# PIERCING THE CORPORATE VEIL
# US LESSONS FOR ROMANIA & SLOVAKIA[1]

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**Abstract:** This article describes and analyses the doctrine of piercing the corporate veil. First it introduces this doctrine and its history and development in the United States - the jurisdiction which represents its. Second, it analyses its possible implementation within two chosen jurisdictions in Central and Eastern Europe: Romania and Slovakia. Authors' aim is to assess their home jurisdictions and whether they apply the doctrine or only some parts of it or nothing at all. Authors go through different areas of the legal system, as company law, civil law or bankruptcy law and reflect on them. Finally, authors reason why this doctrine is of an importance to any legal system and why the legislators in CEE region should insert and apply it.

**Key words:** Piercing the corporate veil, liability, mother company, subsidiary, fiduciary duty, Romania, Slovakia.

## 1. INTRODUCTION

How many companies do you think exist in the entire world? Are there as many companies and partnerships as people? Probably not. Presumably, there is neither a trustworthy source which would and could estimate this figure. To reach a reliable number we would have to go to company registry in each jurisdiction and add them one by one.[4] Despite the fact that it seems as an interesting task, we do not need to undergo such a complicated journey. Our point at the beginning of this article is to show that companies and all other types of legal entities represent a fundamental part of our everyday life and despite their "fictious" background we live with these entities in unity. In addition to small or medium sized businesses, there is currently another world phenomenon – multinational corporations.[5] In the past decades multinational corporations have to huge extent superseded small and medium sized business all over the world. Nowadays, they represent main actors driving economic globalization. Since the Industrial Revolution, large multinational corporations have come to dominate the national and global economic scene. Some of them are as economically powerful as some states.[6]

Even if we were all skeptical towards the corporate wealth and we would acknowledge the possible threat of these corporate monsters, it is indisputable that the role of business, trade and industry is to form prosperity for shareholders, employees, customers and society at large. In addition, companies do not only contribute towards the world's wealth but also towards novel technology, new environmental solutions and discovery of cure.

It is our belief that in order to provide well-balanced legal environment for both, the natural persons as well as legal persons, it is necessary to impose adequate controls over the conduct of legal persons in order to avoid and prevent

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[4] Only in the United States the number of companies is extremely high: 29,114,798 companies as to the date of 18th April 2012, *available online at* http://www.manta.com/mbl (last accessed April 18, 2012). In the United Kingdom, based on the statistics of Companies House, there were as to 23rd May 2011 2,534,510 companies limited by shares and 106,068 companies limited by guarantee, *available online at* http://www.companieshouse.gov.uk/freedomInformation/infoReleasedPDFs/discLog220.pdf (last accessed April 18, 2012).

[5] For the purposes of this article we define Multinational Corporation [hereinafter also as "MNC"] as, *"a cluster of corporations of diverse nationality joined together by ties of common ownership and responsive to a common management strategy".* To better understand the concept of Multinational Corporation, it is helpful to show the differences from uninational corporations. First, MNCs operate and control their assets and across national borders. Second, the managerial organization is structured in a way to allow across border operations. More on the background of multinational corporations *see* Detlev F. Vagts, *The Multinational Enterprise: A New Challenge for Transnational Law,* 83 HARV. L. REV 739 (1970). This article provides reader with historical challenges for the legal framework at the beginning of the rise of multinational corporations in the modern history. On the main characteristics of multinational corporations *see* Olufemi O. Amao, *The Foundation for a Global Company Law for Multinational Corporations*¸ 21 INT'L COMPANY & COM. L. REV 275 (2010).

[6] In 2009, in the world's 100 largest economic entities, there were 44 corporations. Wal-Mart Stores had revenues exceeding the respective GDPs of 174 countries including Sweden, Saudi Arabia and Venezuela. Sinopec, China's leading energy and chemical company, was bigger than Singapore. For more, *see* Tracey Keys, Thomas Malnight, *Corporate Clout: The Influence of the World's Largest 100 Economic Entities*, GLOBAL TRENDS, *available online at* http://www.globaltrends.com/images/stories/corporate%20clout%20the%20worlds%20100%20largest%20economic%20entities.pdf (last accessed April 18, 2012).

deceitful and fraudulent demeanor, such as money laundering, corruption, hiding and shielding assets from creditors and other claimants, illicit tax practices, self-dealing or market fraud and circumvention of disclosure requirements.[7] One of such controls is the piercing of corporate veil.

This type of control has not been fully introduced in all jurisdictions. Central and Eastern Europe being affected by US, French or German law, all of which recognize and apply the veil-piercing doctrine, do in certain situations disregard the limited liability doctrine. However, neither Romania nor Slovakia have implemented clearly-set standards for piercing the corporate veil and as authors show both countries rather apply unmethodical approach which leads to non-uniform and unforeseeable court decisions. This article aims not only to introduce the characteristics of the veil-piercing doctrine and the circumstances when this doctrine should be applied using the United States as an example, but also describe and analyze different statutory provisions in Romania and Slovakia which enable in distinct situation disregarding the limited liability. In conclusion, authors provide their *de lege ferenda* recommendations.

## 2. STARTING WITH PRACTICAL IMPLICATIONS: KATIE ELLEN WEST V. WILLIAM C. COSTEN

Katie Ellen West, et al, v William C Costen et al,[8] is a famous 1983 case dealing with consumer protection and corporations. We have chosen to start with it because it will provide the reader with a clear understanding of the purpose of the doctrine and the way American courts understand and apply the law it.

Very briefly the facts: A class action was brought against MSF (a debt collection company) and its President, William C Costen for a number of violations of the Fair Debt Collection Practices Act. (FDCPA)[9] The violations of the FDCPA being proven, the court awarded the plaintiffs damages according to the provisions of the aforementioned statute. On the other side, Costen alleged that he was not a debt collector under the FDCPA and that even if he was, he cannot be held individually liable due to the existence of the corporate veil. As Costen was found to qualify as an indirect debt collector under the Act, the Court had to analyze whether there are any legal justifications to keep the corporate veil or to pierce it. For the purposes of this article we are going to focus more on the court's reasoning on this matter.

First, the court took into account the fact that Costen was not only the President of MSF, but also its dominant shareholder, owing – even after restructuring – 64% of the company's authorized stock, the rest being actually transferred to his wife. Furthermore, the court looked at the previous case law and found that, although it was held that the "*corporate structure should never lightly be disregarded…the corporate structure is not, however, a shield for dominant shareholders to hide behind while defrauding or injuring creditors, or conducting illegal operations*".[10] Thus, the court stated that "when substantial ownership of all the stock of a corporation in a single individual is combined with other factors clearly supporting disregard of the corporate fiction on grounds of fundamental equity and fairness the corporate entity will be disregarded and liability fastened on the individual shareholder".[11]

The court went afterwards into the analysis of the factors which were considered by the case law as determining whether to disregard the corporate shield or not, underlining that no single factor would ever be enough to pierce to veil: inadequacy of corporate capitalization for the venture undertaken (currently referred to as 'undercapitalization'), failure to observe corporate formalities, non-payment of dividends, insolvency of the debtor corporation at the relevant time, siphoning of funds of the corporation by the dominant shareholder, non-functioning of other officers or directors, absence of corporate records, the fact that the corporation is a mere façade for the dominant shareholder.[12]

In applying these factors to the facts of the case, the court found that although MSF had a predictable risk of liability under the FDCPA it did not maintain a fair amount of capital. It had also established that MSF did not pay dividends, although it had paid huge amounts of money as salaries or commissions to its President. Siphoning of funds became clear when evidence showed that Costen's income grew while those of the company decreased severely. Also, it was established that Costen received amounts of money on the peak of MSF' s bankruptcy, that nepotism was a rule in the company's activity, Costen having a number of relatives on the pay role and getting personal loans from the company for private purposes. Last, but not least, the company failed to maintain records in accordance to the applicable laws.

But as the court held – and in this we think it resides the whole idea of the veil piercing – the most important reason to disregard MSF corporate shield and impose personal liability on Costen, is that "***it would be unfair to the plaintiffs and contrary to the purpose of FDCPA to uphold MSF corporate façade.*** *[…] MSF is liable to the plaintiffs for some blatantly*

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[7] More on the use of corporate entities for illicit purposes and mechanisms to prevent the misuses of corporate vehicles *see* BEHIND THE CORPORATE VEIL: USING CORPORATE ENTITIES FOR ILLICIT PURPOSES, OECD (2001).

[8] *Katie Ellen West, et al. v William C. Costen, et al*. Civ. A. No 79-0210-R, US District Court, W.D. Virginia, Roanoke Division. March 2, 1983, pp. 564-588.

[9] As the FDCPA does not fall within the scope of this article we will not go into many details concerning this part. But for those unfamiliar with its content, we shall emphasize that it is a Federal Statute which regulates the activity of debt collection agencies by establishing a set of rules of conduct and also sanctions for their violation. Among the rules of conduct there are obligations to inform the debtors about their rights (to dispute the debts for example), prohibitions to use threats, to make false representations of the consequences incurred in case of non-payment, to contact third parties without their consent (as specifically provided by the act), to charge extra fees for collection services, etc. Among sanctions there are administrative fines, civil penalties and also the possibility for punitive damages, which are usually awarded for each infringement of the act and for each person that was affected by such infringements.

[10] *Id.*, p. 585.

[11] *Ibid*, p. 585.

[12] *Ibid*, p. 585.

*illegal collection practices. Yet MSF is no longer doing business and it thus seems likely that its assets, if any remain, will be totally inadequate to meet plaintiffs' damages. […]. Furthermore, the FDCPA's purpose to eliminate abusive debt collection practices by debt collectors, would be frustrated if MSF's corporate façade was an effective shield against persons seeking their private remedies under the Act*".[13] As a conclusion the court stated that: "*Costen has misused the corporate form and […] justice requires that MSF's corporate form be disregarded and liability imposed on Costen*".[14]

Thus the doctrine is used for reasons of equity and fairness, but also in order to achieve justice and make sure that the purpose of law is not going to be frustrated by the misuse of other legal protections. Also, we have to notice that although the criteria are quite strict and numerous, the courts are free to use the doctrine when all the factors are met and the situation calls for it.

## 3. THE DOCTRINE OF PIERCING THE CORPORATE VEIL

The doctrine of piercing the corporate veil and related rules of separate legal personality[15] and limited liability[16] have been discussed and analyzed since the beginning of twentieth century.[17] It is necessary to emphasize at the very beginning – as seen in above mentioned case – that this doctrine represents an exception to the general rule of limited liability and should be given effect only under very explicit circumstances.

The moment when the court should pierce the corporate veil and disregard the limited liability is generally in such situations, when the company acts as a cloak for frauds. In the first cases in the United States, the courts used their equity powers to disregard party's attempt to shelter a fraud or illegality by a corporate form. The Supreme Court of Minnesota described the threshold for veil-piercing as following: "*Where the corporate form is used by individuals for the purpose of evading the law, or for perpetration of fraud, the court will not permit the legal entity to be interposed so as to defeat justice.*"[18]

### 3.1. Definition

The definition given by Black's Law Dictionary on the piercing the corporate veil reads as follows: *"the judicial act of imposing personal liability on otherwise immune corporate officers, directors, or shareholders for the corporation's wrongful acts."*[19] This definition reveals the main essence of veil piercing. Once the Court decides to disregard the statutorily imposed boundaries for corporate liability it may held personally liable different parties, such as the corporate officers, directors or the shareholders of the company which might be either natural or legal person. Hence, the spectrum of possible liable persons is fairly wide. To simplify this, we could differentiate between two types of persons which may be held personally liable:

a. corporate directors or managers[20] who act on behalf of a company; and

b. mother companies.

Further in our article we will discuss the veil piercing in order to hold personally liable directors who have gone into business personally under a company's cloak as well as mother companies who effectively control and manage their subsidiaries. Before that, it is essential to distinguish between different types of veil-piercing concerning the effect of such judiciary action as the corporate veil cases come in a great variety.

### 3.2. Classification of the Doctrine of Piercing the Corporate Veil

Courts use 'veil' as a metaphor in various circumstances and approach it differently and therefore often cause confusion as they do not differentiate between the various attitudes with which they address the company when lifting the

[13] *Katie Ellen West, et al. v William C. Costen, et al*. Civ. A. No 79-0210-R, US District Court, W.D. Virginia, Roanoke Division. March 2, 1983, page 587.
[14] *Id*., p. 587.
[15] Most of the worlds' jurisdictions recognize legal persons and assign those rights and obligations. The process of recognizing this legal concept varies from jurisdiction to jurisdiction. The break-through in the United States was the case *Trustees of Darmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819) where the Court defined the corporation as *"a corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as an incidental to its very existence.* In Germany, the debate on the nature of legal personality began shortly after 1868 during the period of drafting the German Civil Code. More on the theories, *see e.g.* Jethro W. Brown, *The Personality of the Corporation and the State,*21 L.Q.R. 365 (1905); George F. Deiser, *The Juristic Person,* 57 U. Pa. L. Rev. 131 (1908); Arthur W. Machen Jr., *Corporate Personality,* 24 Harv. L. Rev. 261 (1910-1911).
[16] The reason why legal systems introduced the concept of limited liability is very simple; it was necessary to encourage investment and increase the financial capital. In Europe, France was the first one introducing this doctrine by Commercial Ordinance of 1673, *see* Toubeau, Les institutes du droit consulaire ou les elements de la jurisprudence des marchands, d'un tres-grand secours ou palais, utiles a tous marchands et negociants, et necessaires aux juges et consuls (2nd ed. 1700). In the United States, the state governments started to grant limited liability to companies in their charter in1786, *see* Joseph S. Davis, Essays in the Earlier History of American Corporations 447 (1917).
[17] *See e.g.,* John Dewey, *The Historic Background of Corporate Legal Personality,* 35 Yale L.J. 655 (1926); Elvin R. Latty, *The Corporate Entity as a Solvent of Legal Problems,* 34 Mich. L. Rev. 597 (1936) or Warmer Fuller, *The Incorporated Individual: A Study of the One-Man Company,* 51 Harv. L. Rev. 1373 (1938).
[18] *Erickson v. Revere Elevator Co.,* 110 Minn 443, 444, 126 N.W. 130 (1910).
[19] Black's Law Dictionary, (9th ed. 2009).
[20] For the purposes of this article these two terms will be used interchangeably.

veil.[21] Hence, as we analyze the veil-piercing in different jurisdictions, it should be clear what is meant under the "piercing the veil" and what types of "piercing" courts may render.

This classification is based on Professor´s Ottolenghi article,[22] where he analyzes also decisions rendered by English courts and he differentiates between four categories of "piercing". The first category is **the peeping behind the veil** which is the least offensive and the veil is lifted only to discover the composition of a company and to gain information involving the management and shareholders of a company and what is their inter-relationship regarding the control of the company.[23]

The second technique of lifting the veil is **the penetrating the veil** which purpose is to impose the responsibility of shareholders and directors for company´s acts or to establish their direct interest in the company´s assets.[24]

The third category is **the extending the veil** which aims to embrace several different legal entities as one enterprise entity/as one corporate group, so that the whole attention would be oriented towards one legal entity instead of number of legal entities.[25]

The final form of lifting the veil is when courts are **ignoring the veil**. This approach takes place in such cases when a court believes that the company was not founded for commercial or other sound grounds, but only as a way to defraud or defeat creditors and to circumvent laws.[26] The decision of a court to ignore the company completely is not always insightful. There are two main reasons. First of all, the court has different types of remedies which can be issued and have the same legal effect, namely to declare void the malfeasant action, and secondly these remedies do not affect the rights of other and third parties as the "ignoring the veil" does. Therefore, such extreme type of piercing the corporate veil is deemed spurious and courts should avoid it.

## 4. PIERCING THE CORPORATE VEIL IN THE UNITED STATES

The reason why we chose the United States among multiple jurisdictions which apply the doctrine as a model or an example is simple. The United States might be considered as a cradle of this doctrine as well as of innovation and creativity when it comes to introduction of new theories and approaches.

The general rule of the company law in the United States is that a corporation being a separate legal entity limits the creditor's rights to the assets of the corporation. However, it was already in 1854 in the case *York & Maryland Line Railroad v. Winans,*[27] when the Supreme Court of the United States pierced the corporate veil of between mother company and its subsidiary and concluded that the subsidiary should be liable to the same extent as its mother company. Despite the fact that in this case the Supreme Court applied reversed piercing, when holding the subsidiary liable for the actions of mother company, not *vice versa*, the main implication of this case is that the Supreme Court was willing to set aside the corporate structure and look what was inside it and decide based on the economic reality, *e.g.* how the assets were divided and what was the decision-mechanism within the corporate group.

Since then, the doctrine of piercing the corporate veil has developed and faced numerous challenges. Unfortunately, as most of the law in the United States is still regulated on the state level, including corporate and enterprise law, there is no federally accepted doctrine of veil-piercing and therefore it is the decision of state courts to what extent they apply and use this doctrine. Moreover, even if the case comes before federal court, it should apply state law standards. With this respect,

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[21] *See* Smadar Ottolenghi, *From Peeping Behind the Corporate Veil, to Ignoring it Completely*, 53 MODERN L. REV. 338, 339 (1990).

[22] *Ibid,* p. 339.

[23] The most descriptive example is the *Daimler v Continental Tyre Co.* [1916] 2 AC 307 (HL), where the question was whether the defendant, a British company should pay the plaintiff, a British registered company, even though all the latter´s shareholders and directors were resident in Germany. In this case, the court lifted the veil to look who were the directors and shareholders of the company as to find out whether the company falls within the Trading with the Enemy Act 1914. This case is recognized by many jurists as the reference for lifting the corporate veil to determine the character of a company. Nevertheless, the decision held that the directors stand *in front* of the veil, so that there is no need to unveil them. Not only have their actions been regarded as those of the company, but also their mind has been regarded as the company´s, in cases where knowledge or will are required, as for assessing the negligence or criminality of the company.

[24] In the *Macaura v Northern Assurance Co.* [1925] AC 619 (HL) it was held that no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest.

[25] This technique can be illustrated by the case *Gilford Motor Co. Ltd. v Horne* [1933] Ch 935, CA, where a managing director formed a company of his own to solicit customers instead of soliciting them from his employers. The court withheld such structure and considered this company a sham to cloak his wrongdoings.

[26] *Id* 21, p. 351; This approach is analogous to the situations dealt with insolvency or bankruptcy acts in the U.S. as in the EU legislation, when a transfer of assets made with an intention to defraud creditors shall be held void and the court shall take steps to restore the position to what it would have been if that individual(s) had not entered into that transaction. On the other hand, if a person in order to avoid seizure of his/her assets by the creditors transfers them to a company under his/her control, the court may issue an injunction restraining him from disposing of his/her shares in the company, as well as restraining him from procuring the disposition of these assets (*Re a Company Ltd.* [1985] BCLC 333).

[27] *York & M.L.R.R. v. Winans*, 58 U.S. 30 (1854). This case involved an alleged patent infringement liability of a Pennsylvania subsidiary for parented railway cars which were operated on the subsidiary´s line from York, Pennsylvania, to the Maryland boundary, where they continued on to Baltimore on the line of its parent, a Maryland corporation. The subsidiary defended to be only a nominal organization to satisfy the formal requirements of Pennsylvania law requiring local incorporation of railroads operating in the state. The parent corporation managed the cars and operated the subsidiary´s line. However, the book entries credited the subsidiary with one third of the net profits of its line. Due to this fact, the court held the subsidiary liable.

piercing of the corporate veil has become very chaotic as many courts fail to explain the legal grounds of their decision and hence forming confusion and unforeseeability.[28]

However, this situation could be resolved by establishing a federal doctrine or by continuously applying one specific state veil-piercing doctrine properly and with full justification.[29]

### 4.1. Diverse Veil-Piercing Doctrines

The case law concerning the corporate veil is not only large-scale but it is also quite diverse as to the given court reasoning and justification. Therefrom, courts have established several differential argumentations for piercing the corporate veil. In this part we will describe and analyze three core veil-piercing doctrines applied by the U.S. courts from New York to California.

#### 4.1.1. Instrumentality Doctrine

In 1931 in a famous New York case *Lowendahl v. Baltimore & Ohio,*[30] Justice Frederick Powell has established his test for veil-piercing, where the factual circumstances are indicating that a company is a mere **instrumentality**. This test has been since then widely applied through entire US. In the Powell's test there are three conditions for liability:

a) an excessive exercise of control;

b) some wrongful or inequitable conduct; and

c) a causal relationship between the plaintiff's loss and the parent's conduct.

Evaluating the control, which needs to be in a case of the piercing 'excessive', depends not on a stock ownership, but on a *de facto* extreme intrusion in to the company's everyday decision making. Furthermore, this 'supremacy' must be abused for fraud or other unlawful or unjust action.[31] Powell later specified these three conditions into a list of evidentiary guidelines for the courts to decide whether or not the company is in the control of a third party[32] (director or mother company):

- The party owns all or the majority of the stock of the company;
- The party finances the company out of its own resources;
- The party and the company share offices and also directors (in case of mother company and its subsidiary);
- The party subscribes to all of the capital stock of the company or otherwise causes its incorporation;
- The company has grossly inadequate capital;
- The formal legal requirements of the company are not observed;
- The party reimburses the salaries and other expenses or losses of the company;
- The company has substantially no business except with the mother company or the director;
- The company has essentially no assets excepts those granted by the mother company or the director;

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[28] Several cases were decided without any discussion of the legal grounds or without specifically stating whether they apply a federal precedent or a state precedent. *E.g. Mas Marques v. Digital Equip. Corp.*, 490 F. Supp. 56 (1980) (discriminatory employment practices) or *Baker v. Raymond International Inc.,* 656 F. 2d 173 (5th Cir. 1981) (recovery of damages for injuries sustained while working on a barge).

[29] *See Piercing the Corporate Law Veil: The Alter Ego Doctrine under Federal Common Law*, 95 HARV. L. REV. 853, 861-865 (1982) and Thomas K. Cheng, *The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines,* 34 B. C. INT'L & COMP. L. REV. 329, 376-377 (on the concerns when the federal policy and federal statute faces state corporation law).

[30] *Lowendahl v. Baltimore & Ohio RR*, 247 AD 144, at 154; 287 NYS 62, at 73 aff'd 272 NY 360; (1936) 6 NE 2d 56. In this case plaintiff recovered judgment on a promissory note against individuals who executed the note and against a corporation to whom they transferred their business, on the grounds that the transfer of the business was made when the individuals were wholly insolvent, with intent do defraud creditors. Plaintiff sued defendants, who were majority stockholders of the corporation claiming the transfer to be fraudulent and due to the fact that the corporation had no independent existence and that defendants dominated it, the corporation was merely defendants' agent. The final decision of the appellate division held that the evidence did not show that the corporation was an agent of the defendants or defendants knew about plaintiff's claim at the time the assets were transferred. Despite the final decision, the most important thing about this ruling is the piercing of the veil and evaluating whether and how the stockholders controlled the corporation.

[31] KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL 81 (2007).

[32] [Hereinafter "The Party"].

- The company operates without profit;
- In the official records of the mother company the subsidiary is described as a department or division or its business or financial responsibility is referred to as the mother's own;
- The party uses the property of the company as its own;
- The mother and he company file consolidated income tax returns and/or consolidated financial statements;
- The company's loan transactions benefit the party at the expense of the company;
- The directors of the company do not act independently but they follow the orders from the mother company, whereas they prioritize the interests of mother company before the interests of the company;
- Decision making for the company is carried out by the mother company and its directors;
- Contracts between the party and the company are more favorable to the party; and
- The Party and the company share funds, business, common directors and supervision to such an extent that they should be considered as one enterprise.[33]

Numerous occurrences of these indicators represent a strong suggestion for the courts to become suspicious when dealing with the mother and subsidiary company or with a director with an excessive control. These criteria focus on the degree of financial and operational independence and a possible overlap in corporate personnel.[34] The instrumentality doctrine further requires the plaintiff to prove that the defendant's conduct heavily participated on the plaintiff's loss.

#### 4.1.2. Alter Ego Doctrine

On the Eastern Coast, Californian courts established the *alter ego* doctrine which is currently commonly used also in other US states. According to this doctrine, two conditions must be met before the corporate veil might be pierced. Firstly, there has to be such a unity of ownership and interest that the two affiliated companies or a director and the company itself do not represent separate personalities and the company represents an *'alter ego'* of the Party. Secondly, there has to be an inequitable result if the acts in question are treated as those of the Party alone. Occasionally, courts also require a third condition that the Party would hold a control over the company. Though, other courts consider the control to be a part of the 'unity of ownership and interest' factor.[35]

Several leading legal academics do not differentiate between the *alter ego doctrine* and the *instrumentality doctrine* as the core inquiry in both theories emphasizes the same two substantive factors and the causation with the plaintiff's injury.[36] Additionally, there is also the *identity doctrine*, which arises from the *alter ego* and the *instrumentality doctrine* and was introduced in the 1962 by Justice Powell as well.[37]

#### 4.1.3. Sham or Shell Corporation Doctrine

Some of the early cases involved corporations with little or no existence at all. These corporations lacked assets, business or even employees. They were only officially registered, had an official seat but did not exercise any activity. They represented only a "sham" or "shell" as they were only a "mere instrument" for the parent company or its director. Other cases involved transfers of individual assets without consideration to acquainted subsidiaries and companies to avoid creditors. In cases where the company was a part of fraudulent conveyances, courts generally granted recoveries to such transfers and disregarded the formal existence of the company as a separate entity and invoked equitable principles.

### 4.2. U.S. Empirical Study of 2006

All the above stated doctrines and theories work as well in practice. Different courts apply them and once the given requirements are met, they will pierce the veil and set aside the limited liability of either parent or director or other third party which misuses the statutory limitation of liability.

[33] Frederick Powell, *Parent and Subsidiary Corporations*, pp. 8-34 and pp. 54-81, in PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 138-140 (1987).
[34] Thomas K. Cheng, *Form and Substance of the Doctrine of Piercing the Corporate Veil*, 80 MISS. L.J. 487, 505 (2010).
[35] *Id. 33*, pp.118-119.
[36] For more *see* Kurt A. Strasser, *Piercing the Veil in Corporate Groups*, 37 CONN. L. REV. 637, 640 (2005).
[37] This doctrine was introduced in one of the Powell's case *Zaist v. Olson,* 154 Onn. 563, 227 A.2d 552 (1962).

In 2006, Peter B.Oh, an associate professor of law at the University of Pittsburg re-examined 2,908 veil-piercing cases to show the probability and reasons of veil-piercing in the United States [hereinafter '2006 Study'].[38] For the purposes of this article, only several findings are of an essence:

- The 2006 Study shows an increased overall veil-piercing rate of 48.51% which is substantially higher than in Thomson Study which was approximately 40%;[39]
- Only closed corporations have been pierced;[40]
- Piercing of the corporate veil occurs more often against inter-organizational bargains and irrespective of whether the controlling shareholder is an individual or a corporate parent. However, parent corporations enjoy a bit more success defending themselves against claims by an individual creditor (36.37%) than by another organization (40.91%);[41]
- Courts when justifying the veil-piercing generally apply the alter ego doctrine (62.94%) or the instrumentality doctrine (61.54%). In numerous cases, the court authorized the piercing due to the sham/shell corporation doctrine (60.14%). Alternatively, courts simply describe the facts of a case and not necessarily cross-refer to a specific doctrine (domination 66.58%).[42]

Both empirical studies prove that once a veil-piercing issue arises, there is around 50% of a chance that a state or a federal court in the United States will pierce the veil. However, the studies show that the courts are more likely to reach into the pocket of individual shareholders or a director than of a mother company. The reason for such tendency is that the doctrine of limited liability is intended precisely to protect the mother company which diverse its risks and whose subsidiary goes bankrupt. Only situations as already described and as such confirmed by these two studies, where the courts will pierce the corporate veil between the mother company and its subsidiary is when a parent goes beyond its normal and usual role as a shareholder and uses subsidiary as a mere agent or instrument or a department. A corporation exposes itself to liability only if it totally ignores or circumvents the corporate formalities of the subsidiary. Hence, with sufficient planning and legal consultations mother companies can avoid such liability.

## 5. PIERCING THE CORPORATE VEIL IN ROMANIA

The Romanian legal system undertook serious changes during the last 3 decades. Immediately after the fall of communism a new Company Law no 31/1990[43] was enacted in order to allow the creation and the functioning of private business sector. It has established from the very beginning the principle of separate legal personality and of limited liability, but only recently it had addressed issues like the status of the managers or corporate governance principles. Even so, the definition of control is still not to be found in the Company Law, but in the Capital Market Law.[44] Economic interest groups are addressed in a separate statute[45] which deals more with corruption than with economy, and so is bankruptcy[46]. Romania remains tributary to the French legal system which is the traditional source of inspiration.[47] The doctrine of piercing the corporate veil can be found throughout the Romanian legislation although it is not specifically named so and was not

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[38] This research represents already a second study providing such empirical data. For the first time in 1991, Professor Robet B. Thompson conducted a research on federal and state cases on the piercing of the corporate veil. This project covered all Westlaw cases since 1985 that involved attempts to pierce the corporate veil. It examined around 1,600 cases and reported also factual data of each case, *see* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study,* 76 CORNELL L. REV. 1036 (1991).

[39] Peter B. Oh, *Veil Piercing*, 89 TEX. L. REV. 81, 107 (2010).

[40] *Supra,* p. 110.

[41] *Supra,* p. 129.

[42] *Supra,* pp. 132 – 133.

[43] Company Law no 31/1990 was initially published in the Official Gazette no 126-127/17.11.1990 and republished in the Official Gazette no 1066/17.11.2004.

[44] Capital Market Law no 297/2004 was initially published in the Official Gazette no 571/29.06.2004. It offers definitions of "controlling" and "controlled party", but provides no applications for any them.

[45] Law no 161/2003 on introducing certain measures for ensuring transparancy in exercising public dignities, public offices and in the business environment, on preventing and sanctioning corruption was published in the Official Gazette no 279/21.04.2003. In Romanian original: Legea nr. 161/2003 privind unele măsuri pentru asigurarea transparenţei în exercitarea demnităţilor publice, a funcţiilor publice şi în mediul de afaceri, prevenirea şi sancţionarea corupţiei.

[46] Initially insolvency and bankruptcy were dealt by Law no 64/1995 on judiciary reorganization and bankruptcy published in the Official Gazette no 130/29.06.1995. It was replaced by Law 85/2006 on the insolvency proceedings, published in the Official Gazette no 359/21.04.2006.

[47] For example, Art 138 that we are going to refer to was considered a real innovation in the Romanian law, as it has no correspondent in the Romanian Commercial Code. As Art 137, which was its predecessor, Art 138 was inspired by the French legislation, especially by Law 98/1985. *See* STANCIU CĂRPENARU, VASILE NEMEŞ AND MIHAI HOTCA, LAW NO 85/2006 ON INSOLVENCY PROCEEDINGS, WITH COMMENTS 235 (2006).

developed by courts but by legal provisions. Interestingly many of the pre-requisites for the application of the doctrine are there, but they are not put together into a coherent body of law to be used by the courts.

### 5.1. **Piercing the Corporate Veil under Romanian Company Law**

Recently amended and modernized, the Romanian Company Law no 31/1990 contains no specific provision with respect to liability of shareholders, associates, managers or directors – neither *de jure,* neither *de facto* – towards third parties. The liability is usually related to the company or its owners, not towards creditors. Also, although it contains large provisions with respect to corporate governance, the Romanian Company Law does not define in any way what is "control" or who is the "controlling party". Such definitions are provided by the Capital Market Law which will be referred to later on.

The sole exception that might be used as support for the application of the doctrine of piercing the corporate veil are the provisions of Art 237, paragraphs 2, 3, 4. Paragraph 2 states once again the general rule and principle of the separate legal personality of the firm and the limited liability of the associates, who are to be responsible only within the margins of the subscribed capital. Basically, paragraph 2 states that such limited liability will be maintained in case of dissolution or liquidation of the company.[48] Paragraph 3 brings limitations to the above mentioned rules, by establishing the general situation in which the associates can be held liable beyond the threshold of their subscribed capital: *"The associate who, in the fraud of creditors, abuses the limited nature of his liability and his legal personality different than that of the company is unlimitedly liable for the due liabilities of the dissolved company, respectively liquidated",*[49] while Paragraph 4 provides some specific details which should be taken into consideration when establishing whether the associate is liable or not: "*The liability of the associate becomes unlimited under the terms of paragraph (3), especially when such associate disposes of the company assets as if they were his own or diminishes the company assets in his own personal benefit or in the benefit of third parties, knowing or having to know the fact that in such way the company shall not be able to perform its obligations".*[50]

Two important aspects should be noticed:

There is no distinction with respect to whom can be an associate – a legal or a natural person – which means that these provisions can be used to pierce the veil in both cases: subsidiary – mother company relationship or shareholder/manager – company relationship. Of course when it comes to the liability of the mother company, the possibility remains, for the moment, purely theoretical.

The place where the article is situated within the law – Title VI, Chapter 1: Dissolution of the company – is somehow consistent with the view adopted by the Romanian legislator in Law no 85/2006 on insolvency proceedings. More specifically, it seems that the doctrine may be applied only in cases of dissolution or liquidation of the company, not in all cases where the company is unable to fulfill its obligations or does not have enough funds to cover all the losses incurred by its creditors.[51] It is our conclusion that in the case of Romania, the doctrine of piercing the corporate veil is mostly related to the dissolution of the company.

### 5.2. **Piercing the Corporate Veil under Romanian Bankruptcy Law**

Law no 85/2006 on insolvency proceedings brought several important changes to the previous statute on bankruptcy, Law no 64/1995. The one that concerns us is the one regarding "The liability of the managing organs' members". The

[48] As there is no official English version of the law mentioned here, the Romania – English translation belongs to one of the authors of the article. Art 237, Para 2, reads as follows: "When, for the duration of operation of the company, an associate is liable for the obligations thereof within the limits of the contributions to the share capital, his liability shall be limited to such contribution and in case of dissolution and, if the case, of the liquidation of the company". In Romanian original: "Atunci când pe durata funcţionării societăşii, un asociat răspunde pentru obligaţiile acesteia în limitele aportului la capitalul social, răspunderea sa va fi limitată la acest aport şi în situaţia dizolvării şi, dacă este cazul, a lichidării societăţii".

[49] In Romanian original: „Asociatul care în frauda creditorilor, abuzează de caracterul limitat al răspunderii sale şi de personalitatea juridică distinctă a societăţii raspunde nelimitat pentru obligaţiile neachitate ale societăţii dizolvate, respectiv lihcidate".

[50] In Romanian original: Răspunderea asociatului devine nelimitată în condiţiile alin 3, în special atunci când acesta dispune de bunurile societăţii ca şi cum ar fi bunurile sale proprii sau dacă diminuează activul societăţii în beneficiul personal ori al unor terţi, cunoscând sau trebuind să cunoască faptul că în acest mod societatea nu va mai fi în măsură să îşi execute obligaţiile.

[51] Another argument sustaining this conclusion is the provision of Art 73, Para 2, where there is again mentioned the fact that an action can be filed by the creditors against the directors under the conditions of the bankruptcy law.

previous law provided for such a liability as well[52], but the new version has definitely improved and opens the gate, at least in theory, for the doctrine of piercing the corporate veil.
Thus, art 138 – the relevant provisions – states that:

(1) *In the event that through the report prepared in accordance with the provisions of art 59 (1) are identified persons to whom the occurrence of the insolvency can be attributed to, at the request of the bankruptcy trustee or of the liquidator, the bankruptcy judge may decide that part of the debt of the legal person debtor which ended up in insolvency, is to be covered by the members of the supervising bodies within the company and/or by the management, and also by any other person that has caused the insolvency of the debtor by one of the following deeds:*

a) *They have used the legal person's assets or receivables for personal interests or for those of another person*

b) *They have performed commercial activities for personal interests, under the cover of the legal person*

c) *They have decided, for personal interests, the continuation of an activity that led the legal person, in an obvious way, to cessation of payments.*

d) *They have held a fictive accountability, they have wiped out certain accounting documents or they have not kept the accounting records in accordance with the provisions of the law.*

e) *They have embezzled or concealed part of the legal person's assets or they have increased, fictitiously, its liabilities.*

f) *They have used ruinous means in order to obtain funds for the legal person to delay the cessation of payment.*

g) *In the month preceding the cessation of payment they have paid or ordered to be paid a preferred creditor, to the detriment other creditors.*

(2) *The application of the provisions of paragraph 1 does not impede the application of criminal law for the deeds that constitute crimes.*

(3) *The Creditors' Committee may ask the bankruptcy judge to be authorized to file the action provided by paragraph 1, if the bankruptcy trustee or the liquidator has failed to nominate, in his report on the causes of insolvency, the persons who make themselves responsible for the insolvency of the debtor, or has failed to file the action provided by paragraph 1 and the liability of the persons to which paragraph 1 is referring to is close to the term provided by the statute of limitations.*

(4) *In case of plurality, the liability of the persons nominated in paragraph 1 shall be established jointly, provided that the occurrence of insolvency is contemporary or anterior to the period of time in which they have exercised their mandate or they have detained the position that might have caused the insolvency. Those persons can defend themselves against joint liability if, in the managing bodies of the legal persons, they have opposed the deeds and the acts that have caused the insolvency or they have been absent when the decisions that caused the insolvency were taken and they have asked their opposition to these decisions to be noted in written, afterwards.*[53]

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[52] Art 137 of Law no 64/1995 provided that: (1) Bankruptcy judge may order that part of the legal person debtor's liabilities, now insolvent, to be borne by the board members - directors, managers, auditors and any other person - who have contributed to bring debtor in this situation, by one of the following deeds: a) used the legal person's assets or receivables for itself or for another person, b) performed commercial activities for personal interests, under the cover of the legal person; c) decided for personal interests, the continuation of an activity which was obviously leading the legal person to cessation of payments; d) held a fictional accounting, wiped out some accounting documents or failed to keep accounting records in accordance with law; e) embezzled or concealed part of the legal person or assets or increased in a fictional manner its liabilities, f) used ruinous means to obtain for the legal entity funds to delay cessation of payments, g) in the previous month to cessation of payments, has paid or ordered to pay a preferential creditor to the detriment of other creditors. (2) The provisions of paragraphs. (1) do not preclude criminal proceedings for those actions that constitute crimes. In Romanian original: **(1)** Judecătorul-sindic poate dispune ca o parte a pasivului debitorului, persoană juridică, ajuns în stare de insolvenţă, să fie suportată de către membrii organelor de conducere - administratori, directori, cenzori şi de orice altă persoană - care au contribuit la ajungerea debitorului în această situaţie, prin una dintre următoarele fapte: **a)** au folosit bunurile sau creditele persoanei juridice în folosul propriu sau în cel al unei alte persoane**; b**) au făcut acte de comerţ în interes personal, sub acoperirea persoanei juridice; **c)** au dispus, în interes personal, continuarea unei activităţi care ducea în mod vădit persoana juridică la încetarea de plăţi**; d)** au ţinut o contabilitate fictivă, au făcut să dispară unele documente contabile sau nu au ţinut contabilitatea în conformitate cu legea**; e)** au deturnat sau au ascuns o parte din activul persoanei juridice ori au mărit, în mod fictiv, pasivul acesteia; **f)** au folosit mijloace ruinătoare pentru a procura persoanei juridice fonduri, în scopul întârzierii încetării de plăţi; g) în luna precedentă încetării plăţilor au plătit sau au dispus să se plătească cu preferinţă unui creditor, în dauna celorlalţi creditori. **(2)** Aplicarea dispoziţiilor alin. (1) nu înlătură aplicarea legii penale pentru faptele care constituie infracţiuni.

[53] The original Romanian version reads as follows: **(1)** În cazul în care în raportul întocmit în conformitate cu dispoziţiile art 59 alin 1 sunt identificate persoane cărora le-ar fi imputabilă apariţia stării de insolvenţă a debitorului, la cererea administratorului judiciar sau a lichidatorului, judecătorul sindic poate dispune ca o parte a pasivului debitorului, persoană juridică, ajuns în stare de insolvenţă, să fie suportată de membrii organelor de conducere şi/sau supraveghere din cadrul societăţii, precum şi de orice altă persoană care a cauzat starea de insolvenţă a debitorului, prin una dintre următoarele fapte: **a)** au folosit bunurile sau creditele persoanei juridice în folosul propriu sau în cel al unei alte persoane; **b)** au făcut acte de comerţ în interes personal, sub acoperirea persoanei juridice; **c)** au dispus, în interes personal, continuarea unei activităţi care ducea, în mod vădit, persoana juridică la încetarea de plăţi; **d)** au ţinut o contabilitate fictivă, au făcut să dispară unele documente contabile sau nu au ţinut contabilitatea în conformitate cu legea; **e)** au deturnat sau ascuns o parte din activul persoanei juridice ori au mărit în mod fictiv pasivul acesteia; **f)** au folosit mujloace ruinătoare pentru a procura persoanei juridice fonduri, în scopul întârzierii încetării de plăţi; **g)** în luna precedentă încetării plăţilor au plătit sau au dispus să se plătească cu preferinţă unui creditor, în dauna celorlalţi creditori. **(3)** Dacă administratorul judiciar ori, după caz,

Another important provision with respect to the procedure is the one contained in Art 140 which states that: *The amounts submitted according to the provisions of art 138, paragraph 1, will become part of the debtor's estate and shall be destined, in case of reorganization, for payment of the debts according to the payment schedule, for completing the necessary funds for continuation of debtor's activity, and in case of bankruptcy, for covering the liabilities.*[54]

Four conclusions can be drawn from the two legal provisions just quoted and we shall analyze them each:

First, at least on a theoretical level, piercing the corporate veil is possible, both against shareholders or managers as well as against the mother company. This stems out of the new addendum: "*and any other persons that have caused the insolvency*". Given the fact that the legislators did not make a distinction whether the text refers to a natural or legal person, neither should we, and one can easily assume that the legal text covers both.[55] The provision is an enormous step forward as the previous version of the law did not cover those persons involved, directly or indirectly in the control of the company.[56] Also, there is no distinction made between *de facto* or *de jure* managers, which means that it makes no difference whether those li

Second, given the fact that the legislator has enumerated strictly the deeds that can be used as legal reason for attracting liability of third parties, application of the doctrine is limited on its grounds. The limitation becomes even more stringent if we consider the fact that both the Romanian doctrine and case law have placed the burden of proof on the claimant. Thus, claimant has to prove: the existence of the prejudice, the existence of the deed, intent of the wrongdoer and also the causality connection between the deed and the intent of the wrongdoer.[57] It is evident that the Romanian law does not provide for a legal presumption in favor of the creditors but on the contrary they actually bear the burden of proof. The reason lies in the fact that the conditions adopted by the doctrine and case law for establishing the liability are those from Romanian tort law, art 1357 of the New Civil Code.[58]

Third, it obvious that creditors do not have the primacy in formulating the claim and even when they can do it, it is subjected to certain conditions: only if the bankruptcy trustee or the liquidator has failed to identify those who are liable, or, although it has identified them, has failed to file a claim against them and the action is subjected to the statute of limitations.[59] This creates another form of limitation as those who are directly affected by the bankruptcy of the company have neither a direct recourse to court nor their own standing.[60] Their action is just subsidiary.

Forth, under the Romanian legislation, the affected (and protected) parties are not the creditors but the company itself (the debtor). Therefore it is in the name of the company that the bankruptcy trustee or liquidator is suing those responsible for debtor's bankruptcy and it is the company who recovers the money. Creditors get access to these amounts only indirectly, through the bankruptcy proceedings, under the bankruptcy distribution rules. Thus the doctrine of piercing the corporate veil is not only strictly limited, but it generates only indirect effects on the creditors. De *lege ferenda* the right to action should be given to the creditors directly, free of any other conditions or limitations.[61]

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lichidatorul nu a indicat persoanele culpabile de starea de insolvenţă a debitorului şi/sau a hotărât că nu este cazul să introducă acţiunea prevăzută la alin 1, aceasta poate fi introdusă de preşedintele comitetului creditorilor în urma hotărârii adunării creditorilor ori, dacă nu s-a constituit comitetul creditorilor, de un creditor desemnat de adunarea creditorilor. De asemenea, poate introduce această acţiune, în aceleaşi condiţii, creditorul care deţine mai mult de 50% din valoarea creanţelor înscrise la masa credală. **(4)** În caz de pluralitate, răspunderea persoanelor prevăzute la alin 1 este solidară, cu condiţia ca apariţia stării de insolvenţă să fie contemporană sau anterioarp perioadei de timp în care şi-au exercitat mandatul ori în care au deţinut poziţia care ar fi putut cauza insolvenţa. Persoanele în cauză se pot apăra de solidaritate dacă, în organele colegiale de conducere ale persoanei juridice s-au opus la actele ori faptele care au cauzat insolvenţa sau au lipsit de la luarea deciziilor care au cauzat insolvenţa şi au făcut să se consemneze, ulterior luării deciziei, opoziţia lor la aceste decizii".

[54] The original Romanian version reads as follows: "Sumele depuse potrivit dispoziţiilor art 138 alin 1 vor intra în averea debitorului şi vor fi destinate, în caz de reorganizare, plăţii creanţelor potrivit planului de plăţi, completării fondurilor necesare continuării activităţii debitorului, iar în caz de faliment, acoperirii pasivului".

[55] *See* Stanciu Cărpenaru, Vasile Nemeş and Mihai Hotca, Law no 85/2006 on insolvency proceedings, with comments 328 (2006). The commentary makes no reference to legal persons, but enumerates several categories of natural persons that may be found liable under the new wording of the text: *shareholders, associates, CFO's, departments' chiefs, accountants.*

[56] *Idem*, p. 328. With specific reference to shareholders and associates, the commentary makes a qualification based on Decision no 40/2005 (unpublished, rendered by Bucharest Court of Appeals) stating that: "*they will be liable only if it is proven that they have committed one of the deeds specified expressly in Art 138, which means that they have directly involved in the administration of the debtor or they have administered in fact the activity of the debtor.*"

[57] *See* Stanciu Cărpenaru, Vasile Nemeş and Mihai Hotca, Law no 85/2006 on insolvency proceedings, with comments 326 (2006). Also, see: Decision no 657/2007 rendered by Bucharest Court of Appeals, Decision no 1318/2007 rendered by Constanţa Court of Appeals, Decision no 471/R/2009 rendered by Bucharest Court of Appeals reproduced by Mona Maria Pivniceru a.o., Insolvency procedure 2006-2009, Jurisprudence 352-360 (2009).

[58] Law no 287/2009 regarding the Civil Code was initially published in the Official Gazette no 511/24.07.2009 and was republished in the Official Gazette no 409/10.06.2011.

[59] Decision no 1781/2007 rendered by Bucharest Court of Appeals, reproduced by Mona Maria Pivniceru a.o., Insolvency procedure 2006-2009, Jurisprudence 379-381 (2009). In the mentioned Decision, the Court held that: *"The omission of the liquidator to nominate in his reports the causes of insolvency or those who are liable for the company's insolvency, must create an inequitable situation for the creditors, in the sense that by liquidator's inaction, the creditors are unable to exercise their right to be properly informed and exercise the action themselves."*

[60] The conclusion is supported also by a provision of the Company Law no 31/1990, Art 73, Para 2 which reads as follows: "The liability action against the directors can be filed also by the creditors of the company, who will be entitled of exerting it only in case of opening the procedure regulated by Law no. 64/1995 on the insolvency procedure, as republished". In Romanian original: "Acţiunea în răspundere împotriva administratorilor aparţine şi creditorilor societăţii, care o vor putea exercita numai în caz de deschidere a procedurii reglementate de Legea nr. 64/1995 privind procedura reorganizării judiciare şi a falimentului, republicată".

[61] For a similar opinion please *see* Stanciu Cărpenaru, Vasile Nemeş and Mihai Hotca, Law no 85/2006 on insolvency proceedings, with comments 342 (2006). The commentary pleads for the right of creditors to file the legal action, "*if the bankruptcy trustee,*

An interesting fact is that nowhere in the commentaries of the bankruptcy law or in the court cases we have studied is there a mention of the doctrine itself. "Piercing the corporate veil" is not present anywhere in the Romanian doctrine or case law. Only professor Piperea has recently brought the subject into discussion, during an interview criticizing the Romanian Company Law no 31/1990 (the revised version),[62] and in a recent article analyzing the application of the doctrine in two EUCJ cases related to competition law issues.[63] Until now, Professor Piperea remains a unique voice on the matter.

## 6. PIERCING THE CORPORATE VEIL IN SLOVAKIA

The legal system in Slovakia, as all of the already described systems, confers upon companies separate legal personality which is different from their shareholders. It is the Slovak Civil Code[64] which assigns upon legal persons the capacity to the rights and obligations. However, the Civil Code does not define the notion of legal entity, but only enumerates types of legal persons, companies being one of them,[65] and defines their elementary characteristics.[66] The majority of the provisions regulating companies are to be found in the Slovak Commercial Code[67] [hereinafter 'Co.C'] which represents *lex specialis* towards the Slovak Civil Code which serves as *lex generalis.*

### 6.1. Piercing the Veil under Slovakian Company Law[68]

Pursuant to Slovakian Commercial Code, all the assets of a corporation are isolated from its shareholders and the shareholders are liable only to the extent of the required minimum capital. In the current statutory rules, there is no general set of regulations concerning piercing the corporate veil. However, Co.C in certain provisions opens the door to veil-piercing in connection to the managing director of a company, called 'konateľ'.[69] On the other hand, there are no specific provisions concerning the corporate groups as in the case of Germany.[70] Co.C reflects on the issue only in a very limited extent – with two provisions (§66a and §66b Co.C) on *'Controlled and Controlling person'* and *'Proceedings in Accordance'*.

#### 6.1.1. Liability of Mother 'Controlling' Company

Article 66a defines who the controlled and controlling persons are. Under section 1 of the controlled person is "*a corporation in which a person owns a majority of the voting rights, either because it owns such a participation or it owns company's shares, which involve a majority of voting rights, or because, due to the agreement with other shareholders the controlling person is entitled to perform the majority of the voting rights, regardless of the validity or invalidity of such an*

*liquidator or creditor's committee fail to file it themselves*". The proposal does not seek to change the subsidiary character of creditors' right to file the action. We find this position too moderate, although it might improve a bit the current situation. We are on the opinion that such a right should not be subsidiary or conditional, but awarded to any creditor directly to enhance the efficiency of this legal remedy. Such a decision would not only be justified under procedural grounds but also under logical grounds, the creditors being those who are suffering the actual loss.

[62] Interview reproduced from "Bilanţ" Magazine on http://www.avocatnet.ro/content/articles?id=7216 (last accessed April 19th 2012). During the interview, referring to the limited liability of a sole associate's companies, professor Piperea said that it considers such companies "fictive companies" which should be subjected to the doctrine of piercing the corporate veil in order to protect creditors from fraudulent acts of the sole associate. In Romanian original: "Există foarte multe situaţii practice în care sunt constituite societăţi numai ca un paravan ale stăpânului afacerilor sau unele dintre ele sunt societăţi-fantomă, constituite doar pentru aventuri economice sau pentru fraudarea intereselor creditorilor. Eu le denumesc societăţi fictive. În dreptul anglo-saxon, tehnica societăţii fictive este denumită "a străpunge vălul corporatist", adică a străpunge rolul corporatist, a lua paravanul acela al răspunderii limitate. Adică, deşi societatea este parte în contract, daca tu, creditor, ai de recuperat ceva de la acea societate, iar când faci acest lucru vezi că are un capital social de 200 de lei, constaţi că rămâi cu creanţa în aer. Demonstrând că este o societate fictivă, deci că personalitatea sa juridică este falsă, te poţi duce să-l urmăreşti direct pe asociat, pe stăpânul afacerii. Aceasta este tehnica străpungerii "vălului corporatist" care are o aplicaţie puţin cam confuză în Codul de procedură fiscală."

[63] *See* Prof. Dr. Gheorghe Piperea, *Comisia Europeana a sanctionat opt banci austriece*, on http://www.infolegal.ro/comisia-europeana-a-sanctionat-opt-banci-austriece/2011/04/05/ (last accessed April 19th 2012).

[64] Act No. 40/1964 Coll.

[65] Slovak legal theory divides companies into two groups: personal companies and capital companies. The same division takes place in Germany and France and other continental legal systems. In Anglo-Saxon world, it is *de facto* same, though they differentiate mainly between companies and partnerships. For the purposes of this article, the term company in the Slovak legal environment refers only to the limited liability companies: Limited Liability Company ('*spoločnosť s ručením obmedzeným'*) and Joint Stock Company ('*akciová spoločnosť*').

[66] The general regulation of legal persons is to be found in articles 18-21 of the CC. The text in English of article 18 of the Civil Code reads: "(1) Legal entities are able to have rights and responsibilities. (2) Legal entities are: (a) associations of natural or legal persons; (b) associations of property; (c) territorial units; (d) other entities established by law."
in Slovakian of article 18 of the Civil Code reads: "(1)Spôsobilosť mať práva a povinnosti majú aj právnické osoby.(2) Právnickými osobami sú: (a) združenia fyzických alebo právnických osôb, (b) účelové združenia majetku, (c) jednotky územnej samosprávy, (d) iné subjekty, o ktorých to ustanovuje zákon."

[67] Act No. 513/1991 Coll.

[68] The company law in Slovakia is mainly regulated by the Slovak Commercial Code, as the provisions regulating the types of companies, their characteristics and the rights and obligations stemming out of them are to be found in the II., III., IV. and V. part of the First Chapter of the Slovak Commercial Code.

[69] Slovakian legal language is very peculiar in this aspect and calls the person who is legally responsible for managing and directing the company - "konateľ". Within the registry of companies, one can clearly see who is "konateľ" and hence who is entitled to bind the company vis-à-vis the third persons.

[70] Germany has a statutory body of law of corporate groups – 'Konzernrecht' within articles 15-19 and 291-328 of the Stock Company Act ('Aktiengesetz'). These rules are designed to protect the interests of minority shareholders and creditors. They do not form a direct majority shareholder liability vis-à-vis the minority shareholders or creditors, but rather form a system of reservation of the company's assets.

*agreement."*[71] The subsequent provisions deal only with the proportion of the voting rights and their exercise (section 3 and 4). At this point Slovak legislator stopped.

Article 66a sets out only the conceptual features which are required to be fulfilled in order to acquire the status of controlled or controlling person. Other provisions of the Slovak Commercial Code which reflect on the status of the legal person being controlled or controlling person consider only a partial amount of the issues related to the relationship between a controlled and controlling person, such as an acquisition of individual share, creation of a lien on the shares of the controlled person or protection of the minority shareholders of the controlled person, etc.[72] But, none of the provisions indicates any awareness of numerous liability issues inherent in the relationship between the mother company and its subsidiary.

Furthermore, the authors were not able to find one single case which would hold the mother company liable for the actions of the subsidiary except the competition cases for the breach of competition or abuse of dominant position. Hence, concerning this type of veil-piercing between two interconnected companies, it is obvious that the notion of corporate limited liability is very strong and bullet-proof.

#### 6.1.2. Liability of Managing Director ('Konatel")

All managing directors owe fiduciary duty to the company and to the company's shareholders. They should act with due care and in accordance with the interests of a company. They are obliged to obtain and consider all available information before deciding on a specific issue. Furthermore, they are prohibited from disclosing confidential information to third parties and when exercising their powers they should always prefer and prioritize the interest of the company over their own interests, interests of only some shareholders or interests of third parties.[73] The question though is what the consequences are in the event of a breach of these duties. The section 2 of article 135a of the Co.C establishes a joint and several liability of managing directors once he/she/they breached fiduciary duty, particularly they are obliged to compensate the company those damages which are the result of:

*(a) "managing directors providing performance to a shareholder contrary to the provisions of this Act;*

(b) *managing director acquiring property contrary to article 59a."*[74]

Following the provisions of article 135a, a managing director is not held liable if he or she proves that he or she acted with due care and in *bona fide*.[75] Hence, the Slovakian provisions comply with the general fiduciary duty standards and the legal provisions regulating the liability of managing partner or a member of a statutory body towards the company itself comparable with other legal regulations.[76]

Concerning the manager's liability vis-à-vis a creditor, if the creditor cannot satisfy itself from the company's assets, creditor can itself claim damages from the manager and even if there was some kind of agreement that the company would not pursue any kind of claims against the manager for the company's losses it does not affect the entitlement of creditor.[77] Hence, the creditor may bring an action against the managers in the amount of its claims towards company. This statutory construction extends the liability of the managers in the sense that in the event they breach their fiduciary duty they will be held liable for the damage they caused with their entire personal property. The burden of proof lies on the shoulders of the creditor who would have to prove the breach of fiduciary duty, the damage and the causal link between the occurrence of the damage and the manager's breach of fiduciary duty. In conclusion, the Commercial Code gives a possibility to a creditor to sue the managing directors for the debts of a company and hence pierces the veil between the company and the director. It remains questionable to what extent a creditor can bear its burden of proof and evidence the breach of managing director's fiduciary duty.

#### 6.1.3. Civil Code as a possible path?

As has been already stated, the Slovak Commercial Code is *lex specialis* towards the Slovak Civil Code which serves as *lex generalis*. Therefore, if some specific problem is not governed by the Co.C, the Civil Code steps in and the harmed party may rely on its provisions. Hypothetically, one of such provisions is article 424 which states that *"A person is liable for the damage caused intentionally against good manners."*[78] The equivalent of this provision, article 826 of the German Civil

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[71] The text in Slovakian of article 66a of the Co.C reads: "Ovládaná osoba je spoločnosť, v ktorej má určitá osoba väčšinový podiel na hlasovacích právach preto, že má podiel na spoločnosti alebo akcie spoločnosti, s ktorými je spojená väčšina hlasovacích práv, alebo preto, že na základe dohody s inými oprávnenými osobami môže vykonávať väčšinu hlasovacích práv bez ohľadu na platnosť alebo na neplatnosť takejto dohody (article 186a Co.C)."

[72] *E.g.* §59a sec. 3, § 120, 161f§, 196a of Co.C.

[73] Article 135a , section 1 of the Co.C. The text in Slovakian reads: Konatelia sú povinní vykonávať svoju pôsobnosť s odbornou starostlivosťou a v súlade so záujmami spoločnosti a všetkých jej spoločníkov. Najme sú povinní zaobstarať si a pri rozhodovaní rozhľadniť všetky dostupné informácie týkajúce sa predmetu rozhodnutia, zachovávať mlčanlivosť o dôverných informáciách a skutočnostiach, ktorých prezradenie tretím osobám by mohlo spoločnosti spôsobiť škodu alebo ohroziť jej záujmy alebo záujmy jej spoločníkov, a pri výkone svojej pôsobnosti nesmú uprednostňovať svoje záujmy, záujmy len niektorých spoločníkov alebo záujmy tretích osôb pred záujmami spoločnosti."

[74] The text in Slovakian of article 135a, section 2 of the Co.C. reads:"Konatelia, ktorí porušili svoje povinnosti pri výkone svojej pôsobnosti, sú povinní spoločne a nerozdielne nahradiť škodu, ktorú tým spoločnosti spôsobili. Najmä sú povinní nahradiť škodu, ktorá spoločnosti vznikla tým, že (a) poskytli plnenie spoločníkom v rozpore s týmto zákonom; (b) nadobudli majetok v rozpore s §59a.

Article 59a regulates the contracts between the company and its shareholders or between the company and its managing director. In such cases, if the consideration is at least 10% of the authorized capital, the value of the contractual object has to be determined by an expert.

[75] Article 135a, section 3 of the Co.C.

[76] The same standard is applicable in a case of joint stock company and the members of statutory bodies and supervisory bodies.

[77] Article 135a, section 5 of the Co.C.

Code was applied in a *Trihotel* case[79] from the summer 2007. Pursuant to the article 826a person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable to the other person to compensate the damage.[80] This provision could have been used in a way to pierce the corporate veil, however the bankruptcy proceeding in this particular case has commenced and therefore any other claims were stayed.

Nevertheless, in the *Trihotel* case, the German Federal Court has acknowledged the article 826 as a possible way, how in a case of directors' and shareholders' breach of good manners, could a creditor claim them personally liable. Concerning Slovak case law, such option has not yet been exercised.

### 6.2. Piercing the Veil under Slovakian Bankruptcy Law

Slovak Bankruptcy Statute[81] [hereinafter 'BS'] has been adopted on 9th December 2004. Following the legislator's memorandum, the core objective of this novel regulation when adopted was to strengthen the creditors' position. The entire regulation was drawn in a way to provide creditors with effective legal tools in order to protect themselves in case of debtor's bankruptcy.[82] In addition, the restructuring should be always considered as the first option.[83] Restructuring should encourage and stimulate all the stakeholders to modify their contractual relationships in order to reach a collective satisfaction rather than 10% of their claim.

Concerning the veil-piercing, the BS imposes a system where legal acts of a company might be held null and void in the case they have been carried out with a 'related party' to the detriment of other creditors. Here the mother company as well as managing director come into the picture.

Article 9 of the BS specifies who a 'related party' ('spriaznená osoba') might be:

(a) *a statutory body or a member of a statutory body, managing employee, proxy or a member of a supervisory board;*
(b) *natural person or other legal person who has a qualified interest in the legal entity;*
(c) *a statutory body or a member of statutory body, managing employee, proxy or a member of a supervisory board of a legal person referred to in point (b);*
(d) *close person to a natural person referred to in subparagraphs (a) to (c);*
(e) *other legal entity in which the legal person or any of the persons mentioned in subparagraphs (a) to (d) have a qualified interest.*[84]

Firstly, it is necessary to specify what a qualified interest means. Section 3 of article 9 states that *"the qualified interest for the purposes of this Act means a direct or indirect involvement representing at least 5% share of the authorized capital or of voting rights of the legal person or the possibility of applying influence on the management of the legal person which is comparable to the influence corresponding to this share; the indirect involvement for the purposes of this Act is the share held indirectly through entities in which the holder has a qualified interest.'*[85]

Based on the above stated, it is evident that in the case of bankruptcy proceedings, the court may pierce not just one veil but several veils if company which aims to hide some assets in the courtyard of a related person or a person of a related person. All 'related parties' have to be stated once the bankruptcy proceeding begins.[86] The BS lays down the necessary requirements which once fulfilled, the legal acts between the legal entity undergoing bankruptcy proceeding and 'related party' are to be held void. These provisions do not serve for the purposes of extending the liability but to protect the creditors against fraud which is the fundamental element of any veil-piercing case.

The given provisions are very broad and entitle the creditors to reach quite far. However, another question which needs to be answered is connected to the burden of proof. Moreover, from the pragmatic perspective, who has sufficient time and means to investigate the legal and natural persons with whom the company signed the contract. Within the bankruptcy proceeding, the entitled person who should carry out not only the formal actions but also carefully assess all business transactions of the company is the trustee. Once the trustee finds out the improper agreements and dealings between the company and the related party, trustee can petition the court to hold such legal acts void and bind the parties to

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[78] The text in Slovakian of article 424 of the Civil Code reads:"Za škodu zodpovedá aj ten, kto ju spôsobil úmyselným konaním proti dobrým mravom."

[79] BGHZ 173, 246 (2007).

[80] The text in German of the article 826 reads: "Wer in einer gegen die guten Sitten verstoßenden Weise einem anderen vorsätzlich Schaden zufügt, ist dem anderen zum Ersatz des Schadens verpflichtet".

[81] Act No. 7/2005 Coll.

[82] The former bankruptcy legislation has been extremely ineffective, as the bankruptcy proceedings lasted for approximately from 3 to 7 years and creditors were able to secure around 5-10% of their claims.

[83] Restructuring refers to a similar procedure as reorganization under Chapter 11 of the UCC, which allows the debtor to enter into an agreement with creditors under which all or part of the business continues. Based on this agreement, the debts are restructured, so as the debtor could continue its business.

[84] The text in Slovakian of article 9, section 1 of the BS reads: "Spriaznenou osobou právnickej osoby sa na účely tohto zákona rozumie (a) štatutárny organ alebo člen štatutárneho orgánu, vedúci zamestnanec, prokurista alebo člen dozornej rady právnickej osoby; (b) fyzická osoba alebo iná právnická osoba, ktorá má v právnickej osobe kvalifikovanú účasť; (c) štatutárny orgán alebo člen štatutárneho orgánu, vedúci zamestnanec, prokurista alebo člen dozornej rady právnickej osoby uvedenej v písmene (b); (d) blízka osoba fyzickej osoby uvedenej v písmenách (a) až (c); (e) iná právnická osoba, v ktorej má právnická osoba alebo niektorá z osôb uvedených v písmenách (a) až (d) kvalifikovanú účasť."

[85] The text in Slovakian of article 9, section 1 of the BS reads: "Kvalifikovanou účasťou sa na účely tohto zákona rozumie priamy alebo nepriamy podiel predstavujúci aspoň 5 % na základnom imaní právnickej osoby alebo hlasovacích právach v právnickej osobe alebo možnosť uplatňovania vplyvu na riadení právnickej osoby, ktorý je porovnateľný s vplyvom zodpovedajúcim tomuto podielu; nepriamym podielom sa na účely tohto zákona rozumie podiel držaný sprostredkovane prostredníctvom právnických osôb, v ktorých má držiteľ nepriameho podielu kvalifikovanú účasť."

[86] Article 12, section 4 of the BS.

restitution or compensation of creditors. If the trustee does not act within adequate period of time, only then can the creditor petition the court.[87]

The BS established two requirements in order to hold contractual agreement void. First, there was no adequate consideration and second such agreement caused the bankruptcy of the debtor.[88] These requirements apply to any contractual agreement also with a non-related party. However, in the case of related party, the causation is anticipated, unless proven otherwise.[89] Hence, the burden of proof connected to the causation shifts, which simplifies the entire procedure of submitting evidence.

In conclusion, Slovakian bankruptcy law gives certain leeway for just and fair court actions in case of fraudulent demeanor of a company, managing director or other parties. There is also the positive aspect of shifting the burden of proof in case of related parties. However, in practice waiting till the trustee commences the procedure might impede the procedure and tighten the hands of creditor. Therefore, to speed up the process, the creditors should have standing from the very beginning and should not have to wait until the trustee's inaction.

## 7. CONCLUDING REMARKS

This concludes our analysis and comparison between the US and our Central and Eastern European jurisdictions. We have shown the current legal situation in all three jurisdictions and we have tried to emphasize the advantages of having the doctrine of piercing the corporate veil introduced and applied in our systems. The list of abuses which could be prevented or solved by piercing the veil is very long, with applications in various legal areas. Thus it is our common view and strong belief that the benefits it would bring cannot be denied and the doctrine should be implemented.

It can be easily noticed that the differences between the jurisdictions are quite big, though, slowly, steps are taken towards the application of the piercing the corporate veil doctrine in the CEE region[90] as well, despite the fact that there still is a lot of work to do and many problems to be solved. A major one has to do with the development of law and with adopting and implementing the right terminology. As shown, some applications of the doctrine are already available [in Romania and in Slovakia], though the 'piercing of the corporate veil' is nowhere mentioned as such in the legal literature or in the case law. There is also reluctance and resistance towards the doctrine with respect to its application, at least at a theoretical level. Legal certainty, protection and encouragement of business or investments are always mentioned when the issue of piercing the corporate veil is brought up in the discussion with practitioners, as many fear that it might have a chilling effect on investments. Even more, the formalistic view of the European civil law systems on law is also a serious obstacle. The European approach is that everything should be strictly mentioned and regulated through specific provisions of the law, while in the US, given the peculiarities of the common law system, the doctrine is developed by courts and their case law. Europeans need to understand that not everything can be comprised in the law and that when it comes to such issues, some liberty must be awarded to the courts. Here, also the Court of Justice of the European Union might have something to say in the future and might give certain incentives to the courts for applying the doctrine of piercing the corporate veil.

But the above mentioned concerns related to the chilling effect that might be caused are contradicted by the actual facts and by the US example which shows that the doctrine does not have a general application and it was not created to circumvent or infringe the patrimonial separation between the company's founders and the company itself or the principle of limited liability. On the contrary, the doctrine was, is and remains just an exception from these principles, one judicial mean which requires judges to careful analyze the situation and make sure that there will not be more abuses than the ones which the doctrine is trying to prevent. It is a search for balance and a continuous concern for establishing clear standards, constantly developed by the courts. Even more, its application is still limited as shown by the empirical study described in our article.

Nevertheless a discussion must take place. The doctrine of piercing the corporate veil needs to draw the attention of both practitioners and theoreticians in our countries and we hope that this article will do that. We believe that the US model has many lessons to teach us in this respect and our scholars should dedicate more time to this topic, as it is the only way to learn and advance. We also know that our work is not exhaustive and there are still related topics to be covered. We just need to start from somewhere.

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[87] Article 57 of the BS.

[88] Article 58 of the BS.

[89] Article 58, section 2 of the BS. The text in Slovakian reads: "Právnemu úkonu bez primeraného protiplnenia možno odporovať, ak spôsobil úpadok dlžníka alebo bol urobený počas úpadku dlžníka. Ak ide o právny úkon urobený v prospech osoby spriaznenej s dlžníkom, úpadok dlžníka v case urobenia právneho úkonu sa predpokladá, ak sa nepreukáže opak."

[90] For more on the CEE region and the applicability of doctrine of piercing the corporate veil, *see* Stefan Messmann & Tibor Tajti, The Case Law of Central and Eastern Europe, 33-186 (2007).

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