]*, Kraków: Zakamycze, 2004.

[6] R. Szczepaniak, *Nadużycie prawa do posługiwania się formą osoby prawnej [Abuse of right to use the corporate form]*, Toruń: TNOiK, 2009.

[7] T. Targosz, *Nadużycie… [Abuse…]*, p. 265. R. Szczepaniak, however, claims that there is an undiscovered potential of "equitable" remedies in Polish law. R. Szczepaniak, *Rola sądów w procesie przeciwdziałania nadużyciom osobowości prawnej [The role of the judiciary in preventing abuses of legal personality]*, „Studia Prawnoustrojowe" 2015, vol. 30, pp. 15, 17.

[8] R. Szczepaniak, *Nadużycie…[Abuse…]*, p. 345.

[9] See Polish Supreme Court judgment I PK 179/14 of 17 March 2015, Legalis, in which the court directly referred to the concept of piercing the corporate veil; See also judgment III PK 136/13 of 18 September 2014, Legalis, and II PK 50/13 of 5 November 2013. On the role of piercing the corporate veil in Polish labour law see P. Czarnecki, *Odpowiedzialność pracodawcy a rozwój struktur holdingowych [Liablity of employer and the growth of holding structures]*, Warszawa: Wolters Kluwer Polska 2014, p. 101–180.

[10] Some proposals *de lege ferenda* has already been presented. See M. Rodzynkiewicz, *W kwestii odpowiedzialności wspólnika spółki kapitałowej za jej zobowiązania de lege ferenda [On shareholders' liability for corporate debts de lege ferenda]*, "Przegląd Prawa Handlowego" 2017, vol. 8, pp. 12–20; K. Frelek, *O zasadności unormowania w kodeksie spółek handlowych konstrukcji nadużycia formy spółki [On importance of the abuse of corporate form in Commercial Companies and Partnerships Code]*, "*Zeszyty Prawnicze*" 2013, vol. 13(2) p. 77; See also M. Grześków, *O możliwości implementacji doktryny „piercing the corporate veil" do polskiego prawa spółek i kryteriach jej stosowania [On the possibility of implementation of the „piercing the corporate veil" doctrine into Polish company law and its requirements*, „Internetowy Przegląd Prawniczy TBSP UJ" 2016, vol. 8, p. 121.

disregarded separate legal personality in the foreign jurisdictions (USA, England, and Germany)[11]. Although the facts on veil-piercing cases are similar regardless of jurisdiction, US judges are more willing to pierce the veil than their European colleagues.

II. Piercing the corporate veil as alaw on creditor protection

From the comparative perspective, separate legal personality remains one of the basic features of companies (corporations) in various jurisdictions[12]. Other features, such as legal capacity, capacity to commit legal acts, ability to commit legal wrongs, ability to sue, and being sued are strongly

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[11] See also the Polish literature on piercing the corporate veil in these countries: K. Osajda, *Niewypłacalność spółki z o.o. Odpowiedzialność członków zarządu wobec jej wierzycieli [Insolvency of a company with limited liablity. Liability of board members towards creditors]*, Warszawa: Wolters Kluwer 2015, p. 90–95, 478–482, 530–533; 562–563; P. M. Wiórek, *Ochrona wierzycieli spółki z o.o. poprzez osobistą odpowiedzialność jej wspólników. Koncepcja odpowiedzialności przebijającej i nadużycia formy prawnej spółki w prawie niemieckim i polskim [Protection of the creditors of a company with limited liability through the personal liability of its shareholders. The concept of veil-piercing liability and abuse of corporate form in German and Polish law]* Wrocław: E-Wydawnictwo. Prawnicza i Ekonomiczna Biblioteka Cyfrowa 2016; O. Sztejnert, *Odpowiedzialność przebijająca i przesłanki jej stosowania w niemieckim prawie handlowym [Veil-piercing liability and its requirements in German company law*, „Palestra" 1997, vol. 9–10, p. 124; J. Kołacz, *Piercing the corporate veil – odpowiedzią na nadużycie formy prawnej spółki? (cz. I) [Piercing the corporate veil – a response to abuse of corporate form? (Part I)] „Prawo Spółek"* 2009, vol. 5, p. 14; *(Part II)* „Prawo Spółek" 2009, vol. 6, 2009, p. 39; B. Jankowski, *Nadużycie formy prawnej spółki w prawie amerykańskim [Abuse of corporate form in the American law]* „Państwo i prawo" 1996, vol. 2, pp. 63–76; P. M. Tomaszewski, *Pominięcie osobowości prawnej spółki w prawie USA* (I) *[Disregarding legal personality in the American law (I)]*, „Przegląd Prawa Handlowego" 1995, vol. 10, p. 16; (II) „Przegląd Prawa Handlowego" 1995, vol. 11, p. 14.

[12] R. Kraakman, J. Armour, P. Davies, L. Enriques, H. Hansmann, G. Hertig, K. Hopt, H. Kanda, E. Rock, *The Anatomy of Corporate Law. A Comparative and Functional Approach*, Oxford 2009, p. 5, 9–11; On Polish law see A. Klein, *Ewolucja instytucji osobowości prawnej [Evolution of the institution of legal personality]* [in:] *Tendencje rozwoju prawa cywilnego [Tendencies in development of civil law]*, (ed) E. Łętowska, Wrocław: Zakład Narodowy Imienia Ossolińskich Wydawnictwo Polskiej Akademii Nauk, 1983, p. 69.

connected with separate legal personality[13]. The idea of the protection of the entity's assets from the claim of its owners' creditors (*entity shielding*) provides a conceptual framework for the notion of a separate legal personality. It is done through the separation of the entity's assets from the assets of its members through a concept known *asset partitioning*[14] or *Trennungprinzip* (German law). The colourful metaphor of "corporate veil" represents the separation of assets and legal personality. It delimits the scope of liability of both company and its owners, prevents creditors of the company from grasping the assets of the company, and *vice versa*.

However, there is a constant tension between the goal of protection of a company's assets from the claims of its owners' creditors (and the opposite – the need for the protection of the company's members from the claims of the company's creditors) and the aim of creditor protection. It was submitted that creditors of the company need special protection in law owing to the rule of shareholders' limited liability and the possibility of its abuse[15]. The principle of limited liability on the one hand encourages people to conduct business activity, but on the other it may cause serious externalities, such as transfer of the risk and costs of the business on to society, predominantly on creditors (externality of risk). In consequence, limited liability of shareholders, along with their impact on the management of the company, may lead to the situation

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[13] In English law the ability to commit legal wrong is one of the consequences of separate legal personality (S. Worthington, *Sealy & Worthington Text, Cases & Materials in Company Law*, Oxford: Oxford University Press, 2016, p. 35. In German law the ability to commit legal wrong (*Deliktsfähigkeit*) is distinguished on the grounds of § 828 BGB from the capacity to perform legal acts. In Polish law, pursuant to art. 416 of the Polish Civil Code, the ability to commit legal wrong may be simplified to the existence of a legal person and natural persons who act as corporate bodies. P. Machnikowski, *O zdolności deliktowej [On the ability to commit legal wrong]*, „Acta Universitetis Wratislaviensis" issue 304, 2008, p. 121. Some Polish authors claim also that legal capacity and capacity to commit legal acts are the consequences of legal personality. See J. Frąckowiak, *Osoby prawne [Legal persons]*, [in:] *System prawa prywatnego. Tom 1. Prawo cywilne – część ogólna [System of private law. Volume 1. Civil law – general provisions*, (ed) M. Safjan, Warszawa: CH Beck, 2012, p. 1141–1153.

[14] H. Hansmann, R. Kraakman, R. Squire, *Law and the Rise of the Firm*, "Harvard Law Review" 2005, vol. 119, p. 1337. The notion of *owner shielding* stands as a mirror notion to the *entity shielding*. One of the aspects of *owner shielding* is the limited liability of shareholders.

[15] J. Armour, *Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law*, "Modern Law Review" 2000, vol. 63, p. 355.

known as "moral hazard" – taking risky decisions, the costs of which are eventually paid by creditors[16].

Legal institutions aimed at the protection of creditors can be divided into three groups[17]. The first group consists of disclosure regulations aimed at providing creditors with the current condition of the company[18]. The second group consists of the various regulations concerning an adequate level and maintenance of share capital in the company[19]. The third group represents legal institutions that create a separate bank of assets in order to enable creditors to satisfy their claims successfully[20].

Extraordinary liability of shareholders, despite the rule of limited liability, is one of legal instruments of the third aforementioned group that exists in the context of closely held corporations. The liability may occur as a result of piercing the corporate veil (*Durchgriffshaftung*) and if it happens shareholders might become liable for the obligations of the company.

III. Piercing the corporate veil under US, English, and German laws

The concept of piercing the corporate veil has blossomed in the United States, where it was once described as the most litigated issue in corporate

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[16] F. H. Easterbrook, D. R. Fischel, *Limited…*, p. 104. However, the authors indicate that moral hazard occurs whenever a person or firm has insufficient assets to cover its expected liabilities.

[17] P. Sobolewski, *Środki prawne ochrony wierzycieli spółek kapitałowych [Legal measures for protection of companies' creditors]*, „Przegląd Prawa Handlowego" 2011, vol. 5, p. 15–16.

[18] See in Polish law ex. Art. 8, 39, 40, 41 of the Act of 20 August 1997 National Court Register Act (Journal of Laws. 1997 No 12 item 769 as amended),

[19] See the provisions on contribution capacity, contributions of shareholder (Art. 14 of the Polish Code of Commercial Companies and Partnerships), requirements on the initial level of share capital (Art. 154, 308 of the Polish Code of Commercial Companies and Partnerships), prohibition on returns of contributions (Art. 189, 344 of the Polish Code of Commercial Companies and Partnerships) or the rules of dividend distribution (Art. 192 i n., 347 and next of the Polish Code of Commercial Companies and Partnerships).

[20] See Art. 299 of the Polish Code of Commercial Companies and Partnerships, Art. 21 of the Act of 14 February 2003 – Insolvency Law (Journal of Laws from 2003, No 60, item 535, as amended).

law[21]. In the United Kingdom and in Germany its scope is rather restricted, yet it remains a discussed topic in the academic literature[22]. In each of these three jurisdictions a company (corporation) is a separate legal entity and its shareholders benefit from the rule of limited liability[23].

The idea that lies under the company is the following: a company is a fiction, an instrument designed to do business, and its separate legal personality should be treated as a privilege for its members. Separate legal personality, however, is not absolute. A company, as a legal concept, may operate only within the law. If the shareholders make use of the corporate form to deceive creditors, circumvent the law, evade legal obligations, or even commit a crime, it may result in the disregarding of the separate legal personality of the company in a particular case[24].

Generally the cases in which courts have decided to pierce the corporate veil are based on similar facts. Even in the USA, where corporate law is not regulated by the federal law, but remains a domain of particular state jurisdictions, almost all veil-piercing cases were based on similar doctrinal concepts, regardless of the state in which the decision was given[25]. Piercing the corporate veil is predominantly a concept originating from case law and therefore academics rather focus on the analysis of judges' decisions, their systematization, and a search for common patterns[26]. In spite of the impossibility of presenting all attempts to pierce

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[21] R. B. Thompson, *Piercing the Corporate Veil: An Empirical Study,* "Cornell Law Review" 1990, vol. 76, p. 1036.

[22] K. Schmidt, *Gesellschaftsrecht*, Köln: Carl Heymanns Verlag 2002, p. 218; B. Hannigan, *Company Law*, Oxford: Oxford University Press, 2016, p. 47–58.

[23] § 6.22 (b) Model Business Corporation Act 2000/01/02 Supplement, 3rd Edition, 2003; § 102(b)(6) Title 8, Chapter 1 of the Delaware Code; Salomon v. A Salomon & Co Ltd [1896] UKHL 1; § 13 (2) GmbHG; § 1 (1) AktienG.

[24] United States v. Milwaukee Refrigerator Transit Co., 142 F. 247 (1905); M. Wormser, *Piercing the Veil of Corporate Entity*, "Columbia Law Review", Issue 12, 1912, p. 496, 498, 517; R. Serrick, *Rechtsform und Realität juristischer Person*, Tübingen 1980, p. 1–3 quoted by P. M. Wiórek, *Ochrona…[Protection…]*, p. 92.

[25] P. Blumberg, *Accountability of Multinational Corporations: The Barriers Presented by Concepts of the Corporate Juridical Entity*, "Hastings International and Comparative Law Review" 2000, vol. 24, p. 304.

[26] M. Ventoruzzo, P. Conac, G. Goto, S. Mock, M. Notari, A. Reisberg, *Comparative Corporate Law*, St. Paul, Minn.: West Academic Publishing 2015, p. 151; M. R. Szczepaniak, *Nadużycie…[Abuse…]*, p. 86.

the veil, it seems that several types of cases concerning the discussed matter can be distinguished.

1. Groups of companies

The first group of cases in which courts decide to disregard the separate legal personality of the company are the cases in which the company is somehow engaged in a larger enterprise. The use of capital structures such as concerns or holdings allows entrepreneurs to additionally minimize their risk of business failure[27]. The companies, despite being engaged in the enterprise, remain separate legal personalities with all the consequences of that status. This may, however, weaken the position of other entities on the market by restricting the possibilities of satisfying creditor claims, causing disorientation among clients, and blurring the transactions concluded with different entities engaged in the same enterprise.

German law recognized these hazards quite early and applied legislative methods to contravene them (*Konzernrecht*). German law on groups of companies applies both to groups based on contract and on factual groups of companies. Provisions § 15–19 *Aktiengesetz* regulate the situation of connected enterprises, while § 291–310 apply to contractual concerns. These rules impose additional obligations on the dominant entities. From the perspective of shareholder protection, the most important principles are that the dominant company is to absorb the losses of the controlled company (§ 302) and to provide security to particular creditors of the controlled company under certain circumstances (§ 303). Although these provisions of *Akiengesetz* concern only a German joint-stock company (*Aktiengesellschaft*), initially the judicature used them by analogy in cases concerning *GmbHs*, German private limited liability companies[28]. The settled case law has changed, however, after the bold decision in the

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[27] See on different types of groups of companies: S. Włodyka, *Spółki koncernowe (holdingowe) [Holding companies]* [in:] *System Prawa Handlowego. Tom 2. Prawo spółek handlowych [System of commerial law. Volume 2. Law of companies and commercial partnerships]* ed. S. Włodyka, Warszawa: CH Beck, 2012, p. 1537.

[28] Urteil vom 16.9.1985, II ZR 275/84 ("Autokran"); Urteil vom 23.9.1991, II ZR 135/90 ("Video").

Bremer Vulkan case[29]. In this case the court rejected the concept of factual concern based on the analogy from *Aktiengesetz* in favour of the liability for annihilation of the company (*Existenzvernichtung*). The liability for annihilation was based on piercing the corporate veil mechanism until the case *Trihotel had been* had been decided[30].

The two common law legal systems do not have provisions similar to German *Konznernrecht*, so the topic of groups of companies is the domain of the judiciary and academics. According to one of the theories proposed in the US literature, the corporate veil may be pierced under certain circumstances on the grounds of mutual capital relations between the parent and subsidiary companies[31]. According to the theory of enterprise entity, if one of the parties is a member of the group of companies, the court should take into consideration the structure of the whole enterprise entity, regardless of its formal organization. Particularly in case of a capital group with a complicated structure the court may assign the obligations of one company to the other, if both of the companies participate in the same enterprise entity[32].

A similar theory of *single economic unit* was once proposed in English law in order to justify piercing the corporate veil. This concept, however, was used on the grounds of damages for the parent company for the expropriation of the daughter company[33]. It seems that the theory of *single economic unit* was rather conjured up in order to protect the economic interest of the company in this particular case, than to protect the interest of creditors. Therefore it has not been accepted by the judiciary and now is perceived as a faulty concept[34].

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[29] Urteil vom 17.6.2001, II ZR 178/99 ("Bremer Vulkan").

[30] Urteil vom 16.7.2007, II ZR 3/04 ("Trihotel"). In this case the court applied § 826 BGH concerning tort liability as a legal basis for *Existenzvernichtungshaftung*, it however did not reject *Durchgriff* in case of commingling of assets of the company and its members. P. M. Wiórek, *Ochrona… [Abuse…]*, p. 124.

[31] A. Berle, *The Theory of Enterprise Entity*. *"Columbia Law Review"* 1947, vol. 47, pp. 343. Another aspect of the theory of enterprise entity is the doctrine of "de facto" corporation, which allows the upholding of the obligations of validly incorporated companies.

[32] A. Berle, *The Theory…*, p. 354.

[33] DHN Food Distributors Ltd v. Tower Hamlets London Borough Council [1976] 1 WLR 852.

[34] Woolfson v. Strathclyde Regional Council [1978] UKHL 5; Adams v. Cape Industries plc [1990] Ch 433.

The *theory of enterprise entity*, however, has gained some popularity in the US. Although initially the mere fact of doing business in the form of a enterprise entity did not justify liability of a parent company for its subsidiary[35] a more liberal approach was soon taken. In *Walkovszky v. Carlton*[36] the court rejected the possibility of assigning the liability of a company to the controlling individual, yet it indicated that had the controlling entity been a company, the liability of a parent for its subsidiary would have occurred. Now the theory of *enterprise entity* (called also sometimes *single business enterprise*) occasionally provides a sufficient basis for shareholder liability in cases concerning groups of companies. It becomes an alternative for the "classical" piercing of the corporate veil, which has been strongly criticized in the literature[37].

2. Misobservance of separation of acompany by its shareholders

This group of cases is based on the assumption that if a company is to be given a separate legal personality, its shareholders should treat it as a separate legal entity. Therefore courts refuse to recognize the separate legal personality of a company if a company is an "instrument"[38] in the hands of its shareholders, their "*alter ego*"[39], "completely dominated and controlled entity"[40] or a "sham"[41] used only to evade certain consequences that would threaten shareholders if they had not used the corporate form. Yet the mere limitation of liability does not justify piercing the veil. It is quite the opposite. Doing business in the form of a corporation requires

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[35] Berkey v. Third Avenue Railway Co 244 N.Y. 602 (1927).

[36] 18 N.Y.2d 414 (1966), p. 419.

[37] S. B. Presser, *The Bogalusa Explosion, "Single Business Enterprise", "Alter Ego", and Other Errors: Academics, Economics, Democracy, and Shareholder Limited Liability: Back towards a Unitary "Abuse" Theory of Piercing the Corporate Veil*, "Northwestern University Law Review" 2006, vol. 100, p. 405. See p. 427, where the author states that "[…] the "single business enterprise" doctrine should be killed while it is still in its infancy".

[38] Lowendahl v.Baltimore Ohio R.R. Co. 247 App. Div. 144, 153 (N.Y. App. Div. 1936).

[39] Bucyrus-Erie Co. v. General Products 643 F.2d 413, 418 (6th Cir. 1981).

[40] Zaist v. Olson 154 Conn. 563 (Conn. 1967).

[41] Castleberry v. Branscum, 721 S.W.2d 270, 271 (Tex. 1986).

some degree of instrumentality. The reason why entrepreneurs decide to take advantage of the corporate form with limited liability is to restrict their scope of personal liability. Therefore piercing the corporate veil requires an additional element of dishonesty or abuse in shareholders' conduct. If the abuse of corporate personality occurs, it may deprive the shareholders of legal protection. Some acts, which usually would be assigned to a company, are instead assigned to its members.

In the US law a model summary of the aforementioned principles was presented in *Lowendahl v Baltimore Ohio R.R. Co*[42], where the court decided that if a veil is to be pierced, the three-prongs test must be satisfied (Powell's test). Firstly, the plaintiff should demonstrate the absolute control and domination of a company by its shareholders. Secondly, this control must be used in order to commit fraud, crime, dishonesty that is aimed at the plaintiff's interests. Thirdly, there should be some harm on the plaintiff's side as a result of the defendant's dishonest acts[43]. This is known as the *instrumentality rule*. An alternative theory, the *alter ego theory*, is based on the two-prongs test. Firstly the court should establish the degree of shareholder's control over the company and then assess whether certain acts of the shareholder result in inequity[44]. However recently a new tendency in *alter ego* theory arises. Some cases concerning groups of companies show that the element of inequity, dishonesty, or abuse of the corporate personality is not necessarily required[45]. This causes some degree of similarity between the *alter ego* theory and theory of *enterprise entity*. Both theories gradually abandon the subjective requirement of the shareholder's misbehavior and rely on apparently objective criteria such as organization of the business or degree of domination[46].

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[42] 247 App. Div. 144, 153 (N.Y. App. Div. 1936).

[43] Powell's test was initially formulated on the basis of groups of companies, however, it concerns other cases as well. In his work F. J. Powell presented a catalogue of eleven factors that contribute to total control of the company. F. J. Powell, *Liability of a Parent Corporation For the Obligations of Its Subsidiary*, Chicago: Callaghan 1931; J. Kołacz, *Piercing… (cz. I) [Piercing… (Part I)*, „Prawo Spółek" 2009, vol. 5, p. 14, 19.

[44] Note *Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law*, "Harvard Law Review" 1982, vol. 95, p. 854.

[45] S. B. Presser, *The Bogalusa…*, p. 405, 413.

[46] See N. Am. Van Lines v. Emmons, 50 S.W.3d 103, 119 (Tex. Ct. App. 2001); Pearson

Similarly English courts used to deprive companies of their separate legal personality owing to the fact that their shareholders used the companies as a "façade"[47], "mask"[48], "sham"[49], or "puppet"[50] to conceal facts or evade liability[51]. Colourful language used by judges to describe the companies, whose veil has been "pierced" or "lifted" indicates that the court had found an element of dishonesty, misbehavior, or abuse of corporate personality. This was done in a similar way to the US courts. However, family law divisions did not always require the element of abuse. They used to allow piercing the veil in matrimonial cases if the company was just an *alter ego* of one of the spouses[52], or even if it was "just and necessary"[53].

The end of the Seventies brought a certain degree of apathy on the part of the courts towards the doctrine. Its application became rare and exceptional[54]. Treating a company as a façade, even if the company was totally controlled by a shareholder, ceased to be a sufficient basis for disregarding its separate personality[55]. In the light of most of the recent cases, applying piercing the corporate veil in English law is possible only if the corporate form is abused in order to evade pre-existing legal

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v. Component Tech. Corp., 247 F.3d 471, 485 (3d Cir. 2001); Mesler v. Bragg Mgmt. Co., 702 P.2d 601, 607 (Cal. 1985).

[47] Woolfson v. Strathclyde Regional Council [1978] UKHL 5. In this case the veil was not pierced, yet the court indicated that veil-piercing is justified if a Corporation is a „facade concealing true facts". This term was followed by later decisions. See Adams v. Cape Industries plc [1990] Ch 433, p. 539.

[48] Jones v. Lipman [1962] 1 WLR 832.

[49] Gilford Motor Co Ltd v. Horne [1933] Ch 935.

[50] Wallersteiner v. Moir [1974] 1 WLR 991.

[51] Littlewoods Mail Order Stores v. Inland Revenue Commissioners [1969] 1 WLR 1241; Trustor AB v. Smallbone (No 2) [2001] EWHC 703 (Ch).

[52] Nicholas v. Nicholas [1984] FLR 285; Green v Green [1993] 1 FLR 326.

[53] Mubarak v. Mubarak [2001] 1 FLR 673, 682C. See also Kremen v Agrest (No 2) [2011] 2 FLR where the court stated that it is sufficient to indicate "strong practical reason why the cloak should be penetrable even absent a finding of wrongdoing" (p. 46).

[54] T. K. Cheng, *The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines*, "Boston College International & Comparative Law Review" 2011, vol. 2, p. 10.

[55] Adams v. Cape Industries plc [1990] Ch 433; VTB Capital plc v. Nutritek International Corp [2013] UKSC 5.

obligations, which arose independently of the company, or to frustrate their enforcement (*evasion principle*). Even if shareholders overuse the protection stemming from the separate legal personality of their company by treating it as their *alter ego* or using as a "façade" concealing facts, it is not a sufficient reason to pierce the veil (*concealment principle*)[56].

German law also is based on the assumption that shareholders should observe the separate legal personality of their company. Two examples of misobservance of the rule are "commingling of spheres" (*Sphärenvermischung*) and "commingling of assets" (*Vermögensvermischung*). Commingling of assets means such a way of management that it results in mixing the assets of the company with the assets of shareholders, while commingling of spheres means a lack of organizational separation between shareholders and their company. Generally in the light of the most of the recent cases, only commingling of assets justifies piercing the corporate veil under German law (*Durchgriffshaftung*)[57]. It is essential, however, that the commingling of assets is long-lasting and institutionalized, usually connected with incorrect accounting[58]. Additionally, similarly to piercing the corporate veil in common law countries, some degree of dishonesty or abuse of corporate personality is required. § 128 of *Handelsgesetzbuch*, a provision concerning the liability of partners in general partnership (*Offene Gesellschaft*)[59] stands for the legal basis for such misbehaviour in cases concerning private limited companies (*GmbHs*) as well. Therefore a rule of separation between a company and its members (*Trennungprinzip*) is overcome. § 13 (2) of the *GmbH*, which codifies the rule of limited liability in reference to *GmbHs*, is not applied.

Commingling of assets justifies refusal to apply § 13 (2) *GmbHG,* yet it should be distinguished from commingling of spheres. Commingling of spheres may occur if the rules of representation of the company are not observed, the business name of a company does not differ sufficiently from the business name of its shareholder or if the same assets are used

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[56] Prest v. Petrodel Resources Ltd [2013] UKHL 34; Pennyfeathers Ltd v. Pennyfeathers Property Co Ltd [2013] EWHC 3530 (Ch); A. Schall, *The New Law on Piercing the Corporate Veil in the UK*, "European Company and Financial Law Review" 2016, vol. 13, pp. 549–574.

[57] Zob. P. M. Wiórek, *Ochrona… [Protection…]*, p. 145.

[58] M. Litwińska-Werner, *Nadużycie… [Abuse…]*, p. 83, 87.

[59] Urteil vom 14.11.2005 – II ZR 178/03.

to do business by different entities[60]. Neither of these situations results in piercing the corporate veil with imposition of liability on shareholders for obligations of their company because the *Trennungprinzip* is not overcome. Yet the concept of *Zurechnungsdruchgriff*, "piercing by assigning" may be applied. "Piercing by assigning" means the attribution of certain features, acts, or states of a company's member to that company (or otherwise)[61]. For example the good or bad faith of a company's shareholder may indicate the good or bad faith of that company. Some authors claim that "piercing by assigning" does not mean disregarding the separate legal personality of a company and is done through proper interpretation of law, therefore it differs significantly from *Durchgriffshaftung*[62].

3. Inadequate capitalization

Many cases concerning piercing the corporate veil have been decided on the grounds of inadequate capitalization. The traditional view on share capital stresses its guarantee function – share capital should represent the minimum funds to meet the claims of potential creditors[63]. Regardless of the question of whether provisions on initial capital, rules on capital maintenance, or rules on contributions really provide a company with such a fund, if a company's assets remain on an level adequate to its business scale (material capitalization) creditor protection

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[60] A. Opalski, *Problematyka pominięcia prawnej odrębności spółek kapitałowych [Problematic aspects of the disregarding of legal personality]*, „Przegląd Prawa Handlowego" 2012, vol. 8, p. 19; R. Szczepaniak, *Nadużycie… [Abuse…]*, p. 107.

[61] T. Targosz, *Nadużycie…[Abuse…]*, Kraków: Zakamycze 2004, p. 290.

[62] A. Krawczyk, *Przebicie przez przypisanie w koncernie [Piercing by assigning]*, „Przegląd Prawa Handlowego" 2016, vol. 1, p. 34, 37.

[63] A. Rachwał, *Spółka z ograniczoną odpowiedzialnością [Private Limited Liability Company]* [in:] *System Prawa Handlowego. Tom 2. Prawo spółek handlowych [System of commercial law. Volume 2. Law of companies and commercial partnerships]*, (ed) S. Włodyka, Warszawa: CH Beck 2012, p. 768. See on the role of share capital A. Opalski, *Kapitał zakładowy: skuteczny instrument ochrony wierzycieli czy przestarzała koncepcja prawna? Próba porównania modeli ochrony wierzycieli w prawie państw europejskich i Stanów Zjednoczonych [Share capital: a useful creditor protection device or an old-fashioned legal concept? Comparision of creditor protection models in European countries and the USA]*, "Kwartalnik Prawa Prywatnego" 2004, vol. 2, seee as well no 4.

is increased[64]. Particularly material capitalization becomes important if a company's activity may be potentially dangerous to involuntary creditors (environmental and catastrophes)[65].

In Germany undercapitalization of a company is indicated as one of classic examples of a situation to which *Durchgriff* may be applied[66]. German law provides certain provisions as to the amount of initial capital required, so the situation described as initial undercapitalization is rare[67]. Yet undercapitalization may occur as well when business activity has already been commenced. The provisions remain silent on the adequate level of share capital and its structure after registration of a company, nor have academics reached an agreement on that matter. Yet the concept of qualified material undercapitalization has been described as the most representative one. Qualified material undercapitalization, apart from the requirement of material disproportion between the level of company's assets and its business activity, requires also misbehaviour on the part of the company's members[68]. This concept was once applied as a justification for piercing the corporate veil[69].

The problem of undercapitalization is also recognized in US law. However, unlike in Germany, in most of the states there is no initial capital requirement[70]. Yet this does not mean that the initial material

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[64] M. Mieciński, *Niedokapitalizowanie spółki z o.o. a wysokość kapitału zakładowego [Undercapitalization of a company and the amount of share capital]*, „Przegląd Prawa Handlowego" 1998, vol. 6, p. 14; J. Armour, *Share…*, p. 377.

[65] F. H. Easterbrook, D. R. Fischel, *Limited…*, p. 89, 104; L. Bergkamp, W. Pak, *Piercing the Corporate Veil: Shareholder Liability for Corporate Torts*, "Maastricht Journal of European and Comparitive Law" 2001, vol. 8(2), pp. 167–188.

[66] K. Schmidt, *Gesellschaftsrecht*, p. 240.

[67] 25.000 € for GmbH (§5 (1) GmbHG), and 50.000 € for AG (§ 7 AG). If a company is a public one see also Art. 45 ust. 1 of Regulation of Parliament and Council (UE) 2017/1132 of 14th June 2017 (Dz. Urz. UE L 169 z 30.06.2017, p. 46–127).

[68] C. M. Alting, *Piercing the Corporate Veil in American and German Law. Liability of Individuals and Entities – a Comparative View*, "Tulsa Journal of Comparative and International Law" 1995, vol. 2, p. 207; M. Litwińska-Werner, *Nadużycie… [Abuse…]*, p. 88–90.

[69] Urteil vom 8.7.1970 – VIII ZR 28/69. The courts however base their reasoning in cases concerning undercapitalization on § 826 BGB as a legal basis for tort liability. P. M. Wiórek, *Ochrona… [Protection]*, p. 140.

[70] C. M. Alting, *Piercing…*, p. 202.

undercapitalization problem is not present here. In some cases courts decided that a company was not capitalized adequately to its business activities at the moment of its incorporation[71]. However, in most of the cases undercapitalization is not a separate basis for piercing the veil. Again, additionally some kind of misbehavior or dishonesty from the company's members is required. Therefore undercapitalization may occasionally indicate the abuse of corporate personality[72], yet usually it satisfies just the second prong of the *instrumentality* or *alter ego* test[73].

The undercapitalization reason for piercing the corporate veil together with no initial capital requirement allows courts to take arbitrary decisions on the adequate levels of capitalization. Therefore questions as to whether a courtroom is a proper venue to conduct the complicated economic analysis of share capital adequacy are still actual[74]. Nonetheless, undercapitalization remains one of the key factors that US courts take into consideration when deciding to pierce the veil[75].

IV. Conclusions

The cases where the courts disregarded corporate personality have been decided on various facts. Therefore some academics tried to classify cases by dividing them into groups reflecting the consequences of veil-piercing[76]. Some commentators claim that it is necessary to distinguish *lifting* the corporate veil from its *piercing* and that only the latter results in

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[71] Dewitt Truck Brokers, Inc. v W. Ray Flemming Fruit Company 540 F.2d 681 (4th Cir. 1976); Minton v. Cavaney (1961) 56 Cal.2d 576.

[72] Piercing the corporate veil may occasionally be justified only on the grounds of undercapitalization, without improper behavior of the shareholder. See United States of America v Jon-t Chemicals, Inc.768 F.2d 686 (5th Cir. 1985).

[73] C. M. Alting, *Piercing…*, p. 202.

[74] H. Gelb, *Piercing the Corporate Veil – The Undercapitalization Factor*, "Chicago Kent Law Review" 1982, vol. 51, p. 14. Apparently the Polish Supreme Court gave a negative answer to a similar question in resolution III CZP 72/88 of 13 October 1998, Legalis.

[75] See P. B. Oh, *Veil-Piercing*, "Texas Law Review", Issue 89, 2004, p. 81–145 and presented there empirical research. See also R. B. Thompson, *Piercing…*, p. 1063, table 11.

[76] S. Ottolenghi, *From Peeping Behind the Veil to Ignoring it Completely*, "Modern Law Review" 1990, vol. 53, pp. 338–353.

shareholders' liability[77]. Although recently decided cases do not confirm that view[78], it is necessary to distinguish two basic patterns of piercing the corporate veil.

Piercing the corporate veil in a broader sense occurs whenever a separate legal personality is being disregarded[79]. Therefore the doctrine of piercing the corporate veil concerns various cases in which corporate personality has been disregarded, yet it does not always result in shareholders' liability. However, there is always a certain degree of interference with the corporate personality. Courts look at facts which go beyond legal personality, such as control over the company or the number of shares in the hands of a particular shareholder, in order to assign certain acts, features, or states of a company to its members (or otherwise). This attribution may result in assigning to one of the "sister" companies the good or bad faith of the other "sister" company owing to the fact that their boards of directors consist of the same members. This type of piercing corresponds to *Zurechnungsdurschgriff* in German law, and is described as *concealment* in English law[80].

In a narrow sense piercing the corporate veil means only those situations in which disregarding the separate legal personality of a company results in the shareholders' liability for the company's debts.

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[77] M. Tofel, *Odpowiedzialność ex delicto wspólników spółki kapitałowej [Ex delicto liability of shareholders]* [in:] *Prawo handlowe XXI wieku. Czas stabilizacji, ewolucji czy rewolucji. Księga jubileuszowa prof. Józefa Okolskiego [Commercial law of 21st century. The time of stabilization, evolution or revolution. Jubilee book for prof. Józef Okolski]*, (ed) M. Modrzejewska, Warszawa: Wolters Kluwer 2010, p. 1114; Atlas Maritime Co SA v. Avalon Maritime Ltd (No 1) 1991, All ER 769.

[78] English courts use both of these phrases. See Prest v. Petrodel Resources Ltd [2013] UKHL 34, VTB Capital plc v. Nutritek International Corp [2013] UKSC 5. Por. T. Targosz, *Nadużycie… [Abuse…]*, Zakamycze 2004, p. 164.

[79] Podobnie A. Opalski, *Problematyka… [Problem…]*, p. 10–20; A. Nowacki, *Komentarz do art. 151 [Commentary to art. 151]* [in:] *Spółka z ograniczoną odpowiedzialnością. Tom 1. Komentarz do art. 151–226 k.s.h. [Company with Limited Liability. Volume 1. Commentary to art. 151–226 of the Polish Commercial Companies and Partnerships Code]*, Warszawa: CH Beck, 2017, para 116. Some authors do not distinguish shareholders' liability piercing cases and other piercing cases, see M. Litwińska-Werner, *Nadużycie… [Abuse…]*, p. 85.

[80] See Prest v. Petrodel Resources Ltd [2013] UKHL 34, p. 28, yet Lord Sumption claims that this case does not concern veil-piercing. However, see the definition of *piercing the corporate veil* in p. 16 of the judgment.

This type of piercing the veil occurs frequently in the US[81]; in German law it is represented by *Durchgriffshaftung* and in English law by the *evasion principle*[82].

In each of the three described jurisdictions, piercing the corporate veil is strongly connected with abuse of law, abuse of corporate personality, or at least some kind of dishonesty or misbehavior on the part of shareholders. Piercing is therefore aimed at shareholders who abuse the privilege of limited liability. Yet abuse or misbehavior alone is generally not a sufficient justification for the courts to pierce the veil. However, in the US the veil may be pierced without any element of shareholders' misbehavior, only on the grounds of the particular organizational structure of the enterprise, material undercapitalization, or under the *alter ego* doctrine.

Piercing the corporate veil is just one of the instruments which aim to impose liability on shareholders, despite the principle of limited liability[83]. Common law jurisdictions provide alternative remedies such as agency or resulting trusts, and the result of their application is very similar when it comes to the liability of members[84]. Moreover, each of the three jurisdictions recognizes the liability of shareholders for corporate torts, which is distinct from piercing the veil. In Germany after the *Trihotel* case the concept of *Durchgriffshaftung* has been almost entirely repudiated in favour of tortious liability based on § 826 *BGB* known as *Existenzvernichtungshaftung*[85]. Similarly, English law allows the holding of a shareholder of a parent company liable for the negligence of its subsidiary by extending the scope of the parent company's duty of care to the acts of its subsidiaries[86]. Even in the US, a jurisdiction most willing to pierce the veil, the liability of shareholders for corporate torts has

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[81] Yet piercing the corporate veil in the US may occur in arbitration cases as well. See Oriental Commercial and Shipping v. Rosseel, 609 F. Supp. 75 (S.D.N.Y. 1985).

[82] English law requires additionally that the abuse of corporate personality is done to evade pre-existing legal obligations.

[83] T. K. Cheng, *The Corporate Veil…*, p. 14.

[84] See an example of agency in Smith, Stone and Knight Limited v. Birmingham [1939] 4 All ER 116; an example of resulting trust in Prest v. Petrodel Resources Ltd [2013] UKHL 34.

[85] M. Tofel, *Odpowiedzialność… [Ex delicto…]*, s. 1115.

[86] Lubbe v. Cape Plc [2000] UKHL 41; Chandler v. Cape Plc [2012] EWCA Civ 525.

been extended[87]. The liability based on these principles, however, differs from the liability which occurs owing to veil-piercing. The shareholders are liable for their own acts, while piercing the corporate veil results in shareholders' liability for the company's obligations.

Piercing the corporate veil, as a judicial device which emerged from various cases based on different facts, lacks coherence in its application. General clauses, on which decisions on disregarding legal personality are based, leave courts with much discretion. Therefore piercing the veil is unpredictable and constantly changing. It seems that these changes go in two directions. In continental jurisdictions, where much focus is put on the stability of law, courts withdraw from piercing (lifting) the corporate veil (*Durchgriffshaftung*) in favour of other ways of imposing liability on shareholders. In the US, however, there is a constant tendency to facilitate its application by reducing its tests to one prong, such as the organization of an enterprise or general inequity of shareholder's behaviour. This contributes to the arbitrary character of decisions in veil-piercing cases and weakens their predictability.

Finally, in each of the three jurisdictions, piercing the veil is exceptional. Particularly, if piercing results in shareholders' liability for the debts of a company it is a remedy of last resort. In the light of recent cases decided by German *Bundesgerichthof,* piercing the veil is displaced by tortious liability based on § 826 *BGB*. Similarly in England it is very unlikely that a court will apply this concept. The requirements proposed by the English Supreme Court are almost impossible to satisfy. In the US, a jurisdiction most willing to pierce the veil, critical voices try to restrict its application[88].

Therefore it seems that although a common pattern of piercing the corporate veil in these three jurisdictions can be observed, the current discussion on the doctrine in Polish law should be focused on the question of whether it is reasonable to introduce another shareholder protection device if its major users have almost unanimously decided to abandon it.

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[87] H. Hansmann, R. Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, "Yale Law Journal" 1990, vol. 7, pp. 1879–1934.

[88] S. Bainbridge, *Abolishing Veil Piercing*, "Journal of Corporate Law" 2000, vol. 26, pp. 480–535.