

# Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America

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## I. INTRODUCTION

The veil piercing theory<sup>1</sup> provides only one of many potential remedies for a plaintiff in an action against a corporation in the

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1. Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L.J. 1, 8 (1978) (mentioning the following terms to describe a corporation that should have its veil pierced: “mere adjunct, agent, alias, alter ego, alter, idem, arm, blind, branch, buffer, cloak, coat, corporate double, cover, creature, curious reminiscence,

United States.<sup>2</sup> This doctrine, also called “disregarding [the] corporate entity,”<sup>3</sup> allows U.S. courts to overlook the corporate shield that protects shareholders from lawsuits against the corporation and to hold the shareholders personally liable for claims against the corporation. The veil piercing theory is indisputably a common law theory applied in most U.S. jurisdictions.<sup>4</sup> As an equitable remedy,<sup>5</sup> it allows plaintiffs to recover directly from shareholders of defendant corporations who would otherwise enjoy the benefit of limited liability. What makes this doctrine unique among other equitable remedies in U.S. law is the high degree of attention that it has received during the last century. In fact, piercing the corporate veil has been identified as “the most litigated issue in [United States] corporate law.”<sup>6</sup>

However, despite the frequency with which the doctrine is litigated, there is no clear-cut presentation of its essential aspects in U.S. law that can serve as an absolute point of reference for comparative law purposes.<sup>7</sup> There is somewhat of a consensus among legal scholars that this theory is one of the more confusing doctrines in corporate law,<sup>8</sup> stemming from its overall unpredictabil-

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delusion, department, dry shell, dummy, fiction, form, formality, fraud on the law, instrumentality, mouth piece, name, nominal identity, phrase, puppet, screen, sham, simulacrum, snare, stooge, subterfuge, and tool”).

2. Neil A. Helfman, *Establishing Elements for Disregarding Corporate Entity and Piercing Entity's Veil*, 114 AM. JUR. PROOF OF FACTS 3d 403, § 1 (2010) (stating that besides the veil piercing action, when a plaintiff has a cause of action or judgment against an insolvent corporation, piercing the corporate veil may not be the only remedy available).

3. *Id.*

4. David H. Barber, *Piecing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 373–74 (1981) (internal citation omitted). *See also* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1052 (1991) (referring to California’s “relative lateness in embracing the doctrine of limited liability”).

5. Helfman, *supra* note 2, § 1 at 8 (alluding to other equitable remedies such as “agency, civil conspiracy, aiding and abetting, estoppel, fraud, fraudulent transfer, the trust fund doctrine, the denuding theory, unjust enrichment, and breach of fiduciary duty [, which] may provide alternative grounds for imposing liability on the principals of a protected entity”) (internal citations omitted).

6. Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1, 1 (1997).

7. Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41, 41 (2000) (stating that the doctrine of piercing the corporate veil “is routinely vilified by experts” and that [m]ost commentators recognize that it is a jurisprudence without substance”). *See also* KAREN VANDEKERCKHOVE, *PIERCING THE CORPORATE VEIL* 93 (Steeff M. Bartman et al. eds., 2007) (“Despite the thousands of cases on the matter, the subject remains diffuse, unclear, and incoherent.”).

8. Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 83 (2010) (referring to “the doctrinal mess” created by the different metaphors aimed at explaining veil piercing).

ity.<sup>9</sup> Even the exact definition of the phrase “lifting the veil . . . varies from case to case depending upon the rationale offered for ignoring the legal separateness of the entities.”<sup>10</sup>

In the United States, the use of the expression “piercing the corporate veil” can be traced to as far back as 1839.<sup>11</sup> Courts in the United States enjoy broad discretionary latitude in the application of this doctrine.<sup>12</sup> The doctrine’s contours, as noted, remain largely unsettled.<sup>13</sup> Moreover, the search for the touchstone of the veil piercing theory in the United States is complicated further by the fact that the debate about the theory is largely a discussion about unlimited liability.<sup>14</sup>

As many voices call for the increased accountability of corporate entities,<sup>15</sup> the veil piercing theory remains largely uncertain and inconsistent. There are even calls for its utter abolishment.<sup>16</sup> It is generally accepted, however, that “it is difficult to predict how a court will rule” in a veil piercing case.<sup>17</sup> Many theories have been

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9. José Antunes, *The Liability of the Polycorporate Enterprises*, 13 CONN. J. INT’L L. 197, 215 (1999) (pointing out that the results of the veil piercing theory “are largely casuistic in present cases and almost unpredictable in future cases”).

10. Joseph P. Griffin, *The Power of the Host Countries Over the Multinational: Lifting the Veil in the European Economic Community and the United States*, 6 LAW & POL’Y INT’L BUS. 375, 383 (1974) (internal citation omitted).

11. The phrase “piercing the veil” may have originated in the 1912 law review article. See Maurice Wormser, *Piercing the Veil of Corporate Entity*, 12 COLUM. L. REV. 496 (1912). The first published opinion to use “veil” in this context appears to have been *Fairfield County Turnpike Co. v. Thorp*, 13 Conn. 173, 179 (Conn. 1839).

12. Gerhard O.W. Mueller, *Mens Rea and the Corporation: A Study of the Model Penal Code Position on Corporate Criminal Liability*, 19 U. PITT. L. REV. 21, 23 (1957-1958) (internal citation omitted).

13. See Oh, *supra* note 8, at 145 (describing the doctrine as “mangled and muzzy”).

14. Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1932 (1991) (“[V]eil-piercing is itself simply a form of unlimited liability . . . In sum, the distinction between ‘liberalized veil-piercing’ and ‘unlimited liability’ is largely rhetorical.”).

15. Boudewijn Bouckaert, *Corporate Personality: Myth, Fiction or Reality?*, 25 ISR. L. REV. 156, 170 (1991) (“Towards the end of the century the artificial entity-theory came under vigorous attack from several authors.”). See also John Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. REV. 1091, 1155 (2009) (describing “diverse quarters calling for expansion of corporate group liability”).

16. Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 516 (2001) (internal citation omitted). See also Matheson, *supra* note 15, at 1099 (“Unfortunately, the tests used by the courts to determine the existence of these elements [for veil piercing] are vague and inconsistent. Application of these tests often consists largely of lists that courts recite with little analysis or justification.”).

17. Matheson, *supra* note 15, at 1099.

suggested to deprive shareholders of the limited liability shield.<sup>18</sup> Historically, “limited liability was sought by shareholders as a protection against the activities of unscrupulous directors.”<sup>19</sup> In sum, the enormous amount of jurisprudential and doctrinal attention that the veil piercing theory receives in the United States does little to clarify it. This article will reveal that this holds true even when a systematic approach for comparative law purposes is applied.

Consequently, this article examines the history and uses of the corporate veil piercing doctrine in the United States. It identifies the doctrine’s main elements and highlights the different theoretical components of its application by courts in the United States. This study then analyzes how the veil piercing theory has been received in Latin American civil law jurisdictions.

This article, however, does not purport to provide an exhaustive review of the veil piercing doctrine in the United States, but only to identify its main expressions in order to present an analytical framework for comparative law purposes. Furthermore, this article does not analyze the criminal responsibility of corporate officers for acts related to the performance of their functions or for the furtherance of corporate businesses.

Accordingly, Part II reviews the origin of the corporation in the Western tradition and briefly examines its sources in Roman and Medieval law, with a specific emphasis on the corporate form as understood in the common law tradition. Part III focuses on the main aspects of the corporation in the United States, for the purpose of providing a general background for the application of the veil piercing doctrine in the American legal system. Specifically, Part III explains the corporate elements of separateness and limited liability. Part IV presents the broad spectrum of theories or “tests” utilized by courts in the United States when applying the veil piercing remedy. The purpose of Part IV is to provide the main contours of the difficult-to-understand veil piercing theory, with an eye on comparative law purposes. Part V addresses the treatment that veil piercing has received in recent Latin American jurisprudence, including legal developments, doctrinal analyses, and relevant case law. In this context, Part V outlines the tradi-

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18. Hansmann & Kraakmen, *supra* note 14, at 1879 (“[S]everal authors have recently proposed curtailing limited liability for certain classes of tort claims or for certain types of corporations in order to control its worst abuses . . .”).

19. Walter E. Minchinton, *Chartered Companies and Limited Liability*, in LIMITED LIABILITY AND THE CORPORATION 154 (Tony Orhnia ed., 1982).

tional civil law theories to which Latin American courts have most recently relied on while applying the novel doctrine of piercing the veil. Finally, Part VI offers a discrete doctrinal discussion on the philosophical and theoretical grounds that justify an eventual expansion of the veil piercing theory in Latin America, and with that aim draws extensively from the legal experience of the United States, highlighting potential lines of development for the future.

## II. THE CORPORATION IN THE WESTERN LEGAL TRADITION

The Western legal tradition consists of an amalgam of Roman Law, Canon Law, the *Ius Commune*, European customary law, and their derivatives, which developed over a span of roughly 3000 years that commenced in the Classic period of the Roman Empire.<sup>20</sup> The notion of the corporation was slow to gain acceptance in this tradition, but its central concept of “immortality” eventually helped lead to its expansion in the Western legal culture.<sup>21</sup> Accordingly, this Part summarily reviews the idea of a “corporation” and its evolution in the West.

### A. *Origins of the Corporate Form*

#### 1. *The Corporation in Roman Law*

The idea of a collective group acting on its own behalf is probably as old as humanity itself. In the West, specifically during the early Roman Empire, at least one third of the population belonged to professional colleges called *collegia*, *corpora*, *societates*, *sodalitates*, or *sodalicia*.<sup>22</sup> These institutions operated in the areas of religion, education, government, and other aspects of life.<sup>23</sup> Many of these *collegia* promoted the economic and commercial interests of their members, sought to safeguard their economic privileges, and to control markets and prices.<sup>24</sup> *Collegia* also pro-

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20. See generally JOHN H. MERRYMAN, DAVID S. CLARK & JOHN O. HALEY, *Canon Law, Commercial Law, and the Reception of the Jus Commune in Europe Before the Revolution*, in *COMPARATIVE LAW: HISTORICAL DEVELOPMENT OF THE CIVIL LAW TRADITION IN EUROPE, LATIN AMERICA, AND EAST ASIA* 291–97 (2010).

21. BRUCE BROWN, *THE HISTORY OF THE CORPORATION* 11 (2003) (quoting Chief Justice Marshall as saying: “Among the most important [of its qualities] are immortality . . .”).

22. Francesca Diosono, *Collegia: Le Associazioni Professionali nel Mondo Romano* [Colleges: Professional Associations in the Roman World], *ARTI E MISTIERI NEL MONDO ROMANO ANTICO* 5 (2007).

23. *Id.* at 6.

24. *Id.*

moted the multiple interests of their members in other fields, e.g., professional, economic, territorial, religious, social, welfare assistance, and mortuary services—just to name a few.<sup>25</sup> *Collegia* thus fulfilled a very important social role until 56 BCE, when the Roman Senate ordered the dissolution of most *collegia*, with the exception of those that were strictly professional or religious.<sup>26</sup> During the republican period, Roman laws affecting the recognition and dissolution of *collegia* were highly heterogeneous and often changed depending on alterations in the structures of power.<sup>27</sup> In turn, during the imperial phase, governmental control over *collegia* tightened, as official authorization from either the Emperor or the Senate was required for their creation.<sup>28</sup> The idea was that only *collegia* advancing the *res publica*—that is, the public interest,—which were preoccupied with benefitting the Roman people, should be allowed to operate.<sup>29</sup>

Christian Emperors dissolved Pagan religious *collegia*, but tolerated the existence of professional *collegia* that, although still Pagan, were devoted to important economic activities.<sup>30</sup> Eventually, the *collegia* all but disappeared with the fall of the Western Roman Empire in the late fifteenth century CE,<sup>31</sup> with only German social and trade guilds persisting in the old Roman territories.<sup>32</sup> To date, the oldest surviving *collegium* is the Sacred College of Cardinals (*Cardinalium Collegium*).<sup>33</sup>

Parallels can be drawn between the Roman *collegia* and the *mandatum*, or agency contract, since the latter also facilitated the performance of commercial activities. However, the *mandatum* cannot be considered a corporation, as it is understood in modern

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25. ULRIKE MALMENDIER, SOCIETAS PUBLICANORUM: STAATLICHE WIRTSCHAFTSAKTIVITÄTEN IN DEN HÄNDEN PRIVATER UNTERNEHMER [SOCIETAS PUBLICANORUM: STATE ECONOMIC ACTIVITIES IN THE HANDS OF PRIVATE ENTREPRENEURS] 224 (2002) (Book 49 of *Forschungen zum römischen Recht*), excerpt available at [http://www.econ.berkeley.edu/~ulrike/Papers/Societas\\_Article\\_v3.pdf](http://www.econ.berkeley.edu/~ulrike/Papers/Societas_Article_v3.pdf) (stating that the *collegia* were “restricted to certain social or public functions”).

26. Diosono, *supra* note 22, at 31.

27. *Id.*

28. *Id.* at 33.

29. *Id.*

30. *Id.* at 41.

31. See generally Gerardo Santini, *Some Reflections on Company Law in Europe, in LIMITED LIABILITY AND THE CORPORATION* 74 (Tony Ornhial ed., 1982) (referring to the survival of the Roman *societas* after the fall of the Western Roman Empire).

32. BROWN, *supra* note 21, at 100 (“Our word *guild* derives from the Middle German *geld*, or money, which referred to the initiation fee that the guilds charged members.”) (emphasis in original).

33. *Id.* at 101.



terms. In the *mandatum*, the agent was viewed as someone who acted in lieu of and on behalf of the principal, who ultimately bore all the consequences of the underlying transaction.<sup>34</sup> Instead, the corporate form, as we know it today, possesses its own legal reality and acts on its own behalf.<sup>35</sup> Therefore, the collective institution of the Roman *collegia* seems to be the precursor of the modern legal structure represented by the corporation.

## 2. Catholic Corporations

The original idea of a corporate personality can be found in Canon Law dating back to antiquity. Since ancient times, the Catholic Church used the terms *universitas* and *persona ficta* in order to assert its “separate legal existence.”<sup>36</sup> In this context, the Benedictine Order, created in 529 CE, is the oldest corporation still in existence.<sup>37</sup> Pope Gregory the Great granted approval of the Order,<sup>38</sup> whose charter appealed to the incorporation of the Holy Spirit into a collective, and therefore, holy entity. Centuries later, the Franciscans and Dominicans followed suit and created their own holy corporate orders, which also received ecclesiastical recognition.<sup>39</sup> The idea of incorporation in the context of the sacred reached as far as Catholic England where, in 1534, St. Thomas More referred to Jesus Christ as the “ultimate corporation.”<sup>40</sup>

Intimately related to the underlying concept of the “immortality” of the corporate form, the sacred corporation also centered around the idea of trust and confidence.<sup>41</sup> Property was thus held (or rather administered) by individuals (the trustees) in the name and for the profit of others (the beneficiaries).<sup>42</sup> These two ecclesi-

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34. CHARLES PHINEAS SHERMAN, *ROMAN LAW IN THE MODERN WORLD* 356 (2d ed. 1922) (“In both Roman and modern law, agency is a contract by which one person, called the agent, represents another, called the principal, in dealings with third persons.”).

35. WILLIAM HERBERT PAGE, *THE LAW OF CONTRACTS* 3368 (1920) (“The essential feature, therefore, of the corporation, is the fact that the law recognizes it as a legal person, separate and apart from its members.”).

36. Bouckaert, *supra* note 15, at 160.

37. BROWN, *supra* note 21, at 9.

38. *Id.* at 34.

39. *Id.* at 147.

40. *Id.* at 11 (quoting St. Thomas More: “He [Jesus] doth . . . incorporate all christen folke and hys owne bodye together in one corporacyon mystical.”).

41. Helfman, *supra* note 2, § 2 at 9 (stating that in Medieval England, churches argued that bishops and abbots were perpetual and independent from their members, in order to ensure that their lands and properties remained with them and did not escheat to the Crown upon the death of their holders).

42. BROWN, *supra* note 21, at 95.

ological concepts of perennality and fiduciary duties slowly found a place into the contemporary idea of the corporation, and in this way, became two of the most vital concepts for the application of the modern veil piercing theory.

Subsequently, over time, the idea of the corporation was extended from the ecclesiastical realm into the secular, which saw the creation of guilds and merchant *societas* in Medieval Europe.<sup>43</sup> This aspect is analyzed next.

### 3. *Business Corporations*

A civil law scholar once stated that the corporate personality, as a legal concept, has its roots in the “feudal-religious background” of the Middle Ages.<sup>44</sup> However, the religious backdrop of the corporate personality was lost centuries before the French Revolution.<sup>45</sup>

In effect, the feudal-religious background behind corporations is found in the *commenda*. This institution arose during the Middle Ages as an important economic and legal structure “common to all the Mediterranean,”<sup>46</sup> designed for the carrying out of maritime commerce.<sup>47</sup> Regularly used as a way to provide financing to maritime trade, the *commenda* and its impersonal character, became a useful tool to circumvent usury restrictions.<sup>48</sup> Canon Law recognized a legal personality in the *commenda* separate from its individual members. The unique treatment of the *commenda*’s shareholders under a limited liability structure undoubtedly accounts for its expansive use throughout the Mediterranean.<sup>49</sup>

In the *commenda*, a party contributed capital unilaterally to an entrepreneur for the performance of a maritime venture in exchange for the payment of interest.<sup>50</sup> The resulting relationship between the parties can be characterized as co-ownership of the

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43. *Id.* at 14.

44. Bouckaert, *supra* note 15, at 158.

45. *Id.* at 168.

46. Guido Astuti, *Origini e Svolgimento Storico della Commenda Fino al Secolo XIII* [Origins and Historical Development of the Commenda Until the XIII Century] 98 (1933).

47. David L. Perrot, *Changes in Attitude to Limited Liability—the European Experience*, in *LIMITED LIABILITY AND THE CORPORATION* 92 (Tony Orhnia ed., 1982) (stating that “the device [of the *commenda*] became widely used all over continental Europe to finance overseas trade or other high risk enterprises.”).

48. BROWN, *supra* note 21, at 10-11; *see also* William J. Carney, *Limited Liability*, in *ENCYCLOPEDIA OF LAW AND ECONOMICS* 665 (1998) (commenting on the links between usury and limited liability during the debate over limited liability in England).

49. BROWN, *supra* note 21, at 92.

50. Astuti, *supra* note 46, at 135.

venture. This feature also illustrates how the elements of a partnership and of a loan are easily perceivable in the *commenda*.<sup>51</sup> Later on, the institution of the *commenda* was utilized to develop the concept of *societas pecunia opera* (a company for the work or use of money) in order to bypass the ban on usury imposed by Canon Law and the *Ius Commune*.<sup>52</sup>

It is worth noting that there are important differences between the Roman *societas* and the *commenda* that cause them to be catalogued as two separate institutions. While the former is a consensual *in personam* contract, subject to termination at the death of any of its members, and entails a common patrimony, the latter is a real, that is, *in rem*, contract that survives the death of its members. The twin features of collective capital formation and risk-spreading attached to the *in commendam* formula became highly attractive business tools in the Low Middle Ages.<sup>53</sup>

Also around the tenth century, Italian merchants created a new corporate form called *mahonna* or *maone*, meaning “born in Genoa.”<sup>54</sup> *Maones* held “temporary authority over an entire fleet of *commenda* and *societas maris* ventures.”<sup>55</sup> They issued shares, which possibly makes the *maone* “the earliest form of joint stock company.”<sup>56</sup>

Because Florence was one of the main commercial centers of Western Europe during the High Middle Ages,<sup>57</sup> its guilds also held a prominent role in the organization of businesses throughout that era. Guilds were autonomous entities and, to a certain extent, constituted a city within a city.<sup>58</sup> While guild membership was mandatory to exercise a specified craft, they were not “capitalistic” structures in the modern sense, as they did not “own the means of production or directly manage the manufacturing process.”<sup>59</sup> Instead, guilds set ethical and professional standards for their members and provided mutual spiritual, economic, and social assistance to them.<sup>60</sup>

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51. *Id.* at 48–49.

52. *Id.* at 64–65.

53. Bouckaert, *supra* note 15, at 162–63.

54. BROWN, *supra* note 21, at 96.

55. *Id.* at 95.

56. *Id.* at 97.

57. *Id.* at 101–02.

58. *Id.* at 102 (“[E]ach guild had its own laws, council, assemblies and judges to regulate the activities of its members . . . [and] . . . each guild also had its own ‘trademark,’ and distinct corporate identity.”).

59. BROWN, *supra* note 21, at 102.

60. *Id.*

Over time, the guilds contributed to the development of the Florentine *compagnias*.<sup>61</sup> The term *compagnia* probably derived from the Latin *com* (with) *panis* (bread), an allusion to the idea of a closed group of persons “sharing bread.”<sup>62</sup> As *compagnias* opened themselves to external membership and participation in collective business ventures, new members, who most likely did not share in managerial functions, desired that their liability be limited.<sup>63</sup>

Although much scholarship has been devoted to tracing the origins and exact predecessor of the modern corporation, no concise explanation exists. A full arrangement of corporate forms arose under the aegis of merchant law in medieval times.<sup>64</sup> What is unambiguous, nonetheless, is that the elements of perennity and collective capital are certainly two key components shared by all of the aforementioned medieval associative forms that made their way into the modern corporate form.<sup>65</sup> Among those corporate forms, the *commenda* business structure, in particular, has been mentioned as the “basis of what eventually became the limited liability company.”<sup>66</sup>

#### 4. *Corporations in the Common Law Tradition*

As far back as the Low Middle Ages, companies operated in England without official incorporation and, consequently, “merited a legal definition only as partnerships.”<sup>67</sup> Later, in the early sixteenth century,<sup>68</sup> the continental guilds also had an impact in England in the form of joint stock companies, which occasionally received charters granting them limited liability.<sup>69</sup> Such charters

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61. *Id.* at 109.

62. *Id.*

63. *Id.* at 109-10.

64. BROWN, *supra* note 21, at 109-10 (mentioning the “*collegia, scholæ, gilda, guilds, commenda, mahonna, arti, hanse, compagnia, consorzzeria, societas maris, societas armorum*, and even the *Humiliati* and the *Ordo Vagorum*.”).

65. *Id.* at 110.

66. Maria Teresa Guerra Medici, *Limited Liability in Mediterranean Trade from the 12th to the 15th Century*, in LIMITED LIABILITY AND THE CORPORATION 124 (Tony Orhnlial ed., 1982).

67. Bouckaert, *supra* note 15, at 165.

68. Carney, *supra* note 48, at 661.

69. BROWN, *supra* note 21, at 132 (“The first English commercial company was . . . chartered by the Duke of Brabant, who granted it privileges to trade in the port of Antwerp in 1296.”); *see also id.* at 134 (“[T]he second great English company [was] the Merchant Adventurers.”); *Id.* at 135 (highlighting that the key features of the Merchant Adventurers were their self-government and monopoly on a “particular export trade”); *Id.* (stating that

were granted by the Crown, by authority of parliament, or by common law.<sup>70</sup> By the late sixteenth century, government charter and monopoly status usually existed simultaneously.<sup>71</sup> Thus, great state-owned corporations emerged. Among them are the British East India Company, which dates back to 1600; the New River Company, chartered in 1619;<sup>72</sup> and the Hudson's Bay Company, chartered in 1670, which is the "longest surviving English colonial charter."<sup>73</sup>

A wave of liberalized business laws emerged in England in the late seventeenth century as the charter requirement was no longer necessary to create a corporation,<sup>74</sup> and stock became freely transferable.<sup>75</sup> The monopolistic establishment was quick to react to this liberalizing trend; accordingly, the Bubble Act was passed in 1720,<sup>76</sup> which prohibited "the establishment of corporations except by act of parliament or royal charter," effective for all corporations formed after June 24, 1718.<sup>77</sup>

## B. *Origins of the Limited Liability Shield in the West*

### 1. *Traces of Limited Liability in Roman Law*

Liability in Roman law initially appears to have been unlimited<sup>78</sup> in three aspects. First, the members of a *societas*—partnership, in modern terms—were all liable for the debts of the *societas* and for each other's debts; second, there were no recog-

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they received "their first formal charter about 100 years after the Staplers from the Grand Master of the Teutonic Knights").

70. Minchinton, *supra* note 19, at 138.

71. *Id.* at 139 (referring to the monopoly granted by charters).

72. *Id.*

73. *Id.* at 141.

74. Diosono, *supra* note 22, at 33 (explaining that the American formulae "Chartered by Act of Congress" can well be traced to the Roman formula "CCC"—*coire convocari cogi*—meaning that the Senate has officially met, analyzed the request, and declared that the *collegium* is useful to the *res publica*, and therefore, is chartered).

75. See generally Mark S. Cohen, *Grounds for Disregarding the Corporate Entity and Piercing the Corporate Veil*, in 45 AM JUR. PROOF OF FACTS 3d §§ 1, 11 (1998).

76. Paul Barnes, THE ORIGINS OF THE LIMITED LIABILITY IN GREAT BRITAIN, THE FIRST 'PANIC', AND THEIR IMPLICATIONS FOR LIMITED LIABILITY AND CORPORATE GOVERNANCE TODAY 4 (Dec. 31, 2003), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=488703](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=488703) (explaining the historical-political background that led to the passing of the Bubble Act of 1720).

77. Minchinton, *supra* note 19, at 142–43.

78. Carney, *supra* note 48, at 660 (stating that in Rome liability "remained unlimited").

nized restrictions regarding the amounts to be paid in case of damage; and third, vicarious liability was extensively used.<sup>79</sup>

However, many legal scholars have traced the origin of limited liability in the West “back at least to Roman law.”<sup>80</sup> One case frequently discussed is that of the *pater familias*, who was held only vicariously liable for the debts of his employees to the extent of the sum entrusted to the respective employee.<sup>81</sup> Thus, hints of limited liability are found in Roman law.

After the dissolution of the Western Roman Empire, the principle of joint and unlimited liability existed as the general rule in Mediterranean trade during the twelfth and thirteenth centuries.<sup>82</sup> Scholars note that the widespread use of the principle of unlimited liability was such because it “appeared to be the most efficient way of ensuring the maintenance of commercial obligations.”<sup>83</sup> As third parties joined existing businesses and trade expanded beyond the limits of familial and other closely-knit relationships, it became increasingly onerous to be exposed to the unlimited liability arising from operations dominated by managers who were bound by close links among themselves under the family setting, but who otherwise owed no loyalty to new investors.<sup>84</sup> As a result, a new form of doing business using the corporate form had to be found in the West.

## 2. *Limited Liability in the Common Law Tradition*

Already in England during the sixteenth century, charters contemplated the possibility of granting limited liability to chartered corporations.<sup>85</sup> However, it is likely that the notion of corporate limited liability arose in a systematic fashion in England during the seventeenth century. Despite the fact that limited liability made serious inroads into British corporate law by that time, none

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79. Diosono, *supra* note 22, at 13.

80. Bainbridge, *supra* note 16, at 516 (“[I]t [limited liability] has antecedents stretching back at least to Roman law.”).

81. Perrot, *supra* note 47, at 86–87 (“[T]o sum up, the Romans had a very well developed concept of limited liability and also of corporate personality, but they took no special pains to relate the two together.”).

82. Guerra Medici, *supra* note 66, at 129 (referencing that the principle of unlimited liability “was found in the statutes almost everywhere: at Ragusa, Ancona, Spalato, and also in various Tyrrhenian laws: at Genoa, Pisa, Marseilles, Barcelona, in the ‘Tavola amalfitana’ and elsewhere”).

83. *Id.* at 123.

84. *Id.* at 125.

85. Minchinton, *supra* note 19, at 138.

of the main British legal writers described limited liability as one of “the essential attributes of the corporation.”<sup>86</sup> In 1633, the British Fishery Society moved to limit the liability of its shareholders to the amount of the invested capital.<sup>87</sup> Later, in 1662, an act of Parliament granted shareholders of the British Fisheries Company, the British East India Company, and the Royal African Company limited liability.<sup>88</sup> This act came to embody what is now considered the beginning of the principle that “the liability of members of a chartered company was unlimited unless their charter specified that it was limited.”<sup>89</sup>

Chartered corporations withstood the choking effects of the Bubble Act of 1720 by maintaining their ability to trade stock and through the use of the corporate limited liability shield. Chartered corporations also battled the Bubble Act by limiting creditors to corporate assets,<sup>90</sup> creating what is known today as the *limited partnership*.<sup>91</sup>

Eventually, England passed legislation in 1844 that “forced all associations with transferable shares and all associations of 25 or more persons, whether or not their shares were transferable, to incorporate.”<sup>92</sup> The 1844 Act banned charter provisions limiting liability “but was silent with respect to like provisions in *contracts* with third parties.”<sup>93</sup> Then, in 1855, additional legislation simplified and made uniform the procedure for the creation of corporations by establishing the limited liability corporate form that is still in use in England today.<sup>94</sup>

But it was likely not until the mid-nineteenth century when this definitive legislative action took place in England that corporate limited liability was recognized as a universal, standard legal rule.

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86. JONATHAN W. FOWLER & KURT A. STRASSER, *BLUMBERG ON CORPORATE GROUPS* 3-9 (2d ed. Supp. 2009) (“[N]either Sir Edward Coke, writing in 1612, nor Blackstone, writing in 1765, nor Kyd, writing in 1792, listed limited liability among the essential attributes of the corporation.”).

87. Minchinton, *supra* note 19, at 141.

88. *Id.* at 141-42.

89. *Id.*

90. Carney, *supra* note 48, at 662.

91. Jerold A. Friedland, *Understanding International Business and Financial Transactions*, in *CHOOSING THE APPROPRIATE BUSINESS ENTITY* 274 (3d ed. 2005) (explaining that in the limited partnership, the general partners are in charge of managing the entity, with the limited partners enjoying the benefit of free transferability of their stock).

92. Barnes, *supra* note 76, at 6 (referring to the 1844 “Joint Stock Companies Registration, Incorporation, and Regulation Act”).

93. Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 *J. CORP. L.* 573, 583 (1986).

94. Cohen, *supra* note 75, §§ 1, 5, at 13.

Indeed, England's Limited Liability Act was the first to allow limited liability in 1855.<sup>95</sup> The Joint Stock Companies Act of 1856 followed.<sup>96</sup> It is interesting to note that the main debate leading to the passing of the 1856 Act pivoted around the issue of the allocation of investment risks between shareholders and corporate creditors. Although detractors of limited liability feared that this would "curtail the availability of credit to limited liability corporations and reduce the level of economic activity accordingly,"<sup>97</sup> those objections were put to rest with the passage of the Acts of 1855 and 1856, and also in 1897, when the British House of Lords upheld the limited liability of "what was essentially a one person corporation."<sup>98</sup> In effect, and based on the theories of "agency, fraud, equity, and trusteeship,"<sup>99</sup> the House of Lords decided that when a company has been lawfully incorporated, it becomes an entirely separate personality. The Companies Act of 1867 again recognized the principle of limited liability,<sup>100</sup> and the limited liability trend toward limited liability was subsequently deepened with the passage of England's first Limited Partnership Act in 1907.<sup>101</sup>

Thus, separateness and limited liability became two entirely distinguishable, though related, characteristics of the corporate form in common law, through a process commenced in the mid-1800s and consolidated at the beginning of the twentieth century.

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95. *Id.* See also Carlos E. Díaz, *Mitos y Leyendas Acerca de la Doctrina de Descorrer el Velo Corporativo [Myths and Legends About the Doctrine of Lifting the Corporate Veil]*, 73 REV. JUR. U.P.R. 311, 316-17 (2004) (stating that the principle of limited liability as a basic principle of corporate law gained acceptance only after the second half of the nineteenth century).

96. Barnes, *supra* note 76, at 6.

97. Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 118 (1980).

98. Thompson, *supra* note 4, at 1055 n.101 (referring to *Salomon v. Salomon & Co. Ltd.*, 1897 App. Cas. 22 (1896)).

99. PATRICIA LÓPEZ, LA DOCTRINA DEL LEVANTAMIENTO DEL VELO Y LA INSTRUMENTALIZACIÓN DE LA PERSONALIDAD JURÍDICA [THE DOCTRINE OF PIERCING THE CORPORATE VEIL AND INSTRUMENTALIZATION OF THE LEGAL PERSONALITY] 169 (2003).

100. Minchinton, *supra* note 19, at 146.

101. Naomi R. Lamoreaux & Jean-Laurent Rosenthal, *Entity Shielding and the Development of Business Forms: A Comparative Perspective*, 119 HARV. L. REV. F. 237, 238 (2006) (citing RON HARRIS, *INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION, 1720-1844* (2000)).



### 3. *Limited Liability in Continental Civil Law*

Commentators greatly differ regarding the date of birth of the limited liability concept in the continental West.<sup>102</sup> One author points out that “the directors of the French East India Company [founded in 1664] appear to have had limited liability,”<sup>103</sup> but also affirms that this situation constituted the exception rather than the general rule. Historically, shareholders’ liability remained unlimited in the continental Western legal tradition until the French Revolution.

In France during the 1780s, companies began inserting clauses in their charters that contained limited liability clauses.<sup>104</sup> In 1807, the French Commerce Code modified the existing *sociétés anonymes*,<sup>105</sup> so that it “provided limited liability for joint stock companies.”<sup>106</sup> This institution extended its reach to wherever the influence of the Napoleonic conquests spread,<sup>107</sup> in particular, over the Spanish Civil Code of 1829 and from there to Latin America.

In this context, the combined substratum of the continental Roman law background formed by the traditional Roman *societas*, and the new limited liability forms brought about by the French Commerce Code of 1807, gave way to an entirely new corporate form, which was the *en commandite* partnership (limited partnership), based on the idea that certain shareholders enjoy limited liability.<sup>108</sup> This form, where limited and general partners co-exist, could be seen “in France in 1671, in Ireland in 1782, elsewhere on the Continent and in a few states in the USA in the early nineteenth century, and in England in 1907.”<sup>109</sup>

Despite the aforementioned facts, the notion still persists that “limited liability generally was embraced by the civil law earlier

102. Guerra Medici, *supra* note 66, at 125 (“[A]s far as medieval commerce is concerned, opinion is divided as to when and in what manner this dual system [of limited and unlimited partners] was adopted.”).

103. Carney, *supra* note 48, at 661 (citation omitted).

104. Minchinton, *supra* note 19, at 145 (internal citation omitted).

105. Stanley E. Howard. *The Société Anonyme: From Joint Account to Business Corporation*, 8 ACCT. REV. 11 (Mar. 1933), available at <http://www.jstor.org/pss/238593>.

106. Blumberg, *supra* note 93, at 596.

107. Carney, *supra* note 48, at 661 (citations omitted).

108. See CODE DE COMMERCE [C. COM.] art. L222-1, ¶ 2 (Fr.), available at [http://www.legifrance.gouv.fr/affichCodeArticle.do?jsessionid=2C97676720C779547AE13D4EE4C9AF57.tpdjo13v\\_3?idArticle=LEGIARTI000006222683&cidTexte=LEGITEXT000005634379&dateTexte=20080724](http://www.legifrance.gouv.fr/affichCodeArticle.do?jsessionid=2C97676720C779547AE13D4EE4C9AF57.tpdjo13v_3?idArticle=LEGIARTI000006222683&cidTexte=LEGITEXT000005634379&dateTexte=20080724) (“Les associés commanditaires répondent des dettes sociales seulement à concurrence du montant de leur apport.” [Limited partners are liable for corporate debts only up to the amount of their contributions.]).

109. Carney, *supra* note 48, at 660 (citations omitted).

than in either the United States or England,”<sup>110</sup> due to the advent of the Napoleonic influence. However, reality militates against this notion. In fact, it merits remembering that although France had flirted with limited liability for corporations in the 1807 Napoleonic *Code de Commerce* [Commerce Code], it was sixty years before France passed a major corporation statute in 1867,<sup>111</sup> which was after England had passed its limited liability statutes of 1855 and 1856, as discussed *supra*.

In sum, the key elements of the corporation, identified by business law in the West since the nineteenth century, include an independent legal personality, limited liability, shared ownership in capital, delegated management, and transferable shares.<sup>112</sup> However, at the core of the notion of the corporation rests the idea of separateness, not of limited liability. As English and French cases illustrate, the corporate shield is a relatively recent development in the history of corporations in the West.

### III. THE CORPORATION IN U.S. LAW

#### A. *The Corporate Entity in the United States*

American corporation law is based on British corporation law, and the latter, in turn, can track its roots to Canon Law and Roman Law.<sup>113</sup> The British Bubble Act of 1720 was extended to the American colonies in 1741.<sup>114</sup> However, as it had happened in England, after the passage of that Act, chartered and unchartered corporations continued to exist simultaneously.<sup>115</sup> It must be remembered that pursuant to the Act, the British Parliament was

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110. Blumberg, *supra* note 93, at 596.

111. *Id.*

112. Henry Hansmann & Reinier Kraakman, *The End of the History for Corporate Law*, 89 GEO. L.J. 439, 439–40 (2001).

113. *Id.* at 578–79 (internal citations omitted).

114. Minchinton, *supra* note 19, at 145.

115. Helfman, *supra* note 2, at § 2 (“The development of unchartered joint-stock companies was a source of great distress to the chartered companies because they represented new competition in the battle for investors’ capital. Consequently, in 1720, at the urging of the influential South Sea Company, Parliament passed the Bubble Act. It forbade companies without charters from issuing transferable shares or otherwise imitating corporate features. The Bubble Act backfired; businessmen and barristers circumvented it by combining the partnership and the trust. By designating a few partners as trustees for all the others and by giving them exclusive authority to contract with outside parties, they concentrated managerial power in the hands of a few while maintaining the ability to offer other investors freely transferable shares. The success of these unincorporated associations forced Parliament to relent: the Companies Act of 1844 established a simple procedure for creating a corporation.”).

reluctant to issue charters for joint stock companies. Thus, corporations “became the dominant American form of business entity,” instead of joint stock companies.<sup>116</sup> Due to the passage of the Bubble Act, shareholders of unchartered corporations did not enjoy the benefit of limited liability,<sup>117</sup> and accordingly, charters initially granted by American colonies to corporations, which were chiefly occupied in infrastructure works, did not include the benefit of limited liability.<sup>118</sup> These limitations contributed to the ineffectiveness of the Bubble Act until the Bubble Act Repeal Act was passed in 1825.<sup>119</sup> In this manner, a new era emerged in corporate law in the United States, where corporations proliferated extensively without the need of obtaining a charter.

*B. A Separate, Different Personhood*

Jurisdictions within the United States adopted the traditional view of the corporation that existed at the time of independence from England, which conceived the corporation “as a separate juridical unit.”<sup>120</sup> In 1819, U.S. Supreme Court Chief Justice John Marshall defined the corporation as “an artificial being, invisible, intangible, and existing only in contemplation of law.”<sup>121</sup> In 1839, the Supreme Court of Errors of Connecticut, the predecessor to the Supreme Court of Connecticut, recognized that corporations were “artificial, intangible being[s],” born out of an act of the parties and recognized by the law.<sup>122</sup> Yet another scholar referred to them “as actual persons” that are “dealt with in a quite anthropomorphic manner.”<sup>123</sup>

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116. Carney, *supra* note 48, at 663 (internal citation omitted).

117. Helfman, *supra* note 2, at § 2.

118. John Hicks, *Limited Liability: The Pros and Cons*, in LIMITED LIABILITY AND THE CORPORATION 12 (Tony Orhial ed., 1982) (“[I]t is not surprising that the building of railroads was historically connected with the coming of limited liability.”).

119. See Perrot, *supra* note 47, at 82 (internal citation omitted); see also Helfman, *supra* note 2, § 2.

120. Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, 322 (1990) (internal citation omitted).

121. Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 980 (1971) (quoting *Tr. of Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819)). *Id.* at 980 (mentioning that Chief Justice Marshall wrote that “among the most important [of a corporation’s qualities] are immortality, and if the expression be allowed, individuality; properties by which a perpetual succession of many persons may be considered the same, and may act as a single individual”).

122. See *Fairfield Cnty. Tpk. Co. v. Thorp*, 13 Conn. 173, 179 (Conn. 1839).

123. Wormser, *supra* note 11, at 496 (internal citation omitted).

With the expansion of capitalism, the corporate form proved an ideal vehicle for the promotion of investment and the formation of new business ventures.<sup>124</sup> The independent, detached, and separate nature of the corporation from its owners (shareholders) has doubtlessly become “a fundamental tenet of Anglo-American law.”<sup>125</sup> In the nineteenth century, two major principles related to corporations were extant: the existence of the corporation as separate from its shareholders and the fact that the corporation “could only be created by an act of the state.”<sup>126</sup>

Wormser, one of the first legal scholars to propound the piercing of the corporate veil doctrine in the United States, adhered to the theory of the “fictitious” personality,<sup>127</sup> also called “corporate fiction” or “artificial personality.”<sup>128</sup> Under this theory, the corporation is viewed as almost human, meaning that while there are some circumstances in which the corporation should be treated as if it were an individual,<sup>129</sup> the theory also recognizes that the corporation can never be the same as a person.<sup>130</sup> Later, in 1947, Professor Berle expanded the separateness view of the corporation when he proposed the “enterprise entity” concept.<sup>131</sup> According to his view, related corporations may be viewed as a single economic entity, so that, in effect, the veil of each corporation is pierced to obtain the benefit of the total assets of all of the corporations.<sup>132</sup> In other words, the reality that all of the concerned companies are, in fact, one company alone, prevails over the plurality of formal expressions of this same economic unity. Part IV will review this topic in more detail.

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124. Cohen, *supra* note 75, § 4.4, at 12 (“[B]y 1993, there were nearly four million corporations in the United States. In that year alone, 706,537 new corporations were formed.”).

125. Krendl & Krendl, *supra* note 1, at 1 (internal citation omitted).

126. Brian Abramson, *Why the Limited Liability Company Should Sound the Death Knell of the Application of the ‘Nexus Contracts’ Theory to Corporations*, 1 FL. INT’L U. L. REV. 185, 194 (2006) (internal citation omitted).

127. Wormser, *supra* note 11, at 496 (internal citation omitted).

128. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 18 (1st ed., 1927) (“The policy of our law today sanctions incorporation with the consequent immunity from individual liability.”).

129. Mueller, *supra* note 12, at 36 (stressing the characteristic of the common law as being “a creation by individuals for individuals”). This theory was first proposed by German jurist and thinker Frederick von Savigny. See GUILLERMO BORDA, LA PERSONA JURÍDICA Y EL CORRIMIENTO DEL VELO SOCIETARIO [THE JURIDICAL PERSON AND THE LIFTING OF THE CORPORATE VEIL] 14 (2000).

130. WORMSER, *supra* note 128, at 18.

131. Adolf Berle, *The Theory of Enterprise Entity*, 47 Colum. L. Rev. 343, 344 (1947).

132. Krendl & Krendl, *supra* note 1, at 15.

C. *The Emergence of Limited Liability*

In this way, it appears that the corporate form, which rested upon the elements of perpetual life and central management, became readily accepted in the United States upon its foundation as a new nation.<sup>133</sup> Limited liability statutes were not initially enacted across the United States, because many jurisdictions imposed shareholder liability in a number of areas of the law for various causes of action.<sup>134</sup> For instance, in 1808, Massachusetts became the first state to pass a general charter statute, without the inclusion of a provision allowing limited shareholder liability.<sup>135</sup> However, pressure increased for jurisdictions to pass limited liability statutes or at least to repeal unlimited liability statutes.<sup>136</sup> In fact, New Hampshire and Connecticut accepted limited liability for manufacturing companies in 1816 and 1818, respectively.<sup>137</sup> With the Limited Partnership Act of 1822,<sup>138</sup> New York allowed investors to enjoy limited liability.<sup>139</sup> This statute afforded limited liability to shareholders of manufacturing corporations. Soon afterwards, New York's highest court held that that statute had set the "state policy" in the area of corporate liability.<sup>140</sup> Soon, other states followed suit, but not without great debate and hesitation. Interestingly, New York also pioneered legal development in the field of piercing the veil of non-profit corporations,<sup>141</sup> but a review of those situations lies outside the scope of this article.

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133. STEPHEN B. PRESSER, *PIERCING THE CORPORATE VEIL* § 1:2 (Current through May 2010 Update).

134. Carney, *supra* note 48, at 664 ("[C]alifornia's constitutions of 1849 and 1879 [which] imposed pro rata shareholder liability until 1931" and that in the past, as many as six states have "imposed shareholder liability for unpaid wages, a law that survives in New York and in Wisconsin." Additionally, "both federal and state law imposed double liability for shareholders of banks from 1865 to 1932.").

135. *Id.* See also BROWN, *supra* note 21, at 8 (stating that the Boston Manufacturing Company, established in 1813, is said to have been "[t]he first significant American industrial corporation").

136. Carney, *supra* note 48, at 664 (mentioning, for instance, New Hampshire in 1816, and Rhode Island in 1847).

137. Blumberg, *supra* note 93, at 593.

138. Abramson, *supra* note 126, at 213 (citation omitted). See also Wayne M. Gazur, *The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role*, 58 LAW & CONTEMP. PROBS. 135, 138 & n.6 (1995) (referring to the Uniform Limited Partnership Act of 1994, approved by the National Conference of Commissioners on Uniform State Laws in 1994).

139. Friedland, *supra* note 91, at 274.

140. PRESSER, *supra* note 133, § 1:3.

141. See Matthew D. Caudill, *Piercing the Corporate Veil of a New York Not-For-Profit Corporation*, 8 FORDHAM J. CORP. & FIN. L. 449, 449-90 (2003).

Massachusetts repealed its unlimited liability statute in 1830, but “continued to grant limited liability only by special charter until 1839,”<sup>142</sup> when it finally adopted a general corporation law with limited liability. Limited liability thus gradually became the default rule concerning business associations,<sup>143</sup> over a 150 year development period, and only became universally accepted about 50 years ago in the United States.<sup>144</sup> Admittedly, limited liability was accepted in the United States decades before it was in England, just as the states were much more willing to grant corporate charters.<sup>145</sup> In fact, more than 300 business corporations were formed between 1783 and 1801 in the United States.<sup>146</sup>

Despite widespread positive sentiments towards what had become the sacrosanct concept of limited liability,<sup>147</sup> the concept was not met with complete enthusiasm throughout the United States.<sup>148</sup> In fact, during the Great Depression, courts widely imposed limited liability on banking shareholders, a situation that prompted the government to respond with a “federal deposit insurance and comprehensive regulatory monitoring.”<sup>149</sup>

However, society ultimately recognized the benefits of limited liability, which eventually resulted in the creation of a new form of business organization: the limited liability company. Interestingly, certain scholarship has recognized that, in part, Latin American law influenced the creation of the second limited liability company statute enacted in the United States,<sup>150</sup> which took place in Florida in 1982.<sup>151</sup> Limited liability company statutes allow “par-

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142. Carney, *supra* note 48, at 664.

143. Bainbridge, *supra* note 16, at 506 (“[L]imited liability remains the appropriate default rule.”).

144. Hansmann & Kraakmen, *supra* note 14, at 1923 (“[L]imited liability in both tort and contract evolved over the past 150 years and did not become universal even in the United States until about fifty years ago.”).

145. Blumberg, *supra* note 93, at 585.

146. *Id.* at 587 (citation omitted).

147. Helfman, *supra* note 2, § 3 at 11 (citation omitted).

148. H.A. Shannon, *The Coming of General Limited Liability*, in *ECONOMIC HISTORY* 2 267–91 (1931), reprinted in E.M. CARUS-WILSON, *ESSAYS IN ECONOMIC HISTORY* 358–79 (Edward Arnold ed., 1954). See also J. Saville, *Sleeping Partnership and Limited Liability, 1850-1856*, in *ECONOMIC HISTORY REVIEW* 8 418–33 (1956).

149. Carney, *supra* note 48, at 664.

150. James W. Lovely, *Agency Costs, Liquidity, and the Limited Liability Company as an Alternative to Close Corporation*, 21 *STETSON L. REV.* 377, 383 (1992) (citation omitted). See also Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 *CASE W. RES. L. REV.* 387, 389–90 & 389 n.8 (1991) (“Florida subsequently adopted the LLC [limited liability company] with legislation patterned after Wyoming’s statute,” reportedly to attract foreign investors familiar with the Latin American *limitada*. (citation omitted)).

151. Lovely, *supra* note 150 (citation omitted).

ties seeking to participate in business for profit to pursue this desire under an entirely new kind of business organization: the limited liability company,” which is “a hybrid of the corporate and partnership forms.”<sup>152</sup>

We now turn to a brief discussion of the underlying forces pushing for and against limited liability in the United States.

#### D. *The Economic Argument for Limited Liability*

Currently, limited liability is probably one of the most important principles in U.S. corporate law.<sup>153</sup> Limited liability has often been described in U.S. legal history as the “most attractive feature of the corporation”<sup>154</sup> and as the “greatest single discovery of modern times.”<sup>155</sup> The argument espoused for limited liability is that it allows “investors [to] sleep more easily o’ nights, their rest less frequently disturbed by dreams of bankruptcy and destitution.”<sup>156</sup> In the United States, the benefit of limited liability has long been extended to corporate shareholders; in other words, limited liability applies not just to shareholders who are individuals but also to shareholders that are corporations.<sup>157</sup>

Important policy goals also rest at the heart of the limited liability shield. The purpose of the corporate shield has been said to incentivize investors through the promise that “they will have no personal liability for the corporation’s debts.”<sup>158</sup> An author rightly claims that “the concept of limited liability and its effect has been precisely the main issue or asset about the creation of a corporation.”<sup>159</sup> This principle has long been considered a “strong legal policy” in U.S. law.<sup>160</sup> Therefore, veil piercing emerges as an ex-

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152. Abramson, *supra* note 126, at 218 (quotation marks and internal citation omitted).

153. VANDEKERCKHOVE, *supra* note 7, at 77 (2007) (citation omitted).

154. Cohen, *supra* note 75, § 5, at 5 (citation omitted).

155. Roger E. Meiners, James S. Mofsky & Robert D. Tollison, *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 351 (1978-1979) (quoting a speech by Nicholas Murray Butler, President of Columbia University, in 1911).

156. William J. Reader, *Versatility Unlimited: Reflections on the History and Nature of the Limited Liability Company*, in LIMITED LIABILITY AND THE CORPORATION 191 (Tony Orhnlial ed., 1982).

157. Blumberg, *supra* note 93, at 575 (“[E]ach corporation is protected from liability for obligations of the other fragments of the enterprise.”); *see id.* at 607 (referring to the laws passed in New Jersey from 1888 to 1893, which for the first time in American law, allowed corporations to acquire shares of another corporation, also known as having “intercorporate stock ownership”).

158. Krendl & Krendl, *supra* note 1, at 1.

159. Juan Bertrán, *Is Undercapitalization a Back Door to Avoid Paying Up, Under the Shield of Limited Liability, an Obligation?* 46 REV. DER. P.R. 19, 25 (2006).

160. Krendl & Krendl, *supra* note 1, at 2.

treme exception to this public policy,<sup>161</sup> and is based exclusively on the courts' equitable powers.<sup>162</sup>

Traditionally, several arguments have been expounded for limited liability: (1) the decreased need of investors to monitor management, (2) the free transferability of shares, (3) market efficiency, (4) investment diversification, and (5) the ability of management to invest in riskier projects.<sup>163</sup> Of these traditional arguments for limited liability, perhaps the most persuasive is the notion of efficiency;<sup>164</sup> i.e., that limited liability lowers the costs of shares and therefore encourages investment.<sup>165</sup> Linked with this reasoning is the so-called "democratic" argument, i.e., that limited liability is justified because it encourages the less wealthy to engage in business based on the protections provided by the corporate limited liability form.<sup>166</sup> Limited liability helps to "promote commerce and industrial growth"<sup>167</sup> and encourages initiative, entrepreneurship, and creativity by restricting the risks to the amount of the investments<sup>168</sup> made on a particular business venture.<sup>169</sup> Likewise, tax considerations are also often mentioned as

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161. Bainbridge, *supra* note 16, at 515 & n.8 (pointing out that the courts oftentimes hold that their power to pierce the veil should be exercised "reluctantly," "cautiously," and only in exceptional circumstances); *see also* Zubik v. Zubik, 384 F.2d 267, 273 (3d Cir. 1967) ("[A]ny court must start from the general rule that the corporate entity should be recognized and upheld, unless specific, unusual circumstances call for an exception.").

162. Steven C. Bahls, *Application of the Corporate Common Law Doctrines to Limited Liability Companies*, 55 MONT. L. REV. 43, 61 (1994) ("[T]he doctrine of piercing the limited liability veil of a business is typically left to common law.").

163. Richard A. Booth, *Limited Liability and the Efficient Allocation of Resources*, 18 NW. U. L. REV. 140, 143-45 (1995).

164. Sandra K. Miller, *Piercing the Corporate Veil Among Affiliated Companies in the European Community and in the U.S.: A Comparative Analysis of U.S. German, and U.K. Veilpiercing Approaches*, 36 AM. BUS. L.J. 73, 131 (1998) ("Economists argue that limited liability is indispensable to the functioning of an efficient capital market.").

165. David L. Cohen, *Theories of the Incorporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA. L. REV. 427, 453 (1998) (discussing the ease with which it is possible to constitute a limited liability corporation in most United States jurisdictions).

166. PRESSER, *supra* note 133, § 1:7.

167. Barber, *supra* note 4, at 371; *see also* Carney, *supra* note 48, at 669 (discussing the Price-Anderson Act, which gave limited liability protection to the United States nuclear power industry).

168. Janet C. Alexander, *Unlimited Shareholder Liability Through a Procedural Lens*, 106 HARV. L. REV. 387, 390 (1993) ("Limited liability makes investment less risky.").

169. David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1312 (2007) ("Because even a remote risk of a huge loss may overshadow small gains that are more likely, potential investors may forego investments that have a positive net present value.").



powerful forces behind the push for limited liability in the corporate world.<sup>170</sup>

In sum, proponents of limited liability claim that it constitutes a subsidy aimed at fostering investment that “otherwise would not occur.”<sup>171</sup> The essence of this argument is that voluntary creditors are able to evaluate the risks triggered by limited liability through an investigation of the financial situation of their potential debtors,<sup>172</sup> and thus “adjust their rates of interest accordingly.”<sup>173</sup>

Judge Easterbrook and Professor Fischel developed the “efficiency model” for limited liability, which identifies the economic benefits derived by large, publicly-held corporations.<sup>174</sup> Such entities are generally owned by multiple individuals or shareholders but operated by professional managers. Unlimited liability—the Easterbrook and Fischel model proposes—would increase costs as a consequence of greater shareholder involvement in the monitoring of the corporation. Accordingly, the model eschews the idea that a higher aversion to risk and investment diversification would occur.<sup>175</sup> Consequently, the financial pyramid in contemporary economics rests upon the benefits created by limited liability.<sup>176</sup> Courts within the United States, in turn, have recognized the intimate connection between limited liability and the overall economic growth of the country,<sup>177</sup> implying that the corporate limited liability form is a quintessential tool for the expansion of capitalism.<sup>178</sup>

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170. Carney, *supra* note 48, at 676 (commenting that “the development of the Limited Liability Company and Limited Liability Partnership have eliminated the tax cost for closely held enterprises in recent years”). *See also* Gazur, *supra* note 138, at 136 (mentioning the limited liability corporation’s “superiority in offering both limited liability to participants and federal partnership income tax treatment”).

171. Millon, *supra* note 169, at 1312.

172. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 104 (1985) (mentioning that voluntary creditors are “employees, consumers, trade creditors, and lenders”).

173. PRESSER, *supra* note 133, § 1:7.

174. *See generally* Easterbrook & Fischel, *supra* note 172; Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989).

175. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 55–56 (1991).

176. Millon, *supra* note 169, at 1347 (“Limited liability is designed to function as a risk allocation device.”).

177. Krendl & Krendl, *supra* note 1, at 12–13 (referring to the *Lowendahl* court, which feared that an expansion of veil piercing could have triggered “widespread corporate failures” during the depression).

178. I. JAMES D. COX ET AL., *CORPORATIONS* §§ 7.7, 7.11 (1995) (“[I]ndeed, limited shareholder liability is not simply a principle of corporate law, but a cornerstone of capitalism.”), *cited in* Diaz, *supra* note 95, at 318 n.16.

The discussion of the corporate shield is really a dialogue about the concept (and fiction) of a legal entity. In raw terms, the limited liability that a corporation enjoys is a benefit created by individuals to guard against being forced to transfer their own assets to third parties if something goes wrong with a business. It is not an exaggeration to state that by amending (or upsetting) the concept of corporate limited liability, the very existence of capitalism would be at stake. Furthermore, the argument is made that with an expansion of the veil piercing theory, the savings and investments of millions of small investors would be at the mercy of the basest of forces in the legal market.<sup>179</sup>

Despite its benefits, a legal scholar has identified “the device of limited liability [as] being of concern only to those who were to put money into a business,”<sup>180</sup> and therefore, not of relevance to the general public. But on this topic, more analysis will be made in Part VI.

#### IV. CONTEXT FOR THE VEIL PIERCING DOCTRINE IN THE UNITED STATES

##### A. *Theories on the Nature of Corporations that Influence the Veil Piercing Doctrine*

No consensus on the notion of a corporation exists under U.S. law. Of the many theories attempting to provide a definition of the corporation’s legal nature, two opposing ones are most important: the contractualist view versus the statistic perspective.<sup>181</sup> The latter, and perhaps the more dominant, views the process of incorporation as a “privilege” granted by the government to its citizens.<sup>182</sup> In this view, it is the government that allows the birth of the corporation; therefore, it is the government that has the power to regulate all of the aspects related to its existence and termination.<sup>183</sup> Under this doctrine, the right to use the corporate

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179. Díaz, *supra* note 95, at 367.

180. Reader, *supra* note 156, at 200.

181. Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 99, 100 (1989) (“The contractual theory of the corporation is in stark contrast to the legal concept of the corporation as an entity created by the state.”).

182. PRESSER, *supra* note 133, § 1:9.

183. *Id.* Professor Berle described this theory in 1947 in the following terms: “the legal doctrine of corporate personality was built around the idea of a sovereign grant of certain attributes of personality to a definable group, engaged in an enterprise.” *Id.* His idea of the corporation is identified as the “enterprise entity” theory. *Id.*

form exists in tandem with the duty to exercise it responsibly.<sup>184</sup> Thus, in cases where there is an abuse of the corporate form,<sup>185</sup> it becomes the government's duty to take away that "privilege." This notion likely bred the contemporary concept of corporate social responsibility as a standard of behavior for multinational corporations,<sup>186</sup> within the current context of strong criticism to the use of the corporate shield by these entities.<sup>187</sup> Limited liability has been said to "invite financial irresponsibility."<sup>188</sup> This theory has made important inroads into the mindset of the American public over the years.<sup>189</sup>

On the other hand, the contractualist view explains the nature of the corporate form as a private agreement between private parties, similar to that which exists in any contract.<sup>190</sup> This doctrine on the "contractual nature" of the corporation explains that limited liability is a result of the natural state of the corporate form; that is, that limited liability finds its source in the common free will of the parties,<sup>191</sup> and not in the action or intervention of the government. The theory also holds that governments should respect this natural order, and that, as a result, courts should only pierce the veil in cases of contractual violations.<sup>192</sup>

These contrasting views on the nature of the corporation are not without relevance in the United States. Whether or not to grant a legal entity limited liability still ignites a heated debate in American society.<sup>193</sup> In fact, whether or not a court will pierce the veil in a particular case depends on which theory regarding the nature of the corporation that the court applies. Some jurisdictions within

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184. *Id.* § 1:2.

185. Thompson, *supra* note 4, at 1041 (citing Professor Ballantine, who stated that "it comes down to a question of good faith and honesty in the use of corporate privilege for legitimate ends").

186. See generally Carney, *supra* note 48, at 665 ("[L]iability is generally viewed as a device for minimizing the social cost of private activities, and for forcing actors to internalize the full cost of their actions.").

187. Reader, *supra* note 156, at 195 ("[B]oards are answerable to their shareholders and for some decisions must seek their consent [but] . . . for most practical purposes . . . they are answerable, so long as things go well [financially], only to themselves.").

188. Meiners et al., *supra* note 155, at 365 (citation omitted).

189. Cohen, *supra* note 165, at 428 ("Americans never overcame their early and strong suspicion of corporations as hard-to-control entities that were dangerous to the republic.").

190. PRESSER, *supra* note 133, § 1:2.

191. *Id.* (citations omitted).

192. *Id.*

193. Cohen, *supra* note 165, at 428 ("For it is limited liability that sets a corporation apart from regular business partnerships and which provokes the greatest ire in its critics and praise in its defenders.").

the United States have shown to be more prone towards demolishing the limited liability shield, whether based on statutes or judicial precedent, while others have mounted a staunch defense of the corporate veil.<sup>194</sup> Thus, courts subscribing to the contractual theory will likely be much less inclined to pierce than those favoring the “privilege” approach.

Consequently, the reception of the veil piercing doctrine in the United States at the state level reflects the underlying attitude of the American people toward the concept of limited liability in the corporate world, and ultimately, Americans’ attitude towards wealth itself.<sup>195</sup> As it happens with many fundamental concepts in common law, there is simply no consensus on a single theory that explains the legal nature of corporations. This reality, as we will see, affects the whole edifice of U.S. corporate law, especially the veil piercing theory.

### *B. Early Legislation Authorizing the Removal of the Limited Liability Shield*

It is interesting to note that “the earliest limited liability statute preceded the earliest judicial reference to veil piercing by a mere 12 days.”<sup>196</sup> The Massachusetts Act of 1809 became effective March 3, 1809,<sup>197</sup> and shortly thereafter, on March 15, 1809, in *Bank of U.S. v. Deveaux*, the Court referenced the veil piercing provision of the Massachusetts Act.<sup>198</sup> This case has been considered the first veil piercing case in the United States.<sup>199</sup>

In 1839, the Supreme Court of Errors of Connecticut recognized that the U.S. Supreme Court had already “drawn aside the veil,” particularly in matters related to the determination of the jurisdiction of the courts.<sup>200</sup> The Supreme Court of Errors of Connecticut pointed out that such a measure had the purpose of carrying

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194. *Id.* at 429 (“[S]ome statutes, notably Delaware’s, make it almost impossible to pierce an LLC’s veil for anything short of outright fraud.”).

195. *Id.* (“[P]iercing the veil, therefore, is a useful prism through which to view over time the contrasting attitudes toward entities with limited liability.”).

196. Oh, *supra* note 8, at 81 n.3. See also FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 43 (2011).

197. See Handlin & Handlin, *Origins of the American Business Corporation*, 5 J. ECON. HIST. 1, 10 (1945).

198. *Bank of U.S. v. Deveaux*, 9 U.S. 61 (1809), *overruled in part by*, *Louisville, C. & C.R. Co. v. Letson*, 43 U.S. 497 (1844).

199. MAGALY PERRETTI, *LOS NEGOCIOS JURÍDICOS SIMULADOS Y EL LEVANTAMIENTO DEL VELO SOCIETARIO [SIMULATED LEGAL TRANSACTIONS AND THE LIFTING OF THE CORPORATE VEIL]* 99 (2007).

200. *Fairfield Cnty. Tpk. Co. v. Thorp*, 13 Conn. 173, 179 (Conn. 1839).

into effect “the spirit of the Constitution”<sup>201</sup> by ensuring that shareholders were not excluded from the court’s jurisdiction. In other words, veil piercing was understood exclusively within the context of jurisdictional issues, and its application remained exceptional beyond those grounds.<sup>202</sup>

More than a century passed before the Model Business Corporation Act of 1950 established limited liability as the default rule of American corporate law.<sup>203</sup> However, the Act authorized two exceptions. First, limited liability would not be the default rule where unlimited liability was specifically acknowledged in a corporation’s articles of incorporation; and second, limited liability would not be upheld when the shareholder’s own act caused the liability.<sup>204</sup>

### C. *Veil Piercing in Closely Held and in Publicly Traded Corporations*

Before the creation of publicly held corporations, closed corporations enjoyed the dominion of the market. The key characteristics of closed corporations—namely, convergence of ownership, tight management, and a lack of investment diversification,<sup>205</sup>—were paramount to trigger the first theoretical and jurisprudential approximations of veil piercing in the United States. At its core, the approach centered on the belief that the risk of loss should be borne by the shareholders who created it and not by innocent third parties, particularly “involuntary” creditors.<sup>206</sup>

The emergence of publicly traded corporations in the market, and their increased dominance of it, caused the re-thinking of many concepts originally analyzed in a context of closed corporations. Public corporations came to add certain elements that greatly complicated the overall regulation of corporations in the United States—namely, “(1) large numbers of passive shareholders; (2) a market for freely-trading stock; (3) substantial assets;

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201. *Fairfield*, 13 Conn. at 179.

202. *Id.*

203. 1 MODEL BUS. CORP. ACT ANN. § 6.22(b) (3d ed. Supp. 1997) (“Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts of debts of the corporation except that he may become personally liable by reason of his own act or conduct.”) (internal quotation marks and citation omitted).

204. Thompson, *supra* note 6, at 8.

205. See generally THE GOVERNANCE OF CLOSE CORPORATIONS AND PARTNERSHIPS: US AND EUROPEAN PERSPECTIVES (Joseph A. McCahery, Theo Raaijmakers & Erik P.M. Vermeulen eds., 2004).

206. PRESSER, *supra* note 133, § 1:7.

and (4) potential tort liability that may not only exceed the firm's assets but that may not be fully insurable at any premium.<sup>207</sup>

Counter-intuitively, the impact of public corporation dominance did not produce a similar influence on veil piercing case law.<sup>208</sup> Veil piercing continued to occur almost exclusively in the context of closed corporations<sup>209</sup> and within corporate groups.<sup>210</sup> Moreover, evidence shows that until 1992, no court within the United States had "ever pierced the veil of a publicly-traded corporation."<sup>211</sup> Courts have, in effect, given less favorable treatment to shareholders of closed corporations when they are individuals,<sup>212</sup> and generally, the fewer shareholders there are, the greater the probability of the occurrence of veil piercing.<sup>213</sup> These assertions are supported by the results of a survey undertaken by Professor Thompson in the 1990s, which used data from cases from the previous three decades.<sup>214</sup> The assessment found that closed corporations with only one shareholder "were pierced in almost 50% of the cases; for two or three shareholder corporations, the percentage dropped to just over 46%, and for close corporations with more than three shareholders, the percentage dropped to about 35%."<sup>215</sup>

Definitively, from strictly a matter-of-fact viewpoint, veil piercing in the United States occurs exclusively with closed corporations. However, the doctrinal debate is rich with respect to piercing in publicly traded corporations, as this Article will review *infra*.

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207. Hansmann & Kraakman, *supra* note 14, at 1894.

208. Thompson, *supra* note 4, at 1070-71. ("The willingness [of courts] to sometimes hold shareholders of close corporations liable, but never shareholders of public corporations, suggests that limited liability's positive role in facilitating the public market for shares is strong enough to overcome any justifications for piercing.")

209. Claudia Pardinias, *The Enigma of the Legal Liability of Transnational Corporations*, 14 SUFFOLK TRANSNAT'L L.J. 405, 408 (1990-1991) ("The doctrine applies primarily to closely held corporations.")

210. Thompson, *supra* note 6, at 7.

211. Glenn G. Morris, *Piercing the Corporate Veil in Louisiana*, 52 LA. L. REV. 271, 278 (1992).

212. Thompson, *supra* note 6, at 10.

213. *Id.* at 9 (reporting that in his survey conducted from the mid-1950s until 1985 no piercing occurred in corporations with more than nine shareholders) (citation omitted).

214. Thompson, *supra* note 4, at 1054-55.

215. *Id.*

D. Finding the “Law” Behind “Case Law” on Veil Piercing

1. Veil Piercing According to Federal Law: The Notion of Fraud at the Epicenter

In the United States, veil piercing is quintessentially a state doctrine,<sup>216</sup> rather than a federal one.<sup>217</sup> However, the U.S. Supreme Court, in *Simmons Creek Coal Co. v. Doran*, set the foundation for the development of the veil piercing doctrine at the level of individual states.<sup>218</sup> In that case, the Court held that the incorporators’ knowledge of an occurrence in a close corporation established grounds for veil piercing.<sup>219</sup> A few years later in 1905, the Circuit Court for the Eastern Division of Wisconsin first expressed the general rule on veil piercing in the paramount case entitled *United States v. Milwaukee Refrigerator Transit Co.*<sup>220</sup> There, the court held that “a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears.”<sup>221</sup> Then, the court set the ground rules for veil piercing in the following terms: “when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.”<sup>222</sup> In other words, the *Milwaukee* decision held that in any of the scenarios described above, the corporation would be treated as a partnership, thus making all of the partners subject to joint and unlimited liability.<sup>223</sup>

During the twentieth century the expansion of the veil piercing theory revolved mainly around the concept of fraud in the corporate context.<sup>224</sup> In fact, fraud is a rich ground for veil piercing since it may arise in a variety of different contexts, including lies

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216. Daniel G. Brown, *Jurisdiction Over a Corporation on the Basis of the Contacts of an Affiliated Corporation: Do You Have to Pierce the Corporate Veil?*, 61 U. CIN. L. REV. 595, 622 (1992) (“The current condition of state law concerning the disregard of the corporate entity is confusing and at times random.”).

217. Cohen, *supra* note 75, § 6, at 6-7 (“Efforts to pierce corporate veil are governed by law of state of incorporation.”).

218. *Simmons Creek Coal Co. v. Doran*, 142 U.S. 417, 439-40 (1892).

219. *Simmons*, 142 U.S. at 439-40.

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

221. *Milwaukee*, 142 F. at 255.

222. *Id.*

223. See Abramson, *supra* note 126, at 213 (“[A]ll partners have unlimited liability for debts arising from both the contracts and torts of the firm.”).

224. Helfman, *supra* note 2, § 4 at 12 (“Early piercing cases typically involved some form of fraud.”).

or misrepresentations about the purpose of the entity, its capital, debts, assets, independence, the identity of its representatives, or regarding other representations made to third parties. Fraud may also involve greed—implying an illicit transfer of property (monies or assets) not belonging to the transferor. Consequently, a myriad of stakeholders, including shareholders, directors, officers, accountants, and even corporations themselves, may be involved or may have colluded to perpetrate frauds in multifarious and infinite contexts.<sup>225</sup>

Three years after *Milwaukee*, the U.S. Supreme Court held in *J.J. McCaskill Co. v. United States* that veil piercing should be allowed in instances where a shareholder had knowledge of a fraud committed by another shareholder.<sup>226</sup> The Court also stated that limited liability should not be enforced “so far as to enable the corporation to become a means of fraud or a means to evade its responsibilities.”<sup>227</sup> In this manner, the notion of fraud may be found at the inception of the veil piercing jurisprudence in the United States.

In 1912, the U.S. Supreme Court held in *United States v. Reading Co.* that circumventions of the law would not be tolerated to escape liability in a parent-subsidary scheme.<sup>228</sup> The Court’s seminal decision noted the complex corporate structure of Reading Co., a railroad company, which involved a holding company that owned Reading Co. and a wholly-owned subsidiary coal company, originally organized by Reading Co.<sup>229</sup> Because Reading Co. was conducting both mining activities and transportation services in interstate commerce, the Court sustained the holding that Reading Co. had committed an antitrust violation.<sup>230</sup> Because the corporate form was used fraudulently to violate the law, and courts will not tolerate fraud, the Court ultimately considered all of the corporations in the holding to be a single entity.<sup>231</sup> In 1925, the U.S. Supreme Court clarified the general rule on liability in the parent-subsidary context in *Davis v. Alexander*, holding that when a subsidiary company is controlled by a parent company, and when the two operate “as a single system, the dominant com-

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225. Krendl & Krendl, *supra* note 1, at 6 (citations omitted).

226. *J.J. McCaskill Co. v. United States*, 216 U.S. 504, 514-15 (1910).

227. *J.J. McCaskill Co.*, 216 U.S. at 515.

228. *U.S. v. Reading Co.*, 226 U.S. 324, 355 (1912).

229. *Reading*, 266 U.S. at 341-2.

230. *Id.* at 355.

231. *Id.* at 358.



pany will be liable for injuries due to the negligence of the subsidiary company.”<sup>232</sup>

The corporate form faced a commensurable crisis during the Great Depression due to reported abuses of the corporate veil.<sup>233</sup> It was precisely during these years that the New York Court of Appeals, the state’s highest appellate court, intervened in a case that is probably considered the most important in regards to veil piercing: *Berkey v. Third Avenue Railway Co.*<sup>234</sup> *Berkey* answered whether a parent and subsidiary corporation were genuinely separate corporations such that they should be considered different corporations.<sup>235</sup> In making its determination, the court considered whether assets were identified as belonging to the parent or the subsidiary, whether annual reports were produced separately, whether employees depended on the parent exclusively, and on other aspects aimed at determining the autonomy of both entities, including the independence of operations, expenses, and payments, the existence of inter-company loans, stand-alone bank accounts, and other banking operations.<sup>236</sup> *Berkey* identified a clear standard for veil piercing in the law of principal and agent.<sup>237</sup> Indeed, the ideas of complete dominance and obtrusive interference with an agency were utilized to consider whether the parent corporation was the principal and the subsidiary corporation was the agent.<sup>238</sup> Finding that the defendant parent corporation fell short of meeting those standards, the *Berkey* decision stated that a case must be subject to the “tests of honesty and justice.”<sup>239</sup> With these decisions, and in only a few decades, courts in the United States, including the U.S. Supreme Court, expanded the grounds for veil piercing from fraud to now encompass negligence, but in this latter case, New York circumscribed it to the parent-subsubsidiary context.

Decided in 1936, *Lowendahl v. Baltimore & Ohio Railroad Co.*<sup>240</sup> was the first case to apply the so-called Powell rule—to be reviewed *infra*—which is “perhaps the most frequently applied and

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232. *Davis v. Alexander*, 269 U.S. 114, 117 (1925).

233. *Morris*, *supra* note 211, at 289.

234. *Berkey v. Third Ave. Ry. Co.*, 244 N.Y. 84, 95 (Ct. App. N.Y. 1926).

235. *Berkey*, 244 N.Y. at 88.

236. *Id.* at 87-88.

237. *Id.* at 95.

238. *Id.*

239. *Id.*

240. *Lowendahl v. Balt. & Ohio R.R. Co.*, 287 N.Y.S. 62 (N.Y. App. Div. 1936).

most clearly articulated of the rules in the corporate veil area.”<sup>241</sup> The Appellate Division of the Supreme Court of New York relied on the notion of fraud as the cornerstone of veil piercing.<sup>242</sup> In this case, debtor shareholders managed to deceive creditors through fraudulent conveyances made by a soon-to-be defunct corporation.<sup>243</sup> Afterwards, the shareholders sought to shield themselves raising the limited liability defense.<sup>244</sup> The court went on to identify three factors for veil piercing allegations: (1) that there is a complete domination of finances, policy and business practices in a way that between related companies there is “no separate mind, will or existence of its own;”<sup>245</sup> (2) that control is used to commit fraud or wrong, to violate a statute or legal duty, or for an illegal, dishonest, or unjust act; and (3) that there is proximate cause between the harm and the act.<sup>246</sup>

In *Anderson v. Abbott*, in 1944, the U.S. Supreme Court expanded the veil piercing doctrine beyond fraud.<sup>247</sup> In fact, the Court incorporated public policy considerations in the undercapitalization of corporations as a ground for veil piercing.<sup>248</sup> The Court reinforced the fact that limited liability is the default rule in U.S. jurisprudence because “large undertakings are rested, vast enterprises are launched, and huge sums of capital [are] attracted”<sup>249</sup> by it. The Court added that despite these benefits, when corporations do not contain adequate capital, the shareholder(s) responsible for this fault can be held liable.<sup>250</sup>

In 1983, in the case of *First National City Bank v. Banco para el Comercio Exterior de Cuba*, the U.S. Supreme Court stated that veil piercing should be allowed in accordance with “both international law and federal common law . . . informed . . . by articulated congressional policies.”<sup>251</sup> It reasoned that, “an incorporated entity . . . is not to be regarded as legally separate from its owners in all circumstances.”<sup>252</sup> In its decision, the Court cited *Bangor Punta*

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241. Krendl & Krendl, *supra* note 1, at 13.

242. *Lowendahl*, 287 N.Y.S. at 75.

243. *Id.* at 64-5

244. *Id.* at 65.

245. Krendl & Krendl, *supra* note 1, at 12 (citations omitted).

246. *Id.*

247. *Anderson v. Abbott*, 321 U.S. 349, 357 (1944).

248. *Anderson*, 321 U.S. at 358.

249. *Id.* at 362.

250. *Id.*

251. *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 623 (1983).

252. *First Nat'l City Bank*, 462 U.S. at 629.

*Operations, Inc. v. Bangor & Aroostook Railroad Co.*,<sup>253</sup> which allowed veil piercing “in the interests of justice [when the veil] is used to defeat an overriding public policy.”<sup>254</sup> *Bangor* also employed arguments based on equity, particularly estoppel.<sup>255</sup>

Finally in 1998, in perhaps the best-known contemporary case on veil piercing, *United States v. Bestfoods*, the U.S. Supreme Court focused on the parent-subsiary context for purposes of veil piercing analysis.<sup>256</sup> In its holding, the Court acknowledged the primacy of protecting shareholders of parent corporations from liability for corporate debts.<sup>257</sup> It identified involvement in the subsidiary’s activities rather than in the subsidiary’s control as a standard for veil piercing.<sup>258</sup> In that sense, the parent incurs liability not due to the actions of the subsidiary, but due to its own conduct.<sup>259</sup> The Court stated that the common law allows veil piercing when “the corporate form [was used] to accomplish certain wrongful purposes, most notably fraud, on the shareholder’s behalf.”<sup>260</sup>

Therefore, the notion of fraud was at the center of the veil piercing theory as it developed during the twentieth century. During the second half of that century, a gradual but steady expansion of the standard for veil piercing took place, principally at the state level in the United States, as this paper will review next.

## 2. Veil Piercing Under State Law

The large number of cases dealing with the veil piercing doctrine at the state level impedes a thoroughly detailed presentation for the purpose of a comparative law analysis. The bulk of state veil piercing case law has occurred in the context of the parent-subsiary analysis.

Circumstances under which veil piercing has been allowed appears to have grown more liberal during the last quarter of the twentieth century. In *Pauley Petroleum Inc. v. Continental Oil*

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253. *Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co.*, 417 U.S. 703, 713 (1974).

254. *Bangor Punta Operations, Inc.*, 416 U.S. at 713 (citations omitted).

255. *Id.*

256. *United States v. Bestfoods*, 524 U.S. 51, 61 (1998).

257. *Bestfoods*, 524 U.S. at 70 (1998).

258. *Id.*

259. *Id.*

260. *Id.*

*Co.*,<sup>261</sup> the Delaware Supreme Court ruled that veil piercing should occur only “in the interest of justice, when such matters as fraud, contravention of law or contract, public wrong, or . . . equitable consideration among members of the corporation require it.”<sup>262</sup> In this way, new grounds besides the traditional notion of fraud were added for veil piercing purposes. Later, in 1982, the District of Columbia Circuit Court of Appeals applied what is conceivably the most liberal test for veil piercing in *Labadie Coal Co. v. Black*,<sup>263</sup> in which it held that an individual shareholder will be held liable when he engages in “carefree entrepreneuring . . . through a corporate shell.”<sup>264</sup>

The financial center of the world, New York, has greatly focused the development of its common law doctrine on veil piercing in the parent-subsidary context. To that effect, New York courts have provided the so-called “Ten Factors Test” to determine whether, for veil piercing purposes, one corporation has exerted complete domination over another corporation.<sup>265</sup> These factors are:

- (1) [Whether there is an an] absence of corporate formality in the dominated company;
- (2) [Whether there is] [i]nadequate capitalization;
- (3) Whether funds are put in or taken out of the corporation for other than corporate purposes;
- (4) [Whether there is an o]verlap in ownership, officers, directors, and personnel;<sup>266</sup>
- (5) [Whether the involved companies share] common office space, addresses and telephone numbers;
- (6) [What t]he amount of business discretion [is that a] dominated company possesses;
- (7) Whether . . . corporations deal at arms length [with each other];
- (8) Whether corporations are treated as independent profit centers;
- (9) [Whether t]he payment or guarantee of . . . debts of the dominated corporation [is made by the controlling corporation];
- and (10) Whether the dominated corporation’s property was used by the [controlling corporation] as if it were its own.<sup>267</sup>

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261. *Pauley Petroleum, Inc. v. Continental Oil Co.*, 239 A.2d 629, 633 (Del. 1968).

262. *Pauley Petroleum, Inc.*, 239 A.2d at 633.

263. *Labadie Coal Co. v. Black*, 672 F.2d 92, (D.C. Cir. 1982).

264. *Id.* at 100.

265. *See Liberty Mut. Ins. Co. v. Leroy Holding Co.*, 226 B.R. 746 (N.D. N.Y. 1998).

266. Matheson, *supra* note 15, at 1129 (Overlap has been found to be the “third most frequently discussed factor in parent-subsidary piercing.”).

267. *Liberty*, 226 B.R. 746 (N.D. N.Y. 1998).

Likewise, Massachusetts's common law also possesses a test for veil piercing in the parent-subsidary context. This test consists of the following nine factors: (1) whether the controlling corporation has "majority ownership and pervasive control of the affairs of the [subsidiary] corporation;" (2) whether the controlled corporation is thinly capitalized; (3) whether there has been "nonobservance of corporate formalities or absence of corporate records;"<sup>268</sup> (4) whether the subsidiary corporation pays dividends; (5) whether there are non-functioning officers and directors at the controlled corporation; (6) whether the controlled corporation was insolvent at the time of the litigated transaction; (7) whether there has been "siphoning of corporate funds or intermingling of corporate and personal funds by the dominant shareholders;" (8) whether there has been a "use of the subsidiary corporation for transactions of the dominant shareholder(s);" and (9) whether the subsidiary has been used in promoting fraud.<sup>269</sup>

### 3. *Veil Piercing Tests or the Most Common Factors Used for Veil Piercing*

A note of caution should be included with regard to the factors most commonly used by courts in the United States when determining whether to pierce the corporate veil. In effect, as a scholar has suggested, these factors are "virtually limitless."<sup>270</sup> This paper will examine the most recognized approaches to the veil piercing doctrine—namely the Powell Rule, Wormser's Rule, the Krendls' Theory, and other tests identified by Mark Cohen. This list should not be considered an exhaustive exposition of all of the factors used by U.S. courts in developing the veil piercing doctrine.

#### *i. Wormser's Veil Piercing Doctrine*

Maurice Wormser's famous veil piercing test, presented in 1912, denied the corporate limited liability shield to shareholders when

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268. Cohen, *supra* note 75, § 39, at 39 ("There appears to be a substantial risk that the separate corporate existence will be ignored when business is commenced without issuance of shares, when shareholder meetings or directors' meetings are not held or consents are not signed, when decisions are made by shareholders as though they were partners, when the shareholders do not sharply distinguish between corporate property and personal property, when corporate funds are used to pay personal expenses, when personal funds are used for corporate expenses without proper accounting or when complete corporate and financial records are not maintained.").

269. *Pointer (U.S.A.), Inc. v. H & D Foods Corp.*, 60 F. Supp. 2d 282 (S.D.N.Y. 1999).

270. Cohen, *supra* note 75, § 11.5, at 35.

that privilege was used “to defraud creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate monopoly, or to protect knavery or crime.”<sup>271</sup> In this context, the moralizing notion of “fraud” is recognized as the center of the veil piercing theory. Possibly few legal concepts are broader in meaning and scope than the idea of “fraud.”<sup>272</sup> Statistical surveys have found that fraud (or misrepresentation) “is the second most frequently addressed issue in piercing cases.”<sup>273</sup>

Wormser’s veil piercing doctrine centered on the proposition that to hold the parent liable for the debts or torts of the subsidiary, the latter must have been used as the mere “business conduit” of the former.<sup>274</sup> Under Wormser’s test, there was no requirement of evidence proving actual fraud for veil piercing, but only proof that the subsidiary was “an adjunct of the [parent’s business] . . . a mere agency, or instrumentality . . . a mere business department, or bureau, . . . [or] a mere sham or device in order to evade an existing legal obligation.”<sup>275</sup>

ii. *Frederick Powell’s Veil Piercing Test (“Powell Rule”)*<sup>276</sup>

As of 1991, New York courts heard more veil piercing cases than any other state in the United States.<sup>277</sup> In his monumental study entitled *Parent and Subsidiary Corporations*, published in 1931, Professor Frederick Powell formulated what came to be known as the “Powell Rule.”<sup>278</sup> The Powell Rule is a veil piercing test listing the main factors used by New York courts to determine whether to pierce the veil in a parent-subsidiary context.<sup>279</sup> Accordingly, many courts from other jurisdictions have extensively followed the Powell Rule.<sup>280</sup> The Powell Rule’s preliminary test includes the following three elements or rules: the instrumentality rule, im-

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271. Wormser, *supra* note 11, at 517.

272. BLACK’S LAW DICTIONARY 926 (7th ed. 1999) (defining fraud as “a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment”).

273. Matheson, *supra* note 15, at 1128.

274. Wormser, *supra* note 11, at 503.

275. *Id.* at 504–05.

276. *See generally* FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATIONS OF ITS SUBSIDIARY (1931).

277. Thompson, *supra* note 4, at 1050.

278. Krendl & Krendl, *supra* note 1, at 7.

279. *Id.* at 13–14 (citations omitted).

280. *Id.* at 14.

proper purpose (defendant's fraud or wrong), and unjust loss or injury.<sup>281</sup> These will be described in turn.

The Instrumentality Rule, also called the "alter ego" or "mere instrumentality" test, maintains that the subsidiary performs not independently, but "under the domination and control and for the purposes of" the parent corporation.<sup>282</sup> Additionally, when a corporation was a "shell," with "no assets . . . no furniture, no equipment, no space, . . . no employees," it would be subject to veil piercing.<sup>283</sup>

The intermediate appellate court in New York first established the requirements of the instrumentality test in *Lowendahl v. Baltimore & Ohio Railroad Co.* as follows:<sup>284</sup>

- (1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice ill respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and (2) Such control must have been used by the defendant to commit fraud or wrong, to perpetuate the violation of a statutory or other positive legal duty or a dishonest or unjust act in contravention of the plaintiffs legal rights; and (3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.<sup>285</sup>

In *Lowendahl*, the court found that domination requires greater control than that exerted by a majority shareholder,<sup>286</sup> and that control of the subsidiary must have been exerted in the transaction at issue.<sup>287</sup> The doctrine also requires the finding of a fraud, wrong, or injustice, meaning that the parent's conduct in using the subsidiary has been somehow unjust, fraudulent, or wrongful towards the plaintiff.<sup>288</sup> Also, an unjust "loss or injury" needs to oc-

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281. POWELL, *supra* note 276, at 4-6.

282. Krendl & Krendl, *supra* note 1, at 16.

283. Shapoff v. Scull, 222 Cal. App. 3d 1457 (Cal. Ct. App. 1990).

284. *Lowendahl v. Balt. & Ohio R.R. Co.*, 247 A.D. 144, 145 (N.Y. App. Div. 1936) (citations omitted).

285. *Lowendahl*, 287 N.Y.S. at 154, *cited in* SCOTT L. HOFFMAN, THE LAW AND BUSINESS OF INTERNATIONAL PROJECT FINANCE 87 (2008).

286. *Id.* (citations omitted). *See also* Matheson, *supra* note 15, at 1125 (noting that surveys have shown that in the parent-subsidiary context, "dominance is the most frequently addressed issue in piercing cases").

287. Krendl & Krendl, *supra* note 1, at 18.

288. Powell, *supra* note 276, at 82.

cur, meaning that the plaintiff must have actually suffered some harm as a result of the conduct of the defendant parent corporation.<sup>289</sup>

The “unjust loss” usually occurs when there has been a diversion of assets or funds for personal use by the dominant shareholders, and no payment or agreement to pay for them has existed and the use of those assets or funds is not incidental to a legitimate right.<sup>290</sup> This conduct “may be evidence of an alter ego or instrumentality relationship, but may also be used to prove unfairness or injustice.”<sup>291</sup>

In a further effort to systematize the “instrumentality” factor used by New York courts for veil piercing, Powell identified eleven situations where the subsidiary serves as an instrumentality of the parent corporation.<sup>292</sup> Those situations are: (1) ownership of all or most of the stock of the subsidiary by the parent; (2) a common board and/or management and financing of the subsidiary; (3) exclusive capital subscription by the parent or incorporation of the subsidiary by the parent; (4) grossly inadequate capital of the subsidiary; (5) payment of expenses or losses, including salaries, by the parent; (6) no substantial, independent business of the subsidiary except with the parent; (7) assets wholly contributed by the parent; (8) description of the subsidiary in the parent’s internal documentation as a unit thereof or description of its business or financial responsibilities as the parent’s own; (9) use of the subsidiary’s property as if owned by the parent; (10) a lack of independence of the subsidiary’s board or management—the subsidiary is the mere executing organ of orders from and in the interest of the parent; (11) and a lack of observance of formalities for constitution of the subsidiary.<sup>293</sup> In sum, as one commentator noted, “the

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289. *Id.* at 82-83.

290. Cohen, *supra* note 75, at 55.

291. *Id.* at 38.

292. Krendl & Krendl, *supra* note 1, at 16.

293. *Id.* at 16-17. See also Cohen, *supra* note 75, § 55, at 23, identifying Powell’s eleven-point list as follows:

- a) Does the parent own all or most of stock of the subsidiary?
- b) Do the parent and subsidiary corporations have common directors or officers?
- c) Does the parent corporation finance the subsidiary?
- d) Did the parent corporation subscribe to all of the capital stock of the subsidiary or otherwise cause its incorporation?
- e) Does the subsidiary have grossly inadequate capital?
- f) Does the parent pay the salaries and other expenses or losses of the subsidiary?
- g) Does the subsidiary do no business except with the parent or does the subsidiary have no assets except those conveyed to it by the parent?



shareholder who treats the corporate entity as if it were another aspect of his personal business can hardly complain if the court treats the entity as he does.”<sup>294</sup>

Now, in a related but separate situation involving veil piercing between affiliated corporations, two approaches exist. The first bars veil piercing when the strict separateness between two corporations has been fully maintained. This is the doctrine established by the U.S. Supreme Court in its 1925 *Cannon Manufacturing Co. v. Cudahy Packing Co.* decision.<sup>295</sup> The second approach first appeared in *Energy Reserves Group, Inc. v. Superior Oil Co.* in 1978,<sup>296</sup> where the United States District Court for the District of Kansas narrowly construed the U.S. Supreme Court’s holding in *Cannon*.<sup>297</sup> However, the issue of liability between affiliated corporations, similar to parent-subsidary liability, is far from resolved, and calls have been made for the U.S. Supreme Court to resolve the issue.<sup>298</sup>

The second element of the Powell Rule’s preliminary test is the improper purpose element, which is a factor that requires fraud or wrong on the part of the defendant and imports the determination of whether the use of the instrumental subsidiary is marred with a fraudulent or improper objective.<sup>299</sup> According to the *Lowendahl* decision, once instrumentality has been established, the next question is whether the parent used its control over the subsidiary to commit “fraud or wrong, to perpetuate the violation of a statutory or other positive duty or a dishonest or unjust act in contravention of the plaintiff’s legal rights.”<sup>300</sup>

Powell stated seven criteria for a finding of improper purpose: “(1) actual fraud; (2) violation of a statute; (3) stripping the subsid-

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h) Is the subsidiary described by the parent (in papers or statements) as a department or division of the parent or is the business or financial responsibility of the subsidiary referred to as the parent corporation’s own?

i) Does the parent use the property of the subsidiary as its own?

j) Do the directors or executives fail to act independently in the interest of the subsidiary, and do they instead take orders from the parent, and act in the parent’s interest?

k) Are the formal legal requirements of the subsidiary not observed?

*Id.*

294. Krendl & Krendl, *supra* note 1, at 18 nn. 1& 57 (citing H. HENN, LAW OF CORPORATIONS § 252 (2d ed. 1970)).

295. *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333, 335-39 (1925).

296. *Energy Reserves Grp. Inc. v. Superior Oil Co.*, 460 F. Supp. 483 (D. Kan. 1978).

297. Brown, *supra* note 216, at 612.

298. *Id.* at 618.

299. Cohen, *supra* note 75, §23, at 24.

300. *Id.* (citation omitted).

iliary of its assets; (4) misrepresentation; (5) estoppel; (6) torts; and (7) other cases of wrong or injustice.”<sup>301</sup> Under this prong of the Powell Rule, it is not necessary to prove actual fraud.<sup>302</sup> As Professor Cohen explains, “[t]he improper purpose may be something as general or as vague as improperly capitalizing the subsidiary corporation at its outset. Other examples include using the subsidiary to evade a statute, creating unjustified procedural roadblocks for the plaintiff, and making misrepresentations to a potential plaintiff.”<sup>303</sup>

Several court cases have ruled that once the instrumentality requirement is established, the improper purpose requisite may be easily proven. For example, in *Consolidated Sun Ray, Inc. v. Oppenstein*,<sup>304</sup> citing *May Department Stores Co. v. Union Electric Light & Power Co.*,<sup>305</sup> the United States Court of Appeals for the Eighth Circuit deemed that the undercapitalization or removal of assets from the subsidiary by the parent was sufficient evidence to demonstrate improper purpose.<sup>306</sup> Thus, the improper purpose requirement is an ancillary, easily demonstrable, and broad element within the Powell Rule.

The third element of the Powell Rule’s preliminary test is the Unjust Loss or Injury Element, which is common to all liability actions and requires a connection between the tortuous action of the subsidiary (which is controlled by its parent in the manner required by the law) and the damage caused to third parties.<sup>307</sup> In *Schlecht v. Equitable Builders, Inc.*,<sup>308</sup> the Supreme Court of Oregon recognized that it had “uniformly held that the corporate entity of a subsidiary corporation should be disregarded only to prevent fraud or injustice and to protect persons whose rights have been jeopardized by the conduct of the parent corporation.”<sup>309</sup>

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301. *Id.* § 23.

302. *Id.*

303. *Id.*

304. *Consol. Sun Ray, Inc. v. Oppenstein*, 335 F.2d 801, 806 (8th Cir. 1964) (citing *May Dep’t Stores Co. v. Union Elec. Light & Power Co.*, 107 S.W.3d 41, 55 (Mo. 1937)).

305. *May Dep’t Stores Co.*, 107 at 55, cited in *Consol. Sun Ray, Inc.*, 335 F.2d at 806.

306. *Consol. Sun Ray, Inc.*, 335 F.2d at 806-07 (citing *May Dep’t Stores Co.*, 107 at 55).

307. Krendl & Krendl, *supra* note 1, at 21.

308. *Schlecht v. Equitable Builders, Inc.*, 535 P.2d 86 (Or. 1975) (en banc).

309. *Schlecht*, 535 P.2d at 88.

*iii. Powell's Residual Tests*

In addition the elements discussed above, Powell identified other factors for a veil piercing determination, including:

- a) Did the parent's use of the subsidiary amount to actual fraud?
- b) Did the parent use the subsidiary to violate a statute?
- c) Did the parent strip the subsidiary of its assets?
- d) Did the parent use the subsidiary to engage in misrepresentation?<sup>310</sup>

The Powell Rule—or rather, “set of rules”—is not without criticism. Professor Robert Clark, for example, has opined that it is “not a particularly useful tool for practitioners.”<sup>311</sup> He has proposed a different test based on the law of fraudulent conveyances as codified in the Uniform Fraudulent Conveyance Act, which allows creditors to sue for the annulment of conveyances made for inadequate consideration.<sup>312</sup> But Clark's theory is also subject to criticisms of its own. The main observation is that it is very helpful in veil piercing cases where there is commingling of assets, or “milking,” i.e., unlawful, repeated, capital withdrawals.<sup>313</sup> However, in focusing exclusively on creditors, Clark's approach neglects to address other policy considerations contemplated in veil piercing.<sup>314</sup>

*iv. The Krendls' Theory*

In their famous 1978 article, Cathy and James Krendl proposed a revised version of the Powell Rule.<sup>315</sup> Their work focused on three factors to determine veil piercing in the parent-subsi- diary framework: (1) dominance of the parent over the subsidiary; (2) improper purpose; and (3) public policy considerations related to who should bear the risks.<sup>316</sup> This revised exposition of the Powell

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310. Cohen, *supra* note 75, § 24, at 53-56.

311. PRESSER, *supra* note 133, § 1:8 (discussing Robert Clark, *The Duties of the Corporate Debtor to its Creditors*, 90 Harv. L. Rev. 505, (1977)).

312. *Id.*

313. *Id.*

314. *Id.*

315. Krendl & Krendl, *supra* note 1.

316. *Id.* at 23.

Rule included the listing of thirty-one factors to be taken into account in any veil piercing analysis. These broad parameters undoubtedly confirm that there is no litmus test when it comes to the veil piercing analysis. The list is as follows:

- (1) The shareholder is not a party to the contractual or other obligation of the corporation.
- (2) The subsidiary is not undercapitalized.
- (3) The subsidiary does not operate at a deficit while the parent is showing a profit.
- (4) The creditors of the companies are not misled as to which company they are dealing with.
- (5) Creditors are not misled as to the financial strength of the subsidiary.
- (6) The employees of the parent and subsidiary are separate and the parent does not hire and fire employees of the subsidiary.
- (7) The payroll of the subsidiary is paid by the subsidiary and the salary levels are set by the subsidiary.
- (8) The labor relations of the two companies are handled separately and independently.
- (9) The parent and subsidiary maintain separate offices and telephone numbers.
- (10) Separate directors' meetings are conducted.
- (11) The subsidiary maintains financial books and records which contain entries related only to its own operations.
- (12) The subsidiary has its own bank account.
- (13) The earnings of the subsidiary are not reflected on the financial reports of the parent in determining the parent's income.
- (14) The companies do not file joint tax returns.
- (15) The subsidiary negotiates its own loans or other financing.

- (16) The subsidiary does not borrow money from the parent.
- (17) Loans and other financial transactions between the parent and subsidiary are properly documented and conducted on an arm's length basis.
- (18) The parent does not guarantee the loans of the subsidiary or secure any loan with assets of the parent.
- (19) The subsidiary's income represents a small percentage of the total income of the parent.
- (20) The insurance of the two companies is maintained separately and each pays its own premiums.
- (21) The purchasing activities of the two corporations are handled separately.
- (22) The two companies avoid advertising as a joint activity or other public relations which indicate that they are the same organization.
- (23) The parent and subsidiary avoid referring to each other as one family, organization, or as divisions of one another.
- (24) The equipment and other goods of the parent and subsidiary are separate.
- (25) The two companies do not exchange assets or liabilities.
- (26) There are no contracts between the parent and subsidiary with respect to purchasing goods and services from each other.
- (27) The subsidiary and the parent do not deal exclusively with each other.
- (28) The parent does not review the subsidiary's contracts, bids or other financial activities in greater detail than would be normal for a shareholder who is merely interested in the profitability of the business.
- (29) The parent does not supervise the manner in which the subsidiary's jobs are carried out.

(30)The parent does not have a substantial veto power over important business decisions of the subsidiary and does not itself make such crucial decisions.

(31)The parent and subsidiary are engaged in different lines of business.<sup>317</sup>

*v. Mark Cohen's Identification of Veil Piercing Theories*

Professor Cohen's 1998 study demonstrates the actual disarray in which the veil piercing theory finds itself.<sup>318</sup> In fact, he identified five tests existing in United States law for purposes of veil piercing determination: (1) the alter ego theory; (2) the instrumentality theory; (3) equity or totality of the circumstances tests; (4) the sham to perpetuate a fraud theory; and (5) the violation of public policy test.<sup>319</sup>

In Cohen's survey, the Alter Ego or "Identity" Theory<sup>320</sup> has two requisites and a rationale as follows:

(1) That the corporation is not only influenced by the owners, but that there is such unity of ownership and interest between the parent and the subsidiary that their separateness has ceased; and (2) that the facts are such that adherence to the normal attributes of separate corporate existence would sanction a fraud or promote injustice. The rationale for the alter ego theory is that if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors.<sup>321</sup>

The factors utilized under the alter ego test include: "(1) undercapitalization; (2) a failure to observe the formalities of corporate existence; (3) nonpayment or overpayment of dividends; (4) a siphoning off of funds by dominant shareholders; and (5) the majority shareholders having guaranteed corporate liabilities in their individual capacities."<sup>322</sup>

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317. *Id.* at 52-55.

318. Cohen, *supra* note 75.

319. *Id.* at 18.

320. VANDEKERCKHOVE, *supra* note 7, at 83 (referring to the similitude between these two theories).

321. Cohen, *supra* note 75, § 7, at 18.

322. *Id.*

Regarding the Federal Unity or Interest Test, which is also referred to as the Alter Ego test, Cohen stated that it consists of a two-part test:

(1) whether there was such a unity of interest and lack of respect given to the separate identity of the corporation by its shareholders that the personalities and assets of the corporation and the individual are indistinct, and (2) whether adherence to the corporate fiction would sanction a fraud, promote injustice, or lead to an evasion of legal obligations.<sup>323</sup>

Under this theory, the factors subject to review are:

(1) disregard of corporate formalities; (2) inadequate capitalization; (3) intermingling of funds; (4) overlap in ownership, officers, directors, and personnel; (5) common office space, address and telephone numbers of corporate entities; (6) the degree of discretion shown by the allegedly dominated corporation; (7) whether the dealings between the entities are at arms length; (8) whether the corporations are treated as independent profit centers; (9) payment or guarantee of the corporation's debts by the dominating entity, and (10) intermingling of property between the entities.<sup>324</sup>

The connection between the alter ego and the instrumentality theory is blurred by uncertainty. Professor Hamilton highlights this situation and asserts that these theories are "inherently unsatisfactory since [they] merely state[] the conclusion and give[] no guide to the considerations that lead a court to decide that a particular case should be considered an exception to the general principle of nonliability."<sup>325</sup> Cohen alludes to other tests crafted by courts as a response to this vagueness. For example, he mentions *White v. Winchester Land Development Corp.*,<sup>326</sup> where the court mentioned five criteria for the determination of veil piercing:

(1) undercapitalization; (2) a failure to observe the formalities of corporate existence; (3) nonpayment or overpayment of dividends; (4) a siphoning off of funds by the dominant share-

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323. *Id.*

324. *Id.* at 19-20.

325. Hamilton, *supra* note 121, at 979.

326. *White v. Winchester Land Dev. Corp.*, 584 S.W.2d 56, 62 (Ky. Ct. App. 1979).

holder(s); and (5) the majority shareholders having guaranteed corporate liabilities in their individual capacities.<sup>327</sup>

This doctrine has also been referred to as “the equity theory.”<sup>328</sup>

The Sham to Perpetuate a Fraud Theory is a test that does not require evidence of actual fraud, but rather of “constructive fraud,”—understood as “the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent, because of its tendency to deceive others, to violate confidence, or to injure public interests.”<sup>329</sup> The Violation of Public Policy Test is met when there are “attempts [even in the absence of an actual violation of a statute] by corporations to circumvent federal anti-trust statutes.”<sup>330</sup>

In addition to the five theories listed and described *supra*, Cohen also describes several others. The Substantive Consolidation of Bankruptcy Estates Test has been applied when debtors disregard the corporate separation themselves.<sup>331</sup> The remedies are “fraudulent transfer avoidance or equitable subordination claims.”<sup>332</sup> The Milking of Corporate Assets Test refers to the periodical drainage of corporate resources by shareholders.<sup>333</sup> The Puppet Officer Test has been applied by courts when there is wrongdoing by a corporate officer who is not aware of his capacity as such.<sup>334</sup> The Single Business Enterprise Theory, also called Intra-Enterprise Liability,<sup>335</sup> rests on the assumption that “courts would be more willing to hold corporate shareholders liable than individual shareholders.”<sup>336</sup> It does not require evidence of fraud, but takes place when two corporations integrate their “resources to achieve a common business purpose.”<sup>337</sup> One author comments that in practice, enterprise liability “is virtually undistinguishable from liberal piercing of the corporate veils within corporate

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327. Cohen, *supra* note 75, § 9, at 30 (quoting *White*, 584 S.W.2d 56, 62 (Ky. Ct. App. 1979)).

328. *Id.*

329. *Id.* § 10, at 31.

330. *Id.* § 11, at 33.

331. *Id.* § 11.5, at 34.

332. Cohen, *supra* note 75, § 11.5, at 34.

333. *Id.*

334. *Id.* § 11.5, at 35.

335. LARRY D. SODERQUIST, A.A. SOMMER, JR., PAT K. CHEW & LINDA O. SMIDDY, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES, MATERIALS, PROBLEMS* 423 (5th ed. 2001).

336. *Id.*

337. Cohen, *supra* note 75, § 11.5, at 35.



groups.”<sup>338</sup> Another theory is found in federal maritime common law, allowing veil piercing on the grounds of fraud or in accordance with the alter ego theory.<sup>339</sup>

Besides the factors included in the above tests, Cohen identified other factors used by courts, which include, in part, the following: absence of corporate records, nonpayment of dividends, insolvency of the corporation at the time of the transaction, nonfunctioning officers or directors, a lack of officers or directors, a failure to issue stock, an absence of consideration for stock, a corporation’s inability to meet payroll and other obligations, a commingling of funds or assets, stripping the corporation of assets in anticipation of litigation, a use of the corporate shell to advance purely personal ends, the treatment of corporate assets as personal assets, cash advances to shareholders, officers, and directors, advances to the corporation by shareholders, undocumented loans, the corporation’s failure to own or lease real property, the corporation’s failure to maintain bank accounts, the use of multiple corporations as shields for personal dealings, and the use of multiple corporations to circumvent statutory requirements.<sup>340</sup> As the foregoing discussion of the various theories and tests demonstrates, the veil piercing theory truly is in a state of disarray.

#### 4. *Veil Piercing in the Contract and Tort Contexts*

Ideological debates play a great role in shaping the discussion of whether veil piercing should be allowed in tort as well as in contractual situations in the United States.<sup>341</sup> Legal scholars tend to allocate less of a burden of proof for tort plaintiffs than for contract creditors.<sup>342</sup> The argument is that the latter had “prior opportunity to investigate the financial situation of corporations with whom they deal”<sup>343</sup> and that they possess the opportunity for “ex ante bargaining” over risk allocation.<sup>344</sup>

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338. Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 67 (1997).

339. Cohen, *supra* note 75, § 11.5, at 34.

340. *Id.* § 24, at 54-55.

341. SODERQUIST, *supra* note 335, at 404 (“The majority and dissenting opinions in the following two tort-based cases offer contrasting views of when it is appropriate to pierce the corporate veil.”).

342. Barber, *supra* note 4, at 383-84 (mentioning that only “in a few contract cases” courts have pierced the veil).

343. VANDEKERCKHOVE, *supra* note 7, at 80.

344. Millon, *supra* note 170, at 1357.

Statistical studies have exposed the reality that courts tend to pierce the veil three times more often “in contracts than in tort cases.”<sup>345</sup> Possible explanations for this phenomenon are that “most tort claims against businesses are covered by insurance and that only the most controverted and/or potentially remunerative are litigated . . . [and that] the quality of legal representation for entities may generally be higher than for individuals.”<sup>346</sup>

Professor Thompson’s practical study of 1990 encompassed 1,600 veil-piercing cases decided from the mid-1950s through 1985.<sup>347</sup> One of his main findings was that limited liability was removed more often in contract cases than tort cases.<sup>348</sup> However, a recent empirical study conducted after 1985<sup>349</sup> suggests that the opposite result is occurring with greater frequency.<sup>350</sup> But the matter is still clouded, and as it has been suggested, “[i]t is not truly accurate to say that there is such a thing as a ‘contract case’ or a ‘tort case,’ at least in the beginning of litigation.”<sup>351</sup> Currently, “it still seems that courts do not generally distinguish between contract and tort creditors.”<sup>352</sup>

##### 5. *Veil piercing in U.S. Environmental Law Cases*

Federal environmental protection legislation has generated abundant case law on veil piercing.<sup>353</sup> The government is still the most successful plaintiff in veil piercing cases, especially when the case involves environmental issues.<sup>354</sup> The bulk of veil piercing case law imposes direct individual liability on corporate officers,<sup>355</sup> as well as directors and shareholders.<sup>356</sup>

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345. Matheson, *supra* note 15, at 1154.

346. *Id.* at 1121-22.

347. Thompson, *supra* note 4, at 1044 (citation omitted).

348. *Id.* at 1059 (“[C]ourts still pierce more often in contract than in tort.”).

349. Oh, *supra* note 8, at 91 (citations omitted).

350. PRESSER, *supra* note 133, § 1:7, at 7 (citations omitted).

351. Christina L. Boyd & David A. Hoffman, *Disputing Limited Liability*, 104 NW. U. L. REV. 853, 857 (2010).

352. VANDEKERCKHOVE, *supra* note 7, at 81 (citations omitted).

353. PRESSER, *supra* note 133, § 1:11, at 2 (citation omitted).

354. Thompson, *supra* note 4, at 1057, 1061 (citations omitted).

355. *See* Sidney S. Arst Co. v. Pipefitters Welfare Educ. Fund, 25 F.3d 417, 421 (7th Cir. 1994) (discussing individual operator liability); United States v. Ne. Pharm. & Chem. Co., Inc., 810 F.2d 726, 749 (8th Cir. 1986) (noting that president and major shareholder and vice president and principal responsible official of the company found liable for arranging for disposal); New York v. Shore Realty Corp., 759 F.2d 1032, 1052 (2d Cir. 1985) (stating that individual stockholder who manages the business was also an “owner or operator” for purposes of CERCLA liability). The Supreme Court vacated a contrary decision by the Sixth Circuit. *See* Donahey v. Bogle, 129 F.3d 838 (6th Cir. 1997), *vacated*, 524 U.S. 924

In 1984, in the context of litigation involving the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (“CERCLA”), which deals with liability arising from the hazardous waste industry,<sup>357</sup> the United States Court of Appeals for the Eighth Circuit enunciated the leading principle in this area when it stated that:

“To . . . allow Lee [controlling shareholder and manager] to be shielded by the corporate veil would frustrate congressional purpose by exempting from the operation of the Act a large class of persons who are uniquely qualified to assume the burden imposed by CERCLA.”<sup>358</sup>

There are also judicial precedents from 1988 that impose CERCLA liability on an individual shareholder. For example, in *United States v. Mottolo*,<sup>359</sup> the court found the defendant liable “as a site operator in his capacity as the owner of the business.”<sup>360</sup> The court based its holding on the defendant’s admission that he “had incorporated his business in 1980 in an effort ‘to escape potential personal liability by using the corporate entity as a shield.’”<sup>361</sup> In all fairness, it should be clarified that in most CERCLA cases where individual shareholders have been found liable and the corporate veil has been pierced against them, it is not in their capacity as shareholders, but is based on their position as “owners or operators” of the contaminated sites that trigger CERCLA liability.<sup>362</sup>

Environmental liability for cleanup costs has also been imposed on parent corporations when their subsidiaries own a pollution-

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(1998). Subsequently, the Sixth Circuit has upheld findings of individual liability. See *Carter-Jones Lumber Co. v. LTV Steel Co.*, 237 F.3d 745, 746-47 (6th Cir. 2001); *Carter-Jones Lumber Co. v. Dixie Distrib. Co.*, 166 F.3d 840, 846 (6th Cir. 1999). See also *Gen-Corp, Inc. v. Olin Corp.*, 390 F.3d 433, 447 (6th Cir. 2004) (holding that officer and directors may be liable as operators even if they were unaware of the exact location of disposal); *Browning-Ferris Indus. v. Ter Maat*, 195 F.3d 953, 955 (7th Cir. 1999).

356. See *Carter-Jones*, 237 F.3d at 746-47 (applying state law for veil piercing standard but interpreting it broadly); *Ter Maat*, 195 F.3d at 954, (leaving open whether federal or state law governs veil piercing).

357. *Hansmann & Kraakman*, *supra* note 14, at 1930 (citation omitted).

358. *United States v. Ne. Pharm. & Chem. Co., Inc.*, 579 F. Supp. 823, 849 (W.D. Mo. 1984), *aff'd in part, rev'd in part*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987) (citation omitted).

359. 695 F. Supp. 615 (D.N.H. 1988), *cited in* Linda J. Oswald, *CERCLA and the “Erosion” of the Traditional Corporate Law Doctrine*, 86 NW. U. L. REV. 259, 297 n.211 (1992).

360. Oswald, *supra* note 359, at 298 (citation omitted).

361. *Id.* (citation omitted).

362. *Id.* at 299 (citation omitted).

causing facility,<sup>363</sup> provided that the corporate veil can be pierced pursuant to traditional common law principles.<sup>364</sup> Parent companies may also be directly liable as operators if they actively participated in, and exercised control over, the operations of a subsidiary's facility.<sup>365</sup> However, courts have not universally followed this standard in environmental liability cases.<sup>366</sup>

In summary, the legal treatment of the veil piercing doctrine in the United States has been enormously rich during the last one hundred years. The tests or factors to determine its application in a given case vary greatly from state to state and at the federal level. Consequently, for comparative purposes, any analysis involves an almost insurmountable challenge of trying to identify the most common elements of the theory in order to draw parallels, review the current status of its application in both systems, and speculate about future developments.

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363. Thompson, *supra* note 4, at 1062. See Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), 42 U.S.C. §§ 9601–75 (1988), which imposes liability on owners or operators of certain polluting facilities.

364. *United States v. Bestfoods*, 524 U.S. 51, 62-63 (1998) (holding that parent liability for actions of a subsidiary under CERCLA had to be decided in accordance with common law) (citations omitted).

365. *Bestfoods*, 524 U.S. at 53 (unanimously reversing lower court's en banc decision in *United States v. Cordorva Chem. Co.*, 113 F.3d 572 (6th Cir. 1997)). See also *Atlantic Gas Light Co. v. UGI Utilities, Inc.*, 463 F.3d 1201 (11th Cir. 2006) (applying *Bestfoods* to hold parent not liable); *United States v. Kayser-Roth Corp.*, 272 F.3d 89, 102 (1st Cir. 2001) (finding parent liable, stating “[w]hatever the ambiguity created by [*Bestfoods*] reference to [general facility operations], we think it is clear that direct operator liability requires an ultimate finding of the parent's involvement with ‘operations having to do with the leakage or disposal of hazardous waste, or decisions about compliance with environmental regulations’”) (citation omitted); *United States v. Township of Brighton*, 153 F.3d 307 (9th Cir. 1998). *Bestfoods* presumes that activities conducted by dual officeholders were taken on behalf of the subsidiary, not the parent. *Bestfoods*, 524 U.S. at 71. A parent company also faces “derivative” liability if the corporate veil can be pierced. *Id.* In *Bestfoods*, the Supreme Court recognized that courts and commentators disagree “over whether, in enforcing CERCLA's indirect liability, courts should borrow state law, or instead apply a federal common law of veil piercing.” 524 U.S. at 64 n.9 (citations omitted). Because that issue was not presented, the court expressly did not resolve the conflict. *Id.*

366. See *Kelley v. Thomas Solvent Co.*, 727 F. Supp. 1532, 1542 (W.D. Mich. 1989) (referring to CERCLA standards for ignoring the corporate entity that are different from those used in common law veil piercing decisions).

V. LEGAL FRAMEWORK FOR PIERCING THE VEIL IN LATIN  
AMERICAN CIVIL LAW JURISDICTIONS

A. *Limited Liability in Latin America*

As already discussed in this article,<sup>367</sup> limited liability was a later development in the historical legal evolution in the West. The Roman *societas* (modern partnerships) did not include the benefit of limited liability for its members.<sup>368</sup> The lack of limited liability also passed to Latin American civil codes by means of the French Civil Code of 1804.<sup>369</sup> This Code provided in article 1862 that “[w]ith the exception of commercial companies, shareholders are not jointly liable for corporate debts, and no shareholder may make the others liable without their consent.”<sup>370</sup> Yet, to this date, the Latin American institution of the *sociedad colectiva* (partnership), which has survived the era of limited liability, still recognizes the unlimited liability of its partners as a rule.<sup>371</sup>

Well into the nineteenth century, Latin American commercial and securities laws came to encompass the protection of limited liability as a general rule, in order to “provide a legal platform to facilitate financial intermediation.”<sup>372</sup> The benefit of limited liability was extended to different types of legal entities, namely: (1) the traditional stock corporation (*sociedad anónima*),<sup>373</sup> whether

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367. See *supra* discussion in Ch. I § 2.

368. Perrot, *supra* note 47, at 93 (“[W]ith the Roman *societas* ... all the partners had unlimited liability for partnership debts.”).

369. See Dante Figueroa, *Twenty-one Theses on the Legal Legacy of the French Revolution in Latin America*, 39 GA. J. INT’L & COMP. L. 29 (2010) (explaining the multiple connections between Latin American civil law and the French Civil Code).

370. CODE CIVIL [C. CIV.] art. 1862 (Fr.) (“Dans les sociétés autres que celles de commerce, les associés ne sont pas tenus solidairement de dettes sociales, et l’un des associés ne peut obliger les autres si ceux-ci ne lui en ont conféré le pouvoir.” [“With the exception of commercial companies, shareholders are not jointly liable for corporate debts, and no shareholder may make the others liable without their consent.”]).

371. See, e.g., CÓDIGO CIVIL [CÓD. CIV.] (Para.) CIVIL CODE OF PARAGUAY art. 1025 (“En la sociedad colectiva los socios contraen responsabilidad subsidiaria, ilimitada, y solidaria, por las obligaciones sociales.” [“In partnerships partners acquire joint, several, and unlimited liability for social obligations.”]).

372. Juan del Granado & M.C. Mirow, *The Future of the Economic Analysis of Law in Latin America: A Proposal for Model Codes*, in Symposium: Law and Economic Development in Latin America: A Comparative Approach to Legal Reform, 83 CHI.-KENT L. REV. 293, 323 (2008). See also Manuel A. Utset, *Toward a Bargaining Theory of the Firm*, 80 CORNELL L. REV. 540 (1995); Robert E. Scott, *Rethinking the Regulation of Coercive Creditor Remedies*, 89 COLUM. L. REV. 730 (1989).

373. See, e.g., CÓDIGO DE COMERCIO [COD. COM.] art. 86 (Guat.) (“The liability of each shareholder is limited to the payment of the subscribed [paid] shares.”), cited in ALIDA VILLEDA, *El Levantamiento del Velo Corporativo en las Sociedades Anónimas, una Herramienta Legal para Contrarrestar el Abuso en la Utilización de la Personalidad Jurídica*

publicly traded or closely held; (2) the limited partnership (*sociedad en comandita*)<sup>374</sup> with respect to the limited or non-managing partners; (3) the limited liability corporation (*sociedad de responsabilidad limitada*); and (4) the individual limited liability company (*empresa individual de responsabilidad limitada*),<sup>375</sup> which has recently made its debut onto the Latin American corporate stage.<sup>376</sup> The U.S. business trust structure has yet to make its entrance into Latin American law.<sup>377</sup>

The same philosophical approach to the idea of “separateness” underlying the essence of corporations that exists in Anglo-American law is found in Latin American law. For instance, article 201 of the Venezuelan Commerce Code enunciates in the simplest way the reality of the separate personalities of the corporation and its shareholders when it states that “corporations are legal entities separate from their shareholders.”<sup>378</sup> Therefore, no additional comments on the topic of separateness are necessary for comparative law purposes.

Traditionally, Latin American law adhered to the principle that only physical persons could form corporate forms.<sup>379</sup> The idea that corporations may also create and become shareholders of other corporations is a recent development.<sup>380</sup> Over time, however, corporations acting as shareholders of other corporations were permitted and came to enjoy the same benefit of limited liability that individual shareholders had historically enjoyed. In the United

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[*The Lifting of the Corporate Veil in Stock Corporations, a Tool to Counteract Abuse in the Use of the Legal Personality*], UNIVERSIDAD DE SAN CARLOS DE GUATEMALA'S LAW SCHOOL 6, (2006), available at [http://biblioteca.usac.edu.gt/tesis/04/04\\_5702.pdf](http://biblioteca.usac.edu.gt/tesis/04/04_5702.pdf).

374. Gazur, *supra* note 138 at 401 (“A limited partner is not liable to creditors unless the limited partner takes part in the management or control of the business.”).

375. RONY SAAVEDRA, EL LEVANTAMIENTO DEL VELO SOCIETARIO DOCTRINA, LEGISLACIÓN Y JURISPRUDENCIA [THE LIFTING OF THE CORPORATE VEIL. DOCTRINE, LEGISLATION AND JURISPRUDENCE] 91 (2009).

376. Santini, *supra* note 31, at 74 (“[S]ome countries, especially in Latin America, encourage under-takings by individuals by admitting single person corporations with limited liability.”).

377. Fischel, *supra* note 172, at 93 (discussing the benefit of limited liability for business trusts); see generally Dante Figueroa, *Is the Lack of Trusts an Impediment for Expanding Business Opportunities in Latin America?* 24 ARIZ. J. INT'L & COMP. L. 701 (2007) (discussing the comparisons between the Anglo-American *trust* and the civil law *fideicomiso*).

378. CÓDIGO DE COMERCIO [CÓD. COM.] (Venez.), GACETA OFICIAL [Official Gazette], Dec. 21, 1955, available at <http://www.gobiernoenlinea.ve/legislacion-view/sharedfiles/CodigoComercio1.pdf>.

379. See, e.g., CÓDIGO CIVIL [CÓD. CIV.] art. 550 (Chile) (providing that “[i]f due to the death or other accidents the members of a corporation are reduced ...”).

380. MIGUEL ROSILLO, VELO CORPORATIVO Y CONCENTRACIONES 5 (Jurídica, ed., Mexico, 1999), available at <http://www.juridicas.unam.mx/publica/librev/rev/jurid/cont/29/cnt/cnt11.pdf>.

States, the rule is well-settled that individual corporations acting as a single shareholder of another corporation “can obviously escape the full costs of her firm’s behavior, even under a rule of unlimited liability, simply by entering personal bankruptcy.”<sup>381</sup> On the other hand, the creation of single-shareholder companies in Latin America is creating new challenges concerning the ultimate allocation of liability at the corporate level—an issue that is far from being settled and will be discussed *infra*.

*B. Making the Case for Piercing the Corporate Veil in Latin America*

Research conclusively shows that U.S. law influenced Latin American legal developments relating to the veil piercing doctrine.<sup>382</sup> In the absence of widespread statutory regulations encompassing the veil piercing doctrine in Latin America,<sup>383</sup> legal practice has made use of unwritten mechanisms to obtain the same results of veil piercing. In this scenario, doctrinal developments of the veil piercing theory are a product of judicial creativity<sup>384</sup> in Latin America.<sup>385</sup> Interestingly, the very need of such a

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381. Hansmann & Kraakman, *supra* note 14, at 1885.

382. Karl Hofstetter, *Multinational Enterprise Parent Liability: Efficient Legal Regimes in a World Market Environment*, 15 N.C.J. INT’L L. & COM. REG. 299, 314 n.74 (1990) (mentioning that Professor Serick’s work, *Rechtsform und Realität Juristischer Personen* [*Legal Form and Reality of Legal Persons*] (1955), was translated into Spanish by Puig Brutau and published in 1958 as *Apariencia y Realidad en las Sociedades Mercantiles* [*Appearance and Reality in Corporations*], which “had a particular impact on European and also Latin American countries”).

383. Pedro Irueta, *Aplicaciones de la Doctrina del Levantamiento del Velo Corporativo*, in ACTAS DE LAS II JORNADAS DE DERECHO DE LA EMPRESA 246–48 (Pontificia U. Católica de Chile, ed., 2005) (stating that the lack of a structured and specific body of laws aimed at redressing situations of fraud has led to the use of the piercing the corporate veil doctrine as a useful tool to that effect in Chile). See VILLEDA, *supra* note 373, at 113 (“[I]n the Guatemalan legal order currently it does not exist a specific regulation that allows the disregard of the legal personality [corporate veil] of a commercial company . . . .”); see also LÓPEZ, *supra* note 99, at 99–100 (mentioning that with the limited exceptions of Argentina and Uruguay, in all other Latin American jurisdictions, the piercing the veil doctrine is a judicially-created technique); OSVALDO MADRIZ, LA APLICABILIDAD DE LA TEORÍA DEL LEVANTAMIENTO DEL VELO SOCIETARIO DENTRO DE LOS PROCESOS DE PENSIONES ALIMENTARIAS [THE APPLICABILITY OF THE LIFTING OF THE CORPORATE VEIL WITHIN ALIMONY PROCEEDINGS] 67 (2007) (stating that in Costa Rica, “the development of the Piercing the Corporate Veil Theory is owed entirely to the work developed by our courts”) (on file with author); Rosaura Cordero, *El Levantamiento del Velo Social en el Derecho de Ganancialidad* 111 (U. of Costa Rica Law School, 2010) (expressing that in Costa Rica “[t]here is no treatment [of the veil piercing doctrine] in either commercial or civil law”) (on file with author).

384. Ariel Bentata, *Corporations and Similar Entity Law*, 11 FLA. J. INT’L L. 69, 85 (1996-1997) (“There is no piercing of the corporate veil doctrine available in most Latin American countries.”).

theoretical development is disputed in the region. Identifiable doctrinal trends in Latin America consider the veil piercing theory to be altogether unnecessary, based on the fact that extant legal mechanisms serve to achieve the same goals without unduly upsetting the whole legal system. It is further argued that when a corporate structure is used fraudulently, it is the individual persons who act unlawfully, not the legal entity.<sup>386</sup> Therefore, the argument goes, because existing legal instruments are sufficient, there is no need to construct a legal theory focused on the corporation. To these criticisms is added the perception among civil law jurists that “the piercing the corporate veil doctrine is far from providing just solutions to the cases it addresses, based only on the fact that it lacks a delimitation of its foundations and its concrete effects in each particular case.”<sup>387</sup>

However, reality trumps theory, and practice shows that important civil law jurisdictions have been making extensive use of veil piercing in a myriad of areas such as family law, tax law,<sup>388</sup> corporate law, labor law,<sup>389</sup> and bankruptcy law.<sup>390</sup> When it comes to the key field of taxation, the relevance of the veil piercing doctrine in Latin America has been highlighted in strong terms. In effect, a scholar has recognized that:

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385. See PERRETTI, *supra* note 199, at 179–206 (reviewing generally case law on the piercing the veil doctrine in Latin American civil law jurisdictions). See also MAGALY PERRETTI, LA DOCTRINA DEL LEVANTAMIENTO DEL VELO DE LAS PERSONAS JURÍDICAS [THE LIFTING THE VEIL OF LEGAL ENTITIES DOCTRINE] 97-119 (2002).

386. LÓPEZ, *supra* note 99, at 116–31. See also JOSÉ HURTADO, LA DOCTRINA DEL LEVANTAMIENTO DEL VELO SOCIETARIO. ESTUDIO PRÁCTICO SOBRE SU APLICACIÓN POR LOS TRIBUNALES ESPAÑOLES [THE LIFTING THE CORPORATE VEIL DOCTRINE. PRACTICAL STUDY ON ITS APPLICATION BY SPANISH COURTS] 63 (2000).

387. HÉCTOR MIGUENS, LA SUBORDINACIÓN EQUITATIVA DE LAS DEMANDAS INTERSOCIETARIAS DENTRO DE UN GRUPO DE SOCIEDADES EN EL DERECHO CONCURSAL NORTEAMERICANO [EQUITABLE SUBORDINATION TO INTER-COMPANY DEMANDS WITHIN A CORPORATE GROUP IN U.S. BANKRUPTCY LAW] 336 (1996), *cited in* PATRICIA LÓPEZ, LA DOCTRINA DEL LEVANTAMIENTO DEL VELO Y LA INSTRUMENTALIZACIÓN DE LA PERSONALIDAD JURÍDICA [THE DOCTRINE OF PIERCING THE CORPORATE VEIL AND INSTRUMENTALIZATION OF THE LEGAL PERSONALITY] 135 (2003).

388. SAAVEDRA, *supra* note 375, at 115 (mentioning the possibility of an “automatic lifting of the veil” in the case of companies created in tax haven jurisdictions). See also BORDA, *supra* note 129, at 201-36 (reviewing case law in the context of tax litigation in Argentina).

389. See PERRETTI, *supra* note 199, at 237-72 (presenting an exhaustive further treatment of the piercing the veil doctrine in labor matters).

390. PERRETTI, *supra* note 199, at 208 (acknowledging that “the field of bankruptcy law is where most often the piercing the veil doctrine has been applied in continental European law and Argentinean law.”). See also BORDA, *supra* note 129, at 181–90 (reviewing case law in the context of bankruptcy litigation in Argentina).



[F]ictitious companies have been and are the most appropriate tool to evade tax liabilities, through the transfer of assets from physical persons to legal entities, or by taking advantage of the tax benefits triggered by corporate taxes, or the tax advantages concerning export or import tax returns, thus hiding the true taxpayer.<sup>391</sup>

Now, concerning the basic understanding of the theory, several definitions of the veil piercing doctrine have been offered in Latin America.<sup>392</sup> One considers piercing the veil as:

[A] judicial technique of an exceptional character, utilized in the absence of a law, aimed at preventing the effects of acts performed by commercial companies, when these acts constitute a violation of the law, or an abuse of right, whose consequences affect third parties foreign to the performance of the fraudulent or abusive act.<sup>393</sup>

Another author has defined the veil piercing theory as:

[A] judicial technique according to which it is licit for courts to, in certain occasions, ignore or disregard the external form of the legal personality, and thus penetrate in its interior in order to ‘disclose’ the underlying interests hidden behind it, and to reach the persons and assets sheltered under the corporate veil, with the purpose of terminating fraud and abuses, through the direct application of the legal provisions to the individuals that sought to avoid them, and through the declaration of unopposability of the legal personality to third parties suffering injuries.<sup>394</sup>

Yet another author identifies the doctrine as an action aimed at “avoiding . . . through the formal cover of the legal personality the interests of third parties [who] are injured.”<sup>395</sup>

In Panama, for example, where the legal system has been greatly influenced by the common law of the Anglo-American legal system, the Supreme Court of Justice has applied the veil piercing

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391. BORDA, *supra* note 129, at 213.

392. *See, e.g.*, PERRETTI, *supra* note 199, at 177.

393. *Id.*

394. LÓPEZ, *supra* note 99, at 54-55 (quotation was translated from Spanish to English).

395. RICARDO DE ANGEL YAGÜEZ, LA DOCTRINA DEL LEVANTAMIENTO DEL VELO DE LA PERSONA JURÍDICA EN LA RECIENTE JURISPRUDENCIA [THE PIERCING THE VEIL OF THE LEGAL PERSONALITY DOCTRINE IN RECENT JURISPRUDENCE] 22 (2d ed. 1995).

doctrine when there are “strong reasons” to hold shareholders of a stock corporation (*sociedad anónima*) personally liable for the obligations of that corporation.<sup>396</sup> The doctrine has been applied as an *ultima ratio*, in extraordinary, exceptional cases, and as a last resort mechanism, always balancing the elements at play “to find just and equitable solutions.”<sup>397</sup> Additionally, the Panamanian Supreme Court has affirmed the highly restrictive character of the doctrine by applying it only to situations “where a crime has been committed in the Republic of Panama.”<sup>398</sup> The use of language similar to that of U.S. law is striking.<sup>399</sup>

As may be seen, the notion of abuse (or fraud) occupies a central role in the aforementioned definitions of the veil piercing theory.<sup>400</sup> A consensus exists among Latin American scholars that “the corporation is simply an instrument that the State provides to its citizens to facilitate the development of their legitimate activities.”<sup>401</sup> Consequently, if the privilege of limited liability is abused to commit fraud, the privilege should be terminated.

Latin America is a region full of peculiarities and several unsophisticated means of achieving full liability for shareholders who otherwise would enjoy limited liability have been put into practice. One recurrent strategy used by powerful lenders is one of demanding that the shareholders of debtor corporations provide, them-

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396. *Sentencia* of the Supreme Court of Justice of Panama, Feb. 16, 1996 (“La sociedad anónima se considerara como una persona jurídica independiente de sus socios (a.251 Código de Comercio), mientras no sobrevengan razones poderosas que autoricen el desconocimiento de ese principio. Los tribunales y agentes de instrucción deben proceder, caso por caso, con suma prudencia en las situaciones en que se plantea la posibilidad, como *ultima ratio*, de desestimación de la personalidad jurídica de una sociedad anónima.” [The stock corporation is considered as a legal entity independent from its members (a.251 Commerce Code), while no powerful reasons that authorize the disregard of this principle ensue. Courts and instruction agents (‘civil prosecutors’) must proceed with utmost prudence on a case-by-case basis, in all the situations where the possibility of disregarding the corporate veil of a stock corporation is requested as an measure of last resort.]), *cited in* FRANCISCO PÉREZ, ACCIÓN DE AMPARO, CONFIDENCIALIDAD Y LEVANTAMIENTO DEL VELO CORPORATIVO 29 (1996).

397. *Id.* at 30.

398. *Id.* at 31 (mentioning *sentencia* of the Supreme Court of Justice of Panama, Jan. 29, 1991).

399. Robert R. Keatinge, Larry E. Ribstein, Susan Pace Hamill, Michael L. Gravelle & Sharon Connaughton, *The Limited Liability Company: A Study of the Emerging Entity*, 47 *BUS. LAW.* 375, 444 (1992) (“[C]ourts are reluctant to pierce the corporate veil and will do so only in extraordinary circumstances.”).

400. Juan M. Dobson, “*Lifting the Veil*” in *Four Countries: The Law of Argentina, England, France and the United States*, 35 *INT’L & COMP. L.Q.* 839, 853 (1986) (referring to the “1968 Civil Code Reform Act (*Ley 17.711*)” that introduced the abuse of rights doctrine into Argentinean civil law).

401. Díaz, *supra* note 95, at 327.

selves, *in personam* or *in rem* guarantees to back up the debts incurred by the debtor corporation.<sup>402</sup> In these circumstances, whether the stock corporation (“*sociedad anónima*”)<sup>403</sup> or a limited liability corporation incurs the debt, two classes of debtors come into existence: those charged with limited guarantees and those with unlimited guarantees.<sup>404</sup> In the first situation are those individual shareholders or corporate shareholders who have not been forced to provide *in personam* or *in rem* guarantees, and in the second situation are those who have. Ultimately, whether this scheme of unlimited liability exists *de facto* in a given case will depend on the financial or market strength of the debtor individual or corporate shareholder vis-à-vis its lenders and other powerful creditors.

This state of affairs has been somehow moderated in Latin America, as the great majority of corporations are closely held—mostly family-owned and run.<sup>405</sup> Nonetheless, as the momentum of the pendulum begins to oscillate toward more anonymous, large lenders, it is likely that those Latin American, family-owned corporations will find themselves having to sponsor their businesses’ obligations with *in personam* or *in rem* guarantees, which they were not obligated to provide under traditional limited liability alternatives.

### C. *Legal Treatment of the Veil Piercing Doctrine in Latin America: General Principles of Civil Law and Unlimited Liability*

As already mentioned, Latin American civil and commercial codes do not generally contain provisions on veil piercing. Other

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402. Enrique Guadarrama, *SA Cerrada y SA Abierta o Bursátil en Derecho Continental. Características y Diferencias [Closed and Publicly Traded Stock Corporations in Continental Law. Characteristics and Differences]* 1 REV. DE DER. PRIV. 53, 69 (1990), available at <http://www.juridicas.unam.mx/publica/librev/rev/revdpriv/cont/2/dtr/dtr4.pdf> (highlighting that “financially stronger creditors are in a situation to demand additional forms of guarantees and, in particular, to demand guarantees *in rem* and *in personam* from one or more of the shareholders who are economically solvent; instead, modest creditors cannot do that and must content themselves with the guarantee of the corporate capital”).

403. See generally Symposium, *Legal Aspects of Doing Business in Latin America: New Approaches: Looking to the Twenty-First Century: Civil Law Comparisons*, 11 FLA. J. INT’L L. 69, 83 (1996-1997) (describing the characteristics of the *sociedad anónima* in Mexico: “continuity of life, free transferability [of interests], and limited liability”).

404. Guadarrama, *supra* note 402, at 70.

405. Luis F. Andrade, Jose M. Barra & Heinz-Peter Elstradt, *All in the Familia. Family-owned businesses in Latin America need stronger governance structures to survive and thrive in an era of globalization*, MCKINSEY QUARTERLY, Dec. 2001, at 1-2, available at [http://www.mckinseyquarterly.com/All\\_in\\_the\\_familia\\_1114](http://www.mckinseyquarterly.com/All_in_the_familia_1114).

statutory regulations on veil piercing are rare.<sup>406</sup> Consequently, the formation of a Latin American theory on veil piercing must, necessarily, be based on traditional concepts of civil law. General principles of law are the first place to start.

Civil law recognizes from ancient times the principle that any civil damage intentionally or negligently caused must be repaired or compensated.<sup>407</sup> However, this general principle is not sufficient to construct a uniform and coherent doctrine on veil piercing in the region.<sup>408</sup> In other words, the fact that a corporation is liable for its torts or contractual violations does not necessarily imply that its shareholders must also be personally liable for such actions or omissions. Thus, one has to look at well-established liability theories in Latin American civil law in order to determine if a semblance of the elements of the American veil piercing doctrine can be found. The next step is to identify the principles that could be used to build such a theory based on Latin American civil law. Regardless, the veil piercing doctrine will generally be used only when no remedy is available through well-established civil law tort or contractual liability doctrines.<sup>409</sup>

It is equally important to remember that the generally passive role of judges in civil law jurisdictions prevents them from actively contriving new theoretical structures in the absence of legislative statutes dealing with civil liability.<sup>410</sup> However, important jurisprudential developments on the veil piercing doctrine have oc-

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406. JACKELINE ALEGRIA, LA TEORÍA DE LA DESESTIMACIÓN DEL VELO CORPORATIVO COMO MECANISMO JURÍDICO PARA EVITAR EL ABUSO DE LA PERSONALIDAD JURÍDICA EN LA SOCIEDAD ANÓNIMA (THE THEORY OF DISREGARDING THE CORPORATE VEIL AS A LEGAL MECHANISM TO AVOID THE ABUSE OF THE LEGAL PERSONALITY IN STOCK CORPORATIONS) 26 (2007) (providing that in Mexico and Guatemala, for example “there are no specific norms that deal with the disregard [theory]”), available at [http://biblioteca.usac.edu.gt/tesis/04/04\\_7232.pdf](http://biblioteca.usac.edu.gt/tesis/04/04_7232.pdf).

407. See, e.g., CÓDIGO CIVIL [CÓD. CIV.] art. 2314 (Guat.) (“[E]l que ha cometido un delito o cuasidelito que ha causado daño a otro, es obligado a la indemnización” [He who has committed a crime or tort which has inferred harm to another, is forced to compensation]). See also *id.* art. 1645 (stating “[t]oda persona que cause daño o perjuicio a otro, sean intencionalmente, sea por descuido o imprudencia, está obligada a repararlo” [“anyone causing a damage to another, either intentionally or negligently, must repair it”]), available at <http://www.scribd.com/doc/2532415/codigo-civil-guatemala>.

408. J. MARÍA ELENA GUERRA, LEVANTAMIENTO DEL VELO Y RESPONSABILIDAD DE LA SOCIEDAD ANÓNIMA [LIFTING THE VEIL AND LIABILITY OF THE STOCK CORPORATION] 429 (2009) (commenting that the civil actions traditionally available in Latin American law cannot be used to “obtain the results offers by the piercing the corporate veil doctrine”).

409. Irureta, *supra* note 383, at 261 (highlighting the piercing the veil doctrine as a theory of last resort in Chile).

410. *Id.* at 263 (mentioning the perception that the piercing the veil doctrine is seen in civil law jurisdictions as an “eminently judicially-created technique.”).

curred in selected jurisdictions of Latin America. Therefore, this article will now discuss typical civil law institutions conducive to the shaping of a corporate veil piercing doctrine that exists in Latin America.

1. *Failure to Observe Corporate Formalities (the De Facto Corporation Doctrine in Latin America) and Its Relation to Veil Piercing*

U.S. law accepts personal liability before incorporation occurs. In effect, U.S. law allows limited liability to be attributed to “corporate promoters,”<sup>411</sup> who are individuals or entities that create a corporation but are not yet shareholders.<sup>412</sup> Thus, liability is imposed on corporate promoters based on either statutory violations or actions that take place when the corporation has been formed without complying with the laws governing its proper formation.<sup>413</sup> The latter situation is called the *de facto* corporation doctrine, according to which promoters become personally liable for all obligations contracted by the nascent corporation before it gains its legal existence.<sup>414</sup> But since the corporation has yet to exist, there is no corporate veil to pierce. Consequently, liability is imposed on promoters based on general principles of contract law related to civil liability and unjust enrichment.<sup>415</sup> Moreover, nothing impedes the *de facto* corporation from embracing the prior acts performed by its promoters.<sup>416</sup> In that sense, the *de facto* corporation differs from the *de jure* corporation, in that the latter is “one that is fully protected against attacks on its corporateness.”<sup>417</sup>

The strictness of Latin American law with respect to the formation of corporations is very well known. Indeed, civil law juris-

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411. A promoter is defined as “[a] founder or organizer of a corporation or business venture; one who takes the entrepreneurial initiative in founding or organizing a business or enterprise.” BLACK’S LAW DICTIONARY 1046 (9th ed. 2009).

412. Barber, *supra* note 4, at 372-73 (discussing the expectation of limited liability that promoters have in closely held corporations).

413. Gazur & Goff, *supra* note 150, at 404 (“The Wyoming, Florida, and Kansas statutes provide that ‘[a]ll persons who assume to act as a limited liability company without authority to do so shall be jointly and severally liable for all debts and liabilities.’”) (citation omitted).

414. Meiners et al., *supra* note 155, at 353.

415. SODERQUIST ET AL., *supra* note 335, at 193 (“Promoters generally are personally liable under promoters’ contracts, largely because, to be enforceable, a contract has to have at least one party on each side, and . . . a corporation cannot be bound to a contract when it is not yet in existence.”).

416. Meiners et al., *supra* note 155, at 353.

417. *Id.*

dictions establish very stringent requirements for the creation, incorporation, and registration of corporations. In general, these formalities require: 1) the presence of two or more shareholders, 2) the execution of a deed and its registration in several public registries, 3) the filing of notices to the public, 4) the issuance and registration of stock, 5) shareholder meetings, and 6) the practice of other accounting procedures.<sup>418</sup> For example, article 352 of the Chilean Commerce Code, provides that:

The articles of incorporation must mention: . . . 4. The capital contributed by each of the shareholders, consisting either in money, credits, or in any other type of assets; the value assigned to contributions consisting in movable or immovable property; and the form according to which the fair value of such contributions is made when no value has been assigned to such property.<sup>419</sup>

This provision, in turn, is followed by a stringent parole evidence rule, contained in article 353, which states that “no evidence is admissible whatsoever against the letter of deeds granted in compliance with article 350, or to justify the existence of agreements not expressed therein.”<sup>420</sup>

Failure to comply with any of these requirements renders the entity null and void before the law.<sup>421</sup> Article 355A provides a sanction for noncompliance with legal formalities in which “the omission of the notarized articles of incorporation, or the amendment thereof, or their registration in the Registry of Commerce,

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418. See, e.g., Cód. Civ. art. 10 (Chile) (“The acts forbidden by the law are absolutely null and void.”).

419. CÓDIGO DE COMERCIO [CÓD. COM.] art. 352 (Chile).

420. *Id.* art. 353 (Chile).

421. See, e.g., Ley 18,046 on *Sociedades Anónimas* [Stock Corporations], art. 6, para. 1 (Chile), *available at* [http://www.sii.cl/pagina/jurisprudencia/legislacion/complementaria/ley\\_18046a.htm](http://www.sii.cl/pagina/jurisprudencia/legislacion/complementaria/ley_18046a.htm). It states as follows:

[L]a sociedad anónima que no sea constituida por escritura pública o en cuya escritura de constitución se omite cualquiera de las menciones de los números 1, 2, 3 ó 5 del artículo 4, o cuyo extracto haya sido inscrito o publicado tardíamente o en el cual se haya omitido cualquiera de las menciones que para él se exigen en el artículo 5, es nula absolutamente. [“A stock corporation that is not constituted through notarized articles of incorporation or whose articles of incorporation omit any of the mentions required in numerals 1, 2, 3 or 5 of article 4, or whose extract has been untimely registered or published or in which any of the mentions required in article 5 is omitted, is absolutely null and void.”]

*Id.*

produces [an] absolute nullity among the shareholders.”<sup>422</sup> Article 356 of the Chilean Commerce Code, complements this consequence as follows:

The company that is not constituted through notarized articles of incorporation, or not constituted by a private instrument that is subsequently transformed in notarized articles of incorporation, or that is not constituted through a notarized private instrument, is *ipso jure* null and void, and cannot be cured.<sup>423</sup>

Again, complementing these provisions, article 361 of the Commerce Code states that:

The amendment whose extract is not timely registered in the Registry of Commerce shall not produce any effects against the shareholders or third parties, except in the case of cure in accordance to the law and the restrictions imposed by the law. Such deprivation of effects shall operate *de jure*, without prejudice of the action for unjust enrichment that proceeds.<sup>424</sup>

Similarly, article 6A of the Chilean Law on Stock Corporations declares that “the stock corporation not constituted by notarized articles of incorporation, or not constituted by a private instrument that is subsequently transformed in notarized articles of incorporation or that is not constituted through a notarized private instrument, is null *ipso jure*, and cannot be cured.”<sup>425</sup>

Nevertheless, Latin American legislation has recognized that a defective corporation can still operate in the real world. This recognition has been called the “*de facto* corporation doctrine,” an institution that is also present in U.S. law.<sup>426</sup> Forced to deal with the reality that many corporations are defective due to a complete lack of compliance with legal formalities, only partial adherence to the formalities, or other procedural or substantive flaws, Chilean law came to give express recognition to the *de facto* corporation doctrine. Paragraph two of article 356 of the Commerce Code provides the following:

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422. Cód. Com. art. 355A (Chile).

423. *Id.* art. 356.

424. *Id.* art. 361.

425. LEY DE SOCIEDADES ANÓNIMAS [Stock Corporations Law] art. 6, para. 1 (Chile).

426. Helfman, *supra* note 2, at 8 (2010) (referring to the “defective incorporation” theory). See generally Charles E. Carpenter, *De Facto Corporations*, 25 Harv. L. Rev. 623 (1912).

However, if the company exists *de facto*, it creates a community. Profits and losses shall be distributed and bore and the restitution of the contributions shall be made among the community members per their agreement and, in default, in accordance to the rules applicable to companies. Community members shall be jointly and severally liable to third parties with whom they have contracted in the name and on behalf of the community; community members are barred from raising the defense of lack of the instruments aforementioned in paragraph 1. Third parties may prove the *de facto* existence of the community by any legal means.<sup>427</sup>

Other legal texts in Chile explicitly recognize the *de facto* corporation doctrine. For instance, article 6, paragraphs 2, 3, and 4 of the Chilean Law on Stock Corporations provide:

The same nullity shall affect bylaws amendments and the dissolution agreement of a company, even when duly registered and published, when their extracts omit any of the particulars required under article 5; however, these amendments and agreement shall be enforceable against shareholders and third parties until they are declared invalid; the declaration of nullity does not have retroactive effect and shall apply only to situations that occur from the time the nullity decision is rendered; all without prejudice of a cure in accordance with the law. Any essential nonconformity between the deeds and the registrations or publications of the respective extracts is equated with an omission. Essential nonconformity is that which leads to an erroneous understanding of the extracted deed. Signatories of the accord declared null shall be jointly and severally liable to third parties with which they have contracted in the name and interest of the company.<sup>428</sup>

Article 6A of the same Chilean Law on Stock Corporations reaffirms the foregoing rules of article 6 in these terms:

Notwithstanding the foregoing, if the company existed *de facto*, a community among its members shall be deemed to exist. Profits and losses shall be distributed and bore and the resti-

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427. Cód. Com. art. 356 (Chile).

428. LEY DE SOCIEDADES ANÓNIMAS [Stock Corporations Law] art. 6, para. 2, 3, 4 (Chile).



tution of the contributions shall be made among the community members per their agreement and, in default, in accordance to the rules applicable to companies. Community members shall be jointly and severally liable to third parties with whom they have contracted in the name and on behalf of the community; community members are barred from raising the defense of lack of the instruments aforementioned in paragraph 1. Third parties may prove the *de facto* existence of the community by any of the legal means established in the Commerce Code, and the evidence shall be appreciated in accordance with the rule of sound reasoning.<sup>429</sup>

In Peru, the General Law of Corporations defined “irregular corporations” (*de facto* corporations) as those “not created and registered in accordance to that law, or when two or more persons act manifestly as a corporation, but have not created and registered it.”<sup>430</sup> The General Law of Corporations establishes that in the case of irregular corporations, “administrators, representatives, and in general, all those who act before third parties on behalf of the irregular corporation, are personally, jointly, and severally liable for the contracts and, in general, all legal acts executed from the moment the irregularity occurred.”<sup>431</sup> Puerto Rico has also had an interesting experience managing the relationship between the *de facto* doctrine and the veil piercing theory.<sup>432</sup> As a result, both United States law and Latin American law recognize the possibility of holding personally liable those who engage in corporate activities *before* the corporation is formed and also after the corporation is defectively created pursuant to the *de facto* corporation doctrine, save minor substantive differences and procedural matters germane to each legal system.<sup>433</sup>

## 2. *Fraud of the Law*

Since time immemorial, Roman law contained the legal principle *fraud omnia corrumpit*,<sup>434</sup> which means that fraud corrupts

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429. *Id.* at art. 6A.

430. LEY GENERAL DE SOCIEDADES [General Law of Corporations], art. 423, (Peru) available at <http://www.congreso.gob.pe/ntley/Imagenes/Leyes/26887.pdf>.

431. *Id.* at art. 42a, para. 2.

432. Díaz, *supra* note 95, at 329.

433. Larry E. Ribstein, *Limited Liability and Theories of Incorporation*, 50 MD. L. REV. 80, 110 (1991) (stating that in the United States *de facto* doctrine “is not only not conditioned upon incorporation, but is granted despite incorporation”).

434. Dobson, *supra* note 400, at 841.

everything. Civil fraud, or *fraus—fraudis*, implies “a falsity, deception, malice, or abuse of confidence that causes damage, and thus indicates bad faith and illicit conduct.”<sup>435</sup> The Spanish Civil Code has a provision (article 1111), derived from the Digest of Justinian,<sup>436</sup> which gives generic remedies to creditors in case of fraud committed by the debtor corporation and which provides that “[a]fter persecuting all of the assets in possession of the debtor to pay them their credits, the creditors may execute all of the rights and actions to that end [and they also may] challenge the acts that the debtor has executed defrauding them.”<sup>437</sup> Based on that provision, Spanish courts have long applied the fraud of law theory to veil piercing. Thus, the Supreme Tribunal held in an opinion that the purpose of that doctrine is “to avoid . . . prejudice . . . caused to private or public interests by means of fraud . . . .”<sup>438</sup>

In this way, the doctrine of fraud of the law has been used as generic grounds for granting judicial remedies in civil law jurisdictions and is found in multiple provisions of Latin American civil codes as well.<sup>439</sup> In the case of Costa Rica, article 20 of its Civil Code disavows acts that, while performed in accordance with the law, have been used to obtain a result contrary to the finality of the law itself or in a way different than that authorized by the law. In that sense, any fraud against the law is a prototypical reason to invalidate any transaction.<sup>440</sup> Thus, the corporate veil might theoretically be pierced in Latin America based on the fraud of the law doctrine.

Perhaps the most direct link between the traditional civil law notion of fraud and the veil piercing doctrine in Latin America can be found in the Dominican Republic. In 2008, that country passed Law 479-08. This law expressly permits veil piercing in Chapter I,

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435. Rony Saavedra, *Comentarios sobre la Doctrina del Levantamiento del Velo de la Persona Jurídica*, DERECHO Y CAMBIO SOCIAL (Feb. 23, 2012, 10:25 PM), [http://www.derechocambiosocial.com/revista016/velo%20de%20la%20persona%20juridica.htm#\\_ftn1](http://www.derechocambiosocial.com/revista016/velo%20de%20la%20persona%20juridica.htm#_ftn1).

436. FELIPE DÍAZ, LA DOCTRINA DEL LEVANTAMIENTO DEL VELO: DE LA PERSONA JURÍDICA EN EL PROCESO DE CREACIÓN DEL DERECHO [THE LIFTING THE VEIL OF THE LEGAL ENTITY DOCTRINE IN THE PROCESS OF LEGAL CREATION] 155 (1996).

437. *Id.* at 156 (quoting CÓDIGO CIVIL [C.C.] art. 1111 (Spain)).

438. CARMEN BOLDÓ, EL “LEVANTAMIENTO DEL VELO” Y LA PERSONALIDAD JURÍDICA DE LAS SOCIEDADES MERCANTILES [THE ‘LIFTING THE VEIL’ AND THE LEGAL PERSONALITY OF COMMERCIAL COMPANIES] 17 (1993).

439. *See e.g.*, Decision of the Provincial Audience of Segovia, Spain, July 2, 1992, *cited in* PERRETTI, *supra* note 199, at 62 (referring to the abuse of the law as a ground to pierce the corporate veil).

440. CÓDIGO CIVIL [CÓD. CIV.] art. 3, 10 (Costa Rica) (1885), *available at* <http://www.scribd.com/doc/25862978/Codigo-Civil-de-Costa-Rica>.

Title I, Section II and is entitled “*De la Inoponibilidad de la Personalidad Jurídica*” (On the Unopposability of the Legal Personality).<sup>441</sup> Article 12 allows the piercing of commercial companies and individual limited liability companies when the corporate veil is used “in *fraud of the law*, to violate public policy, or *with fraud* and in prejudice of the rights of partners, shareholders, or third parties.”<sup>442</sup> Paragraph II of the same article makes it clear that veil piercing does not cause a “nullity” [termination] of the corporation, but instead, that its effects are exclusively circumscribed to the parties to the transactions vitiated by fraud.<sup>443</sup>

### 3. *Misrepresentation or Deception*

In the United States, a ground for veil piercing exists when the defendant has “induced the creditor to do business with the corporation by making misrepresentations.”<sup>444</sup> A misrepresentation consists of a debtor intentionally or negligently giving a creditor a false impression of the financial strength of the company.<sup>445</sup>

One of the key concepts of the civil law tradition in tort liability is *dolo* (fraud). The definition of fraud in civil law jurisdictions is uniform. The Guatemalan Civil Code defines *dolo* in article 1261 as “any suggestion or artifice employed to induce somebody to an error or to maintain him in it.”<sup>446</sup> The presence of *dolo* makes a transaction voidable but does not allow a court per se to pierce the veil. Moreover, the rigidity of Latin American civil law jurisdictions focus on whether the formalities of a guarantee (whether *in personam* or *in rem*) have been complied with. If they have been complied with, the liability of the guarantor is strictly limited to the amount of the guarantee. In this sense, there is no piercing of the veil (beyond the amount of the guarantee) in Latin American law. In other words, *dolo* could constitute a ground for veil piercing, not per se, but only in the sense that the concerned transaction becomes voidable in the case of misrepresentation.

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441. LEY NO. 479-08 on GENERAL DE SOCIEDADES COMERCIALES Y EMPRESAS INDIVIDUALES DE RESPONSABILIDAD LIMITADA [General Law on Commercial Companies and Individual Limited Liability Companies], art. XII, para. 1, 4, 5 (Dom. Rep.), *amended* by corporate legislation in the Dominican Republic.

442. *Id.*

443. *Id.* art. XII, para. 2.

444. Franklin A. Gevurtz, *Piercing Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil*, 76 OR. L. REV. 853, 860 (1997).

445. *Id.* at 895.

446. CÓD. CIV. art. 1261 (Guat.).

#### 4. *Abuse of Law or Abuse of Rights Doctrine*

The abuse of law or contractual rights theory provides another possible point of comparison with the piercing of the corporate veil doctrine.<sup>447</sup> This theoretical construct, first enunciated by the French jurist Jossrand,<sup>448</sup> prohibits acts or omissions that manifestly go beyond the limits established by the law or those that damage a third party. The rationale is that the rights recognized by the law may not be exercised against the principles of good faith, good morals, and public policy.<sup>449</sup>

German Professor Rudolf Serick, who is credited as being the first civil law scholar to advance a systematic exposition of the veil piercing doctrine within the civil law tradition,<sup>450</sup> explained that there are four situations in which the abuse of law or contractual rights theory would grant a remedy: (1) when a fraud is committed through a legal entity—for example, when the corporate shield is used to defraud a third party; (2) in the case of fraud against a contract or the violation thereof, which occurred during the use of the corporate form; (3) the “catch all” category of harm fraudulently caused to third parties;<sup>451</sup> and (4) when the corporate form is used to hide the fact that the persons intervening in a given act are actually those who were involved in the fraud in the first place.<sup>452</sup> Serick also found three types of abuse in the context of veil piercing: social abuse, individual or personal abuse, and institutional abuse.<sup>453</sup> Social abuse is where a social value or goal is affected, while personal abuse takes place when an ethical rule guiding human relations is violated, and institutional abuse exists where fraud occurs within the corporate form and is precisely the type of abuse that the veil piercing doctrine would address.<sup>454</sup>

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447. PERRETTI, *supra* note 199, at 49 (highlighting that abuse of the law is generally present in civil law jurisdictions “when the exercise of a right exceeds the limits imposed by good faith, morals, and good customs”).

448. *See generally* LOUIS JOSSERAND, DE L'ESPRIT DES DROITS ET DE LEUR RELATIVITÉ - ESSAI DE TÉLÉOLOGIE JURIDIQUE TOME 1, THÉORIE DITE DE L'ABUS DES DROITS [OF THE SPIRIT OF RIGHTS AND THEIR RELATIVITY - ESSAY OF LEGAL THEOLOGY, VOLUME 1] (Dalloz-Sirey ed., 2d ed. 2006).

449. *See, e.g.*, CÓD. CIV. arts. 548, 1461, 1467, 1475, 1717 (Chile) (referring to the principles of good faith, good morals, and public policy).

450. PERRETTI, *supra* note 199, at 34 (citing MARCELO LÓPEZ, EL ABUSO DE LA PERSONALIDAD JURÍDICA DE LAS SOCIEDADES COMERCIALES 103 (2000)). *See supra* note 383.

451. *Id.* at 33 (citing LÓPEZ, *supra* note 53, at 75-77).

452. HURTADO, *supra* note 386, at 45.

453. LÓPEZ, *supra* note 99, at 106 (referring to Professor Serick's analysis of “abuse”).

454. *Id.*

Additionally, the first Spanish judicial case dealing with the veil piercing theory,<sup>455</sup> in which the Supreme Tribunal recognized that the core of the veil piercing doctrine is the notion of fraud against third parties,<sup>456</sup> allowed the piercing of the corporate veil in order to avoid the abuse of the benefit of limited liability in a manner that causes damage to the interests of third parties. In that sense, the Supreme Tribunal condemned what it called the “anti-social exercise of a right [that of limited liability].”<sup>457</sup> The notions of abuse, equity, and fraud were at the core of the Supreme Tribunal’s decision.<sup>458</sup>

There are several examples throughout Latin America demonstrating the remarkable efforts the highest courts have made to find connections between the traditional abuse of law or abuse of rights doctrine and the U.S. veil piercing theory.<sup>459</sup> Perhaps these courts understand “the potential for [its use] as an efficient legal response to abuses of the corporate limited liability shield.”<sup>460</sup> In 1965, the Argentinean Supreme Court decided a pioneering case when it pierced the corporate veil based on the concept of abuse.<sup>461</sup> Specifically the court decided to disregard “the form of the legal personality [and to] lift the veil of the corporate fiction to disclose the goals of the members [who] hide themselves behind the mask of the corporate structure.”<sup>462</sup> Three decades later, the Supreme

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455. HURTADO, *supra* note 386, at 50 (citing a decision of the Supreme Court of Justice of Spain, S.T.S., Jan. 26, 1952 (Spain)) (referring to this 1952 decision of the Supreme Court of Justice of Spain where a landlord sought to prevent the tenant from returning to the property by rejecting a separation of a corporation and coining the case as the “precursor of the piercing the veil doctrine in the area of urban leases [in Spain], which is where the doctrine finds its utmost expression”).

456. DE ANGEL YAGÜEZ, *supra* note 395, at 25, 27-31 (discussing S.T.S., May 28, 1984 (Spain). This article is also cited in SANTIAGO ORTIZ, *EL LEVANTAMIENTO DEL VELO EN EL DERECHO ADMINISTRATIVO. RÉGIMEN DE CONTRATACIÓN DE LOS ENTES INSTRUMENTALES DE LA ADMINISTRACIÓN, ENTRE SÍ Y CON TERCEROS* [THE LIFTING OF THE VEIL IN ADMINISTRATIVE LAW. CONTRACT REGIMEN FOR THE INSTRUMENTAL ENTITIES OF THE ADMINISTRATION, AMONG THEMSELVES, AND WITH RESPECT TO THIRD PARTIES] 24 (2004). *See also* PERRETTI, *supra* note 199, at 38.

457. ORTIZ, *supra* note 456, at 24 (quoting S.T.S., Jan. 26, 1952 (Spain)).

458. HURTADO, *supra* note 386, at 192 (complaining that since 1984 the Spanish Supreme Tribunal has remained “anchored” on the concepts of “abuse, equity, and fraud” when deciding piercing-the-veil cases) (internal quotation marks omitted).

459. *See, e.g.*, HÉCTOR MASNATTA, *EL ABUSO DEL DERECHO A TRAVÉS DE LA PERSONA COLECTIVA. TEORÍA DE LA PENETRACIÓN* [The Abuse of Law Through the Collective Entity. The Theory of Penetration] (Rosario ed., 1967).

460. Hofstetter, *supra* note 382, at 315 (citation omitted).

461. LÓPEZ, *supra* note 99, at 262 (citing Cámara de la Paz, Sala I [Peace Chamber, section I], 1965, “Pontremoli S.A. c. Rosmar S.R.L. y otros,” (Arg.)).

462. *Id.* at 263 (citing Cámara de la Paz, sala I [Peace Chamber, section I], 1965, “Pontremoli S.A.C. Rosmar S.R.L. y otros,” (Arg.)).

Court of Costa Rica expressly held that the exercise of contractual rights cannot be used in an absolute manner so as to violate the exigencies of good faith or to make a mockery of the law.<sup>463</sup>

The Guatemalan Civil Code regulates the abuse of law doctrine in article 1653, providing that “[a]ll excess and bad faith in the exercise of a right, or the omission thereof, that causes damage[] to persons or property, must be compensated.”<sup>464</sup> Article 465 of the same code states that “[t]he owner, in exercise of his right, may not perform acts that injure other persons.”<sup>465</sup> In Argentina, article 1109 of the Civil Code states that “[a]nyone who executes an act, that due to his negligence causes damage to another, is obligated to repair the damage.”<sup>466</sup> These statutory code sections can all be used to build legal support for piercing the corporate veil under the abuse of law or contractual rights theory.

Chilean courts have justified piercing the corporate veil by basing their decisions on the idea that the corporate form is prohibited from acting fraudulently against third parties.<sup>467</sup> In 2002, the Supreme Court of Chile held that “the lifting the veil doctrine is useful to punish cases of abuse of the corporate shield in [committing] fraud of the law.”<sup>468</sup> More importantly, this was reaffirmed in 2008, when the same court held that the purpose of the veil piercing theory is to prevent “abuse of the law and fraud against the law, giving privilege to the principles of supremacy of reality and good faith, which could be overcome if a purely formalistic interpretation were given to the law.”<sup>469</sup>

Nearly a decade prior to these Chilean decisions, the Supreme Court of Puerto Rico analyzed the existence of fraud within related companies that belonged to an economic conglomerate.<sup>470</sup> In that case, the court discussed three types of situations in which

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463. SAAVEDRA, *supra* note 375, at 182 (citing Decision of the Second Chamber of the Supreme Court of Justice of Costa Rica, June 25, 1997).

464. CÓD. CIV. art. 1653 (Guat.).

465. *Id.* art. 465 (cited in VILLEDA, *supra* note 373, at 95).

466. CÓDIGO CIVIL [CÓD. CIV.] art. 1109 (Arg.).

467. *See generally* LÓPEZ, *supra* note 99, at 468–85 (reviewing case law dealing with the abuse of law doctrine as support for piercing the veil in Chile).

468. Cordero, *supra* note 383, at 123 (quoting Corte Suprema de Justicia [C.S.J.] [Supreme Court], 31 diciembre 2002, Rol de la causa: 4965, sentencia (Chile)).

469. Corte Suprema de Justicia [C.S.J.] [Supreme Court], 2 junio 2008, Rol de la causa: 1527-2008 (Chile).

470. Departamento de Asuntos del Consumidor v. Alturas de Florida Development Corp., 1993 WL 840226 (P.R. 1993) (stating that the corporation will be the mere alter ego of its stockholders, “with the benefits produced by the corporate business accruing exclusively and personally to them, . . . if it is necessary to prevent fraud or the accomplishment of an illicit purpose, or to prevent an injustice or wrong”).

veil piercing is allowed.<sup>471</sup> In the first, piercing the veil is allowed when the corporation has one or more shareholders who are natural persons and the interests of the company and the interests of the shareholders are not aligned and become confused.<sup>472</sup> The second situation occurs when there is no real division of capital, management, purpose, and interest between the parent and the subsidiary.<sup>473</sup> The final situation in which veil piercing is allowed is when corporations are members of the same holding.<sup>474</sup> In Colombia, the Council of State referred to the corporate shield as “a privilege that the law grants exclusively for a concrete and determined purpose [and that] when abuse or fraud intervene it is necessary to disregard the external form of the legal entity to disclose the persons or interests hidden behind it.”<sup>475</sup> In a recent decision, the Chilean Appellate Court for Santiago quoted what it considered to be a well-established precedent established by the Chilean Supreme Court, that “it is licit, for courts to disregard, in certain occasions, the external form of legal entities [and] to then penetrate in[to] their interior in order to reveal the underlying subjective interests hidden behind them, and to reach the persons and assets protected under the clothing of an underlying entity.”<sup>476</sup>

In Nicaragua, where no explicit legal provisions concerning the veil piercing theory exist,<sup>477</sup> an indirect application of the doctrine has been used through the abuse of rights and fraud against the law theories.<sup>478</sup> Theoretically, the abuse of law doctrine could be used as a ground to fully develop a theory on veil piercing in Chile, Costa Rica, Guatemala, Argentina, Puerto Rico, Colombia, and Nicaragua. Therefore, the notion of fraud is a solid foundation for veil piercing in the United States and in Latin America.

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471. *Id.*

472. *Id.*

473. *Id.*

474. BORDA, *supra* note 129, at 77.

475. Cordero, *supra* note 383, at 120 (quoting Consejo de Estado [C.E.] [Council of State], Aug. 19, 1999, 10641 (Colom.)).

476. Corte de Apelaciones de Santiago [C. Apel.] [Court of Appeals], 1 enero 2011, Rol de la causa: 71-2010 (Chile) (quoting Corte Suprema de Justicia [C.S.J.] [Supreme Court], 2 junio 2008, Rol de la causa: 1527-2008 (Chile)).

477. IVÁN ESCOBAR, *Levantamiento del Velo de las Personas Jurídicas* [Lifting the Veil of Legal Entities], in ESTUDIOS JURÍDICOS 603 (Hispaner ed., 2007).

478. *Id.* at 604–09.

5. *The Civil Law Doctrine of Simulación and Veil Piercing*

In general, Latin American law does not impose any limitations on how much control a shareholder can have over a corporation, thus allowing a corporation to be the alter ego of its shareholders. In a way, the civil law institution of *simulación* is comparable to the U.S. alter ego doctrine, in the sense that it holds that when there is a total identification between the corporation and its shareholders, the former is considered to be an alter ego of the latter. Using that interpretation, the Supreme Court of Puerto Rico applied the alter ego theory in 1954 when it held, in part, that:

We are aware the corporation possesses a legal personality independent of that of its shareholders. But if the corporation is merely an “alter ego” or “business conduit” of its shareholders, receiving exclusively and personally the benefits generated by the corporate management, then the shareholders would be personally liable if it is necessary to avoid a fraud, or the execution of an unlawful purpose, or to avoid a clear inequity or evil.<sup>479</sup>

Furthermore, in the most recently recorded Puerto Rican Supreme Court of Justice case on veil piercing, the court reiterated the validity of the alter ego theory, allowing the piercing of the veil “when the corporation is an *alter ego*, business conduit, or passive economic instrument of its shareholders.”<sup>480</sup>

In Guatemala, a *simulación* claim is available:

(i) When the legal character of the business that is declared is hidden, and the parties give it the appearance of a different business; (ii) [w]hen the parties falsely declare or confess something that in reality has not happened or that has not been convened between them; and (iii) [w]hen rights are constituted or transmitted through intermediaries in order to hide the real interested parties.<sup>481</sup>

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479. Cruz v. Ramírez, 75 D.P.R. 947, 954 (P.R. 1954).

480. Peguero y otros v. Hernández Pellot, 139 D.P.R. 487 (P.R. 1995).

481. CÓD. CIV. art. 1284 (Guat.).



Generally, two kinds of *simulación* exist in Latin American legal systems: absolute and relative.<sup>482</sup> “Absolute” *simulación* occurs when the parties hide under an apparently “valid” contract, when they have, in fact, secretly agreed upon another contract that destroys or amends the facially valid one.<sup>483</sup> When this occurs, the underlying transaction is voidable. However, if the masking contract created a corporation, no veil piercing can take place, because there is no actual corporation. Rather than having a voidable contract, the general rules on tort liability apply,<sup>484</sup> yet no veil piercing would occur.<sup>485</sup>

Relative *simulación*, on the other hand, takes place when the agreement gives an appearance that hides the true nature of the intended agreement.<sup>486</sup> In this case, the remedy provides that the business receive the effects that the parties tried to hide. The company is used as an alter ego of the shareholders, and the creditor argues that the corporation was a *simulación* and that the business was actually held between him and the shareholders of the simulated corporation.<sup>487</sup> Thus, the same results of the veil piercing doctrine could be achieved through the civil law institution of relative *simulación*.

Chilean law does not deal systematically with the institution of *simulación*.<sup>488</sup> The essence of the doctrine in Chile pivots around the idea that the real intent of the parties prevails over their declared intent. Chilean scholarship has built the theory of *simulación* based on article 1707 of the Civil Code, which reads as follows:

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482. *Id.* art. 1285 (“[L]a simulación es absoluta cuando la declaración de voluntad nada tiene de real; y es relativa, cuando a un negocio jurídico se le da una falsa apariencia que oculta su verdadero carácter [The simulación is absolute when the declaration of will has nothing that is true; and relative, when a false appearance is given to a legal agreement in order to hide its true character].”).

483. PERRETTI, *supra* note 199, at 69 (referring to the doctrine of absolute *simulación* in Venezuela).

484. See CÓD. CIV. arts. 1445, 1467, 1682-83 (Chile) (providing that the transaction affected by absolute *simulación* [simulation] is null and void).

485. ALBERTO LYON, PERSONAS JURÍDICAS [LEGAL PERSONS] 81 (2006).

486. *Id.* at 70.

487. See SAAVEDRA, *supra* note 375, at 111, 114-15 (analyzing *simulación relativa* [relative simulation]).

488. Paolo Ambrosio Leonelli, Rodrigo Andrés Urra Escobar & Gabriela Yolanda Novoa Muñoz, Abuso de la Personalidad Jurídica 29 (Oct. 29, 2004) (thesis, Catholic University of Temuco Law School), available at <http://biblioteca.uct.cl/tesis/paolo-leonelli-rodrigo-urra/tesis.pdf>.

[P]rivate instruments made by the contracting parties to alter what is accorded in a notarized deed shall not bind third parties. The same applies to counter-notarized deeds when no notice of their content has been written at the margin of the mother-deed whose provisions are altered by the counter-notarized deed, and of the notice provided to third parties about such counter-notarized deed.<sup>489</sup>

*Simulación* is thus applied when, for example, a person creates a company with the sole purpose of avoiding his creditors. An absolute *simulación* would occur in this case, since “the person has pretended to create a company when, in fact, has created none, since no real intent to create it has existed . . . and no real consideration exists either.”<sup>490</sup> A comprehensive understanding of the Chilean Civil Code provisions that serve as a foundation of the *simulación* theory necessarily requires that article 1707 be read in conjunction with other Civil Code provisions.<sup>491</sup>

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489. Cód. Civ. art. 1707 (Chile).

490. *Id.*

491. In order to better understand the legal treatment of the doctrine of *simulación* [simulation] in Latin American civil law jurisdictions, an exposition of the pertinent Chilean Civil Code provisions is included below:

Title XXI. On the Proof of Obligations

Article 1698. The burden of proving the existence or extinction of obligations corresponds to those arguing either. Admissible evidence consists of public or private instruments, witnesses, presumptions, admissions, affidavits, and the personal inspection of the judge.

Article 1699. A public or authentic instrument is that approved with the legal formalities by the competent official. It is called a public deed when executed before a notary public and incorporated into a protocol or public record.

Article 1700. The instrument is deemed as authentic with respect to the fact that it has been granted, its date, but not as to the truth of the statements made by the parties therein. In this part it is deemed as authentic only against the signatories. The obligations contained in the instrument are deemed as authentic only with respect to the signatories and to those whom such obligations refer either generally or particularly.

Article 1701. The lack of a public document cannot be replaced by any other means of evidence in the acts and contracts in which the law requires that solemnity; the law shall consider such acts and contracts as not performed or executed even if they contain the promise to transform them in a notarized public deed within a certain period, under a liquidated damages clause: this clause has no effect whatsoever. In all other cases, the instrument that is defective due to the lack of jurisdiction of the official or to any other formal defect, and shall be valid as a private instrument if it is signed by the parties.

Article 1702. The private instrument that is recognized by the party against whom it is reputed to have executed it, and that has been ordered to be recognized in the cases and with the requirements established in this law, shall have the value of a public deed with respect to those who appear or are reputed to have signed it, and also with respect to those whom these persons have transferred the obligations and rights contained in such instruments.

In Venezuela, pursuant to article 1281 of the Civil Code, good faith creditors are entitled to demand the nullification of simulated transactions in cases of testamentary dispositions made by the testator in violation of mandatory assignments, which is an example of a voidable act of *simulación*.<sup>492</sup> This occurs when the testator forms a corporation with one of his legitimate heirs and transfers a quantity of property beyond that which that legitimate heir is entitled to inherit upon the death of his co-shareholder/parent.<sup>493</sup> The same result occurs in Venezuela when, in order to violate the restrictions on the alienation of marital property,<sup>494</sup> a husband were to create a corporation and transfer assets beyond his legal powers.<sup>495</sup> An interesting procedural as-

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Article 1703. The date of a private instrument is counted against a third party only from the date of death of any signatories to such instrument, or from the day when it is copied in a public register, or when it is filed at trial, or when an official with jurisdiction has approved or inventoried it, in an official capacity.

Article 1704. The statements, records and domestic papers are deemed as authentic only against those who have written or signed them, but only in that which appears clearly, and provided that those who desire to take advantage of them does not reject them in the part that is unfavorable to them.

Article 1705. The notice written or signed by the creditor following, either in margin or in the back of a writing that has always been in his power, makes full faith in everything that is favorable to the debtor. The same rule applies to the notice that is written or signed by the creditor following, either in the margin or in the back of such duplicate that is under the control of the debtor. But the debtor who wishes to take advantage of the part of the notice that is favorable to him, must also accept the part that is not favorable to him.

Article 1706. The public or private instrument makes faith between the parties even concerning mere declaratory statements, provided that these statements have a direct relation with the substantive parts of the act or contract.

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Article 1708. No witness evidence shall be admissible with respect to an obligation that must have been established in writing.

CÓD. CIV.]art. 1698-1706, 1708 (Chile).

492. 1 KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 96 (Tony Weir trans., 2d ed. 1987) (stating that the only portion of the estate that the testator is free to devise in the presence of legitimate heirs, is the so-called "*quotité disponible*"). See also BRIGITTE BASDEVANT-GAUDEMET & JEAN GAUDEMET, INTRODUCTION HISTORIQUE AU DROIT XIII<sup>e</sup>-XX<sup>e</sup> SIÈCLES 386 (L.G.D.J., 2000) (Fr.) ("[L]e père dispose librement d'une partie de ses biens, la *quotité disponible*, pour avantager l'enfant de son choix." ["The father disposes freely of a part of his property, called 'available quote,' to benefit the child of his choice."]).

493. PERRETTI, *supra* note 199, at 75. See also BORDA, *supra* note 129, at 107-49 (reviewing case law in Argentina dealing with the piercing of the corporate veil doctrine in the context of trust and estate litigation).

494. See CORDERO, *supra* note 383, at 128-32 (reviewing the judicial application of veil piercing in the context of marital property and family obligations in Venezuela). See also HURTADO, *supra* note 386, at 99 (reviewing Spanish case law on the transference of marital property by the husband using fictitious corporate structures to violate legal restrictions on the alienation of marital property).

495. See, e.g., CÓDIGO CIVIL [CÓD. CIV.] art. 168 (Venez), available at [http://www.gobiernoenlinea.ve/legislacion-view/sharedfiles/Codigo\\_Civil.pdf](http://www.gobiernoenlinea.ve/legislacion-view/sharedfiles/Codigo_Civil.pdf) (referring to

pect of the action of *simulación* in Venezuela is that no statute of limitations applies restricting its exercise.<sup>496</sup>

Also in Venezuela, but in the field of cooperatives, veil piercing is accepted when the harm caused to third parties results in a profit that cooperatives fail to declare to the respective tax authorities.<sup>497</sup> However, piercing does not occur as a consequence of the veil theory, but as a result of the civil law abuse of rights doctrine outlined in article 1185 of the Venezuelan Civil Code.<sup>498</sup> Such abuse manifests itself in the conduct of cooperative members, including “unjust enrichment, insolvency, infra-capitalization, and emptying of the corporation.”<sup>499</sup> Veil piercing in Venezuelan law is thus a legal institution subordinate to other traditional civil law doctrines, among which *simulación* occupies a central role.<sup>500</sup>

## 6. Ultra Vires and Veil Piercing

The *ultra vires* doctrine has been widely adopted in Latin American civil law jurisdictions, most meaningfully, in Argentina, where *ultra vires* is analyzed under the title of “*fines extrasocietarios*” (extra-corporate purposes).<sup>501</sup> Article 54 para-

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the situation where the husband transfers assets belonging to the conjugal community without consent of his wife).

496. *Anzola v. Línea Aeropostal Venezolana C.A.*, [July 19, 1995] (Venez.) cited in PERRETTI, *supra* note 199, at 81-82.

497. Mariadela Bello, *El Levantamiento del Velo Corporativo de las Cooperativas en Venezuela*, 7 JURÍDICAS 117, 126 (2010) (Colom.).

498. CÓD. CIV. art. 1185 (Venez.) (“ El que con intención, o por negligencia o por imprudencia, ha causado un dano a otro, esta obligado a repararlo. Debe igualmente reparación quien haya causado un daño a otro, excediendo, en el ejercicio de su derecho, los límites fijados por la Buena fe o por el objeto en vista del cual le ha sido conferido ese derecho.” [Those who intentionally, or negligently or imprudently, injure another, must repair such damage. Those who injure another, exceeding in the exercise of their rights either the limits established by good faith or the purpose in consideration of which such rights were granted, are also liable.]).

499. *Id.* at 127.

500. See generally JOSÉ MUCI, EL ABUSO DE LA FORMA SOCIETARIA O EL ‘LEVANTAMIENTO DEL VELO CORPORATIVO’ A LA LUZ DE LA DOCTRINA DE LA ADMINISTRACIÓN PÚBLICA Y DE LA JURISPRUDENCIA VENEZOLANAS EN MATERIA CIVIL, MERCANTIL, ADMINISTRATIVA, TRIBUTARIA, LABORAL Y PENAL [THE ABUSE OF THE CORPORATE FORM OR THE ‘LIFTING OF THE CORPORATE VEIL’ UNDER THE DOCTRINE OF THE VENEZUELAN PUBLIC ADMINISTRATION AND JURISPRUDENCE IN CIVIL, COMMERCIAL, ADMINISTRATIVE, TAX, LABOR, AND CRIMINAL MATTERS] (2005) (reviewing the treatment of the veil piercing theory in several areas of Venezuelan law). See also 1 Marisol Sarria, *La Desestimación de la Personalidad Jurídica [The Disregard of the Legal Personality]*, in LIBRO CENTENARIO DEL CÓDIGO DE COMERCIO VENEZOLANO DE 1904 (2004).

501. CARLOS MOLINA, LA DESESTIMACIÓN DE LA PERSONALIDAD JURÍDICA SOCIETARIA [THE DISREGARD OF THE CORPORATE LEGAL PERSONALITY] 89-90 (2002) (Arg.).

graph 3 of the Argentine Commercial Companies Law (CCL) states that:

[T]he acts of a company that hide the securing of extra-company purposes, or that constitute a mere resource to violate the law, the public order or the good faith, or to frustrate the rights of third parties, shall be directly attributed to the shareholders or the controllers who made this possible, and these shall be jointly and severally liable for the damages caused.<sup>502</sup>

The idea is to punish conduct that allows an unlawful action to “masquerade” under a cloud of legality. Thus, *simulación* is at the core of reproachable conduct. Article 955 of the Argentinean Civil Code clearly establishes that “*simulación* occurs when something is concealed.”<sup>503</sup> Article 954 requires that for veil piercing to occur, an “act of the company” must take place.<sup>504</sup> That is, if the act “notoriously exceeds” the corporate purpose, it is unenforceable against the corporation, but the corporate representative who has acted *ultra vires* is still liable to third parties for the consequences of his unlawful act.<sup>505</sup> If the act was done in a manner that violated the representation of the corporation through securities, contracts between absent parties, or executed through forms, and the third party has actual notice of the violation, the concerned acts are not enforceable against the corporation. However, if the third party is not on notice of the violation, the corporation is responsible.<sup>506</sup> In other words, if internal procedures concerning the generation or legitimacy of the act are violated, the act is valid and attributable to the corporation.<sup>507</sup> Most authors are of the opinion that Argentinean law allows the corporation to assume the consequences of an act performed *ultra vires* by its representatives, but only with the unanimous consent of the shareholders.<sup>508</sup>

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502. CÓDIGO DE COMERCIO [CÓD. COM.] art. 451, para. 3 (Arg.), available at <http://www.cnv.gov.ar/leyesyreg/Leyes/19550.htm> (Arg.).

503. FRANCISCO LÓPEZ, EL CORRIMIENTO DEL VELO SOCIETARIO ALCANCES DEL ART. 54, ULTIMO PÁRRAFO, DE LA LEY DE SOCIEDADES COMERCIALES [THE LIFTING OF THE CORPORATE VEIL SCOPE OF ART. 54, LAST PARAGRAPH, OF THE COMMERCIAL COMPANIES LAW] 116 (2005) (Arg.).

504. CÓD. COM. art. 954 (Arg.).

505. LÓPEZ, *supra* note 503, at 105 (mentioning art. 58 of the CCL which provides that the corporate representative binds the corporation in all acts that “are not notoriously foreign to the social purpose”).

506. *Id.* at 109.

507. *Id.* at 105 (mentioning art. 58 of the Commercial Companies Law).

508. *See, e.g., id.* at 107.

The rationale used to explain the Argentinean application of the veil piercing doctrine in *ultra vires* cases is that by not complying with the requirements set by the legislature that grant the benefit of limited liability, the representatives are subject to the general norms imposing joint and several liability.<sup>509</sup> Other Argentinean Civil Code provisions dealing with negligence (e.g., article 1109) are also cited to hold representatives liable for their culpable actions or omissions.<sup>510</sup> Some authors hold that the representatives' liability is based on their fraud and not their negligence.<sup>511</sup> In fact, they sustain that the *simulación* or abuse in which they occur necessarily requires a willful and intentional state of mind on their part, and therefore, mere negligence is not a ground for liability.<sup>512</sup> Whatever the threshold accepted, that is, negligence or fraud, Argentina routinely pierces the veil to hold corporate representatives liable for their *ultra vires* actions.

### 7. *Commingling of Assets and Affairs*

Civil law considers an error of the identity of the person to be a ground for the nullification or invalidation of a contract, when the identity of the person is the principal motivation for entering into the contract.<sup>513</sup> Accordingly, if a creditor is mistaken as to the identity of the corporate debtor, due to the fact that there has been a commingling of assets and affairs, he can demand the nullity of the contract.<sup>514</sup> However, the error does not give the creditor a right to hold the shareholders personally liable for the debts incurred in the vitiated contract. The commingling of assets and affairs has thus been indirectly mentioned as a ground to pierce the veil in civil law jurisdictions. In Spain, the separateness between the parent corporation and the subsidiary is respected<sup>515</sup> when "no confusion between [their] respective commercial transactions and accounting exists."<sup>516</sup> It is fitting to remember that under the veil piercing theory in U.S. law, not only is the parent

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509. LÓPEZ, *supra* note 503, at 109.

510. Cód. Civ. art. 1109 (Arg.).

511. LÓPEZ, *supra* note 503, at 109.

512. *Id.* at 112.

513. *See, e.g.*, Cód. Civ. arts. 784, 790, 2184 (Arg.).

514. *See, e.g.*, Cód. Civ. art. 1259 (Guat.).

515. Saavedra, *supra* note 435, at 1 (referring to the "patrimonial autonomy" existing between a corporation and its shareholders).

516. PERRETTI, *supra* note 385, at 36.

liable for the obligations of the subsidiary, but such liability also occurs among subsidiaries.<sup>517</sup>

In Chile, there have been theoretical analyses on the impact that the separation of assets between corporations would have in veil piercing determinations—that is, whether economic conglomerates create corporations with independent assets for lawful purposes or for purposes that warrant piercing the corporate veil. The legal principle of separation between the corporation and its shareholders is found in article 2503, paragraph 2 of the Civil Code, labeled “radical separation.”<sup>518</sup> However, the principle of radical separation is a legal mandate that cannot be contradicted by other legally binding statutes in that jurisdiction. Therefore, the principle of separateness is the general rule in Chilean law, unless and until, pursuant to applicable legal provisions, that separateness is disregarded.<sup>519</sup> In summary, when the corporate veil is utilized to violate a legal mandate, a “fraud of the law” takes place that would merit disregarding the veil in the Chilean legal system.<sup>520</sup> Ultimately, however, the commingling of assets is a test that is not yet established as a basis for veil piercing in Latin America.

#### 8. *Undercapitalization*<sup>521</sup> and *Purposeful Insolvency*

Statistical studies in the United States estimate that undercapitalization, also called “inadequate capitalization,” has been the “fifth most discussed factor by courts”<sup>522</sup> in veil piercing cases. Undercapitalization occurs when “the capital is illusory or trifling compared with the business to be done and the risks of loss.”<sup>523</sup> *Minton v. Cavaney*, the first reported undercapitalization case in a U.S. court, took place in 1961.<sup>524</sup> In *Minton*, the Supreme Court of California pierced the corporate veil when it held a shareholder personally liable because the corporation’s capital was insufficient to respond to corporate liabilities.<sup>525</sup>

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517. ORTIZ, *supra* note 456, at 21.

518. LYON, *supra* note 485, at 68; CÓD. CIV. art. 2503, para. 2 (Chile).

519. LYON, *supra* note 485, at 69.

520. *Id.* at 70.

521. See SAAVEDRA, *supra* note 375, at 146 (using the expression “infra-capitalization” in Latin America).

522. See, e.g., Matheson, *supra* note 15, at 1130.

523. Cohen, *supra* note 75, § 12, at 36.

524. *Minton v. Cavaney*, 364 P.2d 473 (Cal. 1961) (en banc).

525. *Minton*, 364 P.2d at 580.

As a scholar writes, “[a]ddressing whether a corporation is adequately capitalized requires answering three questions. First, what is ‘capital;’ in other words, what are we measuring? Second, how much capital is enough? Finally, when do we measure the amount of capital?”<sup>526</sup> The most essential question seems to be, how much capital is considered adequate?<sup>527</sup> U.S. law offers two different approaches to confront this conundrum. As discussed *infra*, following either of these two approaches is determinant when dealing with “unintended liabilities,”—that is, with the obligations due to “involuntary creditor[s].”<sup>528</sup>

The first approach looks at the amount of capital at the time of the formation of the corporation, which is known as “the shareholders’ initial investment in the corporation.”<sup>529</sup> In this situation, the focus is on “all the corporation’s assets,” with a special focus on the amount that came from the shareholders.<sup>530</sup> Particular emphasis is given to whether the capital is appropriate according to the “nature and magnitude of the corporate undertaking . . . .”<sup>531</sup>

The second approach focuses on the moment when the specific business was agreed upon or when the damages or torts were committed.<sup>532</sup> Therefore, this approach operates on a case-by-case basis. For instance, U.S. courts have pierced the veil when the defendant periodically transfers money from one corporation to another, creating a purposeful insolvency situation with regard to the liable corporation.<sup>533</sup>

Yet another school of thought suggests using the company’s debt to equity ratio as the parameter.<sup>534</sup> Ultimately, there is no clarity in U.S. law on how much capital is enough to consider a corporation duly capitalized and at what moment the corporate capital should be evaluated for purposes of veil piercing.<sup>535</sup>

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526. Gevurtz, *supra* note 444, at 888.

527. Barber, *supra* note 4, at 371, 390 (“The task for the lawyer in advising a closely held corporation on what amount of capital is adequate is extremely difficult.”).

528. David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1634-35 (1991) (citation omitted).

529. Gevurtz, *supra* note 444, at 889.

530. *Id.* at 888.

531. Cohen, *supra* note 75, § 12, at 35-36 (mentioning that this standard rests on two assumptions: “(1) that the person entering into a transaction with a corporation has a certain level of financial sophistication; and (2) that the bargaining power of the parties is roughly equal”).

532. Gevurtz, *supra* note 444, at 871.

533. *See, e.g., DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 689 (4th Cir. 1976).

534. Easterbrook & Fischel, *supra* note 172, at 113.

535. Guadarrama, *supra* note 402, at 70.



Likewise, Latin American civil law jurisdictions have utilized the notion of undercapitalization, or as it is called in Argentina, “insufficient capitalization,”<sup>536</sup> as a ground for veil piercing. A Latin American author has offered two approaches to the concept of undercapitalization: material and nominal.<sup>537</sup> Material undercapitalization occurs when the company cannot respond to its obligations due to a lack of funds.<sup>538</sup> Nominal undercapitalization occurs when the company does have enough funds, but these come in the form of loans from its shareholders.<sup>539</sup> In other words, the corporation does not own the money, but instead owes it. Of these, only material undercapitalization would raise the possibility of veil piercing.<sup>540</sup>

Arising in this context is the question of what constitutes adequate minimum capital to make an entrance into the market. Latin American jurisdictions, in general, do not require a minimum amount of equity capital to start a business association.<sup>541</sup> In some situations, however, legislation charges a governmental entity with the task of verifying the effectiveness of the capital of certain companies.<sup>542</sup> For example, foreign insurance and re-insurance companies, pension fund administration companies, and securities exchange boards, among others, that want to operate in Chile, must have their declared capital verified by the Superintendant of Pension Fund Administrators.<sup>543</sup> Consequently, in the absence of specific legislation, the probability is low that a court would pierce the corporate veil in Latin America based solely

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536. JUAN M. DOBSON, *EL ABUSO DE LA PERSONALIDAD JURÍDICA [ABUSE OF THE LEGAL PERSONALITY]* 165 (1985).

537. Alfonso Riveiro, *Piercing the Corporate Veil in Spain and Grounds for Liability*, in *Piercing The Corporate Veil* 7 (Susan Meek ed.) (Center for International Legal Studies CD-ROM, Aug. 1998), available at <http://law.wustl.edu/Library/cdroms/IBL/Pierce/W22Riv.htm>.

538. *Id.*

539. *Id.*

540. PERRETTI, *supra* note 199, at 93.

541. Díaz, *supra* note 95, at 355 (“modern corporate legislations do not require minimum capital contributions by shareholders.”); see also Andrés Varela Fleckenstein, *La Doctrina del Levantamiento del Velo en la Jurisprudencia Nacional* [The Lifting the Corporate Veil Doctrine in the National Jurisprudence], in *ESTUDIOS DE DERECHO COMERCIAL. PRIMERAS JORNADAS CHILENAS DE DERECHO COMERCIAL* 94 (Abeledo Perrot ed., 2011) (“[E]ven though there are several legal provisions in Chile that require a minimum capital for the operation of a business, it is also true that that is not the general rule.”).

542. Barber, *supra* note 4, at 395. In the United States the idea of a statutory solution for the dilemma of minimum capital for closely held corporations causes the “inflexibility of treating all corporations the same [and this] militates against the adoption of this approach.” *Id.*

543. CÓD. COM. arts. 126, 131 (Chile).

on the fact that the capital of the involved companies is foreign or below a stated “minimum” to operate, since no such legal standards exist.

In Mexico, the Securities Commission is empowered to determine when the “minimum capital” requirement is met by new entrants into the market.<sup>544</sup> But even in situations where a minimum amount for market entrants is legally mandated,<sup>545</sup> the exact amount varies from country to country and from one area of the economy to another.

In taking into account the big picture, however, over-zealous regulation of the requirement of “adequate capitalization” could boomerang, because risk, whether financial or commercial, is an inherent attribute of doing business. In other words, not all undercapitalized companies fail. Therefore, excessively regulating the market by broadening veil piercing availability on grounds of undercapitalization<sup>546</sup> could get “to the point of dismantling”<sup>547</sup> corporations altogether.

Argentina offers a current example where the notion of “insufficient capitalization” has been used to pierce the veil in conjunction with “the ‘abuse of rights’ theory.”<sup>548</sup> For a long time, the insufficient capitalization of companies has generated strong disapproval in that country’s legal environment.<sup>549</sup> Loud voices calling for government intervention still exist. Accordingly, this is a breeding ground for possible reforms.

### 9. *Disregarding Separateness in the Context of Inter-Company Loans*

Costa Rica offers several interesting instances of the courts disregarding the formal separateness of different corporations. The-

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544. Guadarrama, *supra* note 402, at 70.

545. *Id.* at 71 (“La SA abierta no puede ampararse, para operar dentro del mercado bursátil, en la cantidad establecida por las distintas leyes de Derecho comparado para la SA en general, por el contrario, requiere un capital mínimo cualificado”) [“In order to operate within the stock market, the Stock Corporation may not take shelter in the amount established by foreign laws for Stock Corporations in general; quite the contrary, it requires a qualified minimum capital.”].

546. Bahls, *supra* note 162, at 66 (“Inadequately capitalized firms are likely to engage in unacceptable risky activities.”) (citation omitted).

547. Bertrán, *supra* note 159, at 34.

548. Dobson, *supra* note 400, at 853-54.

549. BORDA, *supra* note 129, at 56 (“[I]nfra-capitalized stock corporations constitute a cheap caricature of what should be understood for a stock corporation and become an instrument of fraud against third parties [and therefore] it is of utmost importance that the State duly regulates their operation.”).

se decisions have been issued in cases dealing with tax litigation. They represent remarkable precedents relevant for veil piercing purposes in Latin America, and therefore, deserve discussion.

The first case is *Tenería Primenca S.A.*,<sup>550</sup> where the court held that the funds transferred to the recipient company constituted a true financing operation that was disguised as a “capital paid in excess” operation, and should, therefore, be dealt with accordingly by the tax authorities.<sup>551</sup> Pursuant to the law, Costa Rican tax authorities have the power to estimate *ex officio*, the tax base when taxpayers do not submit affidavits to the authorities, if the affidavits are affected by any of the following: falsity, illegality, or incompleteness; if the affidavits have been presented but accounting books and registrations do not exist; if the documentation justifying accounting operations has not been presented; if the information requested by the authorities has not been provided; if accounting information is irregular or defective; or if the accounting books have not been updated during the last six months.<sup>552</sup> The documents produced by *Tenería* justifying accounting operations did not provide the data and information requested of it—specifically, *Tenería* failed to provide information about the capital contributed in excess in its other affiliated companies, the form of the contributions, the additional participation in the ownership of the related companies, and the rights to dividends, among other requested information.<sup>553</sup>

Contrary to the allegations of *Tenería*, the court held that capital paid in excess cannot be considered capital contribution or as a contribution to corporate assets when it is not performed with the necessary formalities, if it is not formally registered through the issuance of stock, or if the necessary formalities to be considered a capital contribution according to the corporate bylaws are not observed.<sup>554</sup> Therefore, the court held that “investments” made by one of the companies in the other lacked permanency, and since

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550. *Tenería Primenca S.A.*, Tribunal de Casacion Contencioso Administrativo y Civil de Hacienda de Costa Rica [Contentious Administrative, Civil, and Tax Cassation Court] § IV Aug. 29, 2008, expediente [File] 06-000223-161-CA, *cited in* Informe de Investigación [Research Report], *prepared by* Centro de Información Jurídica en Línea de Costa Rica [Online Legal Information Center of Costa Rica] June 2001 at 11 [hereinafter *Costa Rica Report*].

551. *Tenería Primenca S.A.*, § IV, expediente [File] 06-000223-161-CA, *cited in* Informe de Investigación [Research Report], *prepared by* Costa Rica Report at 11.

552. *Id.* (internal citations omitted).

553. *Id.*

554. *Id.* § I.

the operation in question took place between commercial companies and their dealings are presumed to be for value, it refused to consider the aforementioned “investments” a “loan” to be repaid with interest.<sup>555</sup> The court held instead that they were a true and simple capital investment in the related company.<sup>556</sup>

The second case is *Orlich Bolmarcich*,<sup>557</sup> which considered the validity and efficacy of a stock transfer contract. The court held that this contract is a special category of the purchase contract and, thus, a for-value transaction.<sup>558</sup> Additionally, like all other purchase contracts, the stock transfer contract must specify certain formalities to be valid, such as a description of the object being transferred, the price, the forms of payment, and the registration formalities.<sup>559</sup> Generally, ownership in purchase contracts is transferred upon agreement between the parties over the object and the price. But in the case of movable property, such as stock, ownership is transferred only after registration requirements have been fulfilled. Otherwise, any alleged “transfer” without complying with registration requirements is null and void.<sup>560</sup> None of these formalities were observed in the present case, and because no gratuity may be inferred in transactions between merchants, the supposed “transfer” will be deemed as not having taken place between the parties *ad litem*,—that is, the transfer would be null and void, with no legal effects whatsoever.<sup>561</sup>

The third case is *Finca Las Calabacitas Sociedad Anónima*, where the court invoked the statutory law on the formation of limited liability stock corporations (*sociedades anónimas*) to rule that the transfer of stock to the figurehead or straw man was lawful and that the transferor was entitled to a legal action against the transferee for a lack of compliance.<sup>562</sup> The law in question included

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555. *Id.*

556. *Tenería Primenca S.A.*, § IV, expediente [File] 06-000223-161-CA, cited in Informe de Investigación [Research Report], prepared by Costa Rica Report at 11.

557. *Orlich Bolmarcich*, Tribunal de Casación Contencioso Administrativo y Civil de Hacienda de Costa Rica [Contentious Administrative, Civil, and Tax Cassation Court] § X Decision No. 245 Aug. 1, 2003, expediente [File] 03-000174-0010-CI, cited in Informe de Investigación [Research Report], prepared by Costa Rica Report at 19.

558. *Orlich Bolmarcich*, § X Decision No. 245 Aug. 1, 2003, expediente [File] 03-000174-0010-CI, cited in Informe de Investigación [Research Report], prepared by Costa Rica Report at 19.

559. *Id.* § XII.

560. *Id.*

561. *Id.*

562. *Finca Las Calabacitas Sociedad Anónima*, Sala Segunda de la Corte Suprema de Justicia [Second Chamber of the Supreme Court of Justice of Costa Rica] §§ IV–VII Deci-

several requirements for the formation of a *sociedad anónima*, including a minimum of two shareholders each subscribing at least one share; at least twenty-five percent of the subscribed capital paid at the time of incorporation; and that if contributions are expressed in assets belonging to third parties, these contributions must be paid in full at the time of incorporation.<sup>563</sup> Additionally, the transfer of stock requires the delivery of the title to the transferee and the registration thereof in the appropriate registry.<sup>564</sup> The court noted that nothing in the legislation prohibits the transfer of stock by means of a stock transfer agreement.<sup>565</sup>

In this case, a figurehead seems to have existed at the moment of incorporation—that is, no “real” shareholders existed besides the single shareholder promoting the subsidiary corporation. The court held that the fact that the stock was later transferred back to the figurehead and that the latter failed to pay the fair price have nothing to do with the validity of the corporation itself.<sup>566</sup> In other words, the fact that the corporation could have been a “sham” does not imply that any subsequent transfers of stock are to be treated likewise. Consequently, the court asserted that the transfer of the stock back from the subsidiary to the parent corporation and the parent’s failure to pay the fair price are two different issues that do not invalidate the creation of the subsidiary corporation.<sup>567</sup> In effect, the subsidiary corporation retained all legal rights against the parent to recover the price.<sup>568</sup> As a result, the court denied the application of the alter ego doctrine in this situation.<sup>569</sup>

The final case involves articles 102 and 120 of the Costa Rican Commerce Code, and Law 3,284 of 1964, which was declared unconstitutional by Law 6,965.<sup>570</sup> These statutes imposed restrictions on the expression and payment of corporate capital and

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sion No. 246, Apr. 20, 2005, expediente [File] 91-000522-0181-CI, cited in Costa Rica Report at 22–26.

563. *Finca Las Calabacitas Sociedad Anónim*, at § V, Decision No. 246, Apr. 20, 2005, expediente [File] 91-000522-0181-CI, cited in Costa Rica Report at 22–26.

564. *Id.* § V.

565. *Id.* § VII.

566. *Id.*

567. *Id.* § VIII.

568. *Finca Las Calabacitas Sociedad Anónim*, § VIII, Decision No. 246, Apr. 20, 2005, expediente [File] 91-000522-0181-CI, cited in Costa Rica Report at 22–26.

569. *Id.*

570. Sala Constitucional de la Corte Suprema de Justicia [Constitutional Chamber of the Supreme Court of Justice of Costa Rica] § XV Decision No. 1188 Feb. 17, 1999, expediente [File] 95-000142-0007-CO, cited in Costa Rica Report, at 26, 29–32.

other obligations in foreign currency.<sup>571</sup> The court declared these statutes unconstitutional, holding that corporate capital may be expressed, and paid, in either domestic or foreign currency in Costa Rica.<sup>572</sup> The court reasoned that the Costa Rican legal system recognizes as fundamental certain constitutional guarantees, including the respect of human rights, the rule of law, due process of law, and other individual guarantees, such as private property and freedom of enterprise.<sup>573</sup>

Among these guarantees, the court opined, the respect and promotion of contractual freedom includes the right to enter into agreements in which the price is established in a foreign currency.<sup>574</sup> The court noted that the Commerce Code originally permitted public or private parties to express or perform any contracts or transactions whatsoever in domestic as well as foreign currencies.<sup>575</sup> The amendment of 1984 eliminated that possibility.<sup>576</sup> The court reasoned that restrictions to contractual freedom could only take place within the current constitutional framework based on article 28 of the Costa Rican Constitution.<sup>577</sup> This provision allows governmental restrictions when the exercise of individual rights is damaging to the social morals, the public order, or the equal or superior rights of third parties.<sup>578</sup> Consequently, a freely-agreed upon clause in a contract establishing payment in a foreign currency may only be restricted based on the aforementioned grounds of Article 28 of the Constitution. While recognizing the public policy effects of this holding, the court went on to state that the legislature might not violate fundamental constitutional guarantees.<sup>579</sup>

In sum, Costa Rican courts have disregarded the separateness of corporations, without alluding to the veil piercing theory. However, these judicial precedents may well form a breeding ground

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571. CÓDIGO DE COMERCIO [CÓD COM.] art 102, 120 (Costa Rica) (no longer constitutional).

572. *Sala Constitucional de la Corte Suprema de Justicia* [Constitutional Chamber of the Supreme Court of Justice of Costa Rica] § XV Decision No. 1188 Feb. 17, 1999, expediente [File] 95-000142-0007-CO, cited in *Costa Rica Report*, at 26, 29–32.

573. *Id.* § XIII.

574. *Id.* § XV.

575. *Id.* § XIX.

576. *Sala Constitucional de la Corte Suprema de Justicia* [Constitutional Chamber of the Supreme Court of Justice of Costa Rica] § XII Decision No. 1188 Feb. 17, 1999, expediente [File] 95-000142-0007-CO, cited in *Costa Rica Report*, at 26, 29–32.

577. *Id.* § V.

578. *Id.*

579. *Id.* § XII.

for a more robust re-formulation of the veil piercing theory in that jurisdiction.

*D. Recent Legal Developments in Latin America Relevant to Veil Piercing*

Recently, several theories with a genuinely Latin American flavor have emerged and should be included in this comparative analysis on veil piercing.

*1. The Enterprise Liability Doctrine as a Recent Emergence in Latin American Law*

In the United States, enterprise liability has been defined as the “liability imposed on each member of an industry responsible for manufacturing a harmful or defective product, allotted by each manufacturer’s market share of the industry.”<sup>580</sup> There is, however, discussion as to whether “[l]imited liability for corporations . . . [is] inconsistent with the notion of enterprise liability.”<sup>581</sup> The fact that an enterprise allocates its risks and assets in several corporations is not enough to pierce the corporate veil—other criteria will have to be met. In *In re Silicone Gel Breast Implants Product Liability Litigation*,<sup>582</sup> which is one of the most cited decisions on veil piercing based on the parent-subsidary context, the United States District Court for the Northern District of Alabama found that the parent company was liable for the damages caused to third parties due to defective products when (i) the parent company controlled most of the subsidiary’s actions; and (ii) the principal allowed the subsidiary to put its name in the packages and product inserts and failed to provide proper liability insurance.<sup>583</sup>

In Europe, the enterprise approach rests on the principle that “the parent corporation shall be liable for all the unpaid debts and acts of its subsidiaries for the reason that the former controls the latter, forming thereby a unitary economic enterprise.”<sup>584</sup>

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580. BLACK’S LAW DICTIONARY 926 (7th ed. 1999).

581. Booth, *supra* note 163, at 141.

582. *In re Silicone Gel Breast Implants Product Liab. Litig.*, 887 F. Supp. 1447, 1447 (N.D. Ala. 1995).

583. *In re Silicone Gel Breast Implants Product Liab. Litig.*, 877 F. Supp. at 1452 (also considering other factors in piercing the veil). See also ALAN PALMITER, CORPORATIONS: EXAMPLES AND EXPLANATIONS 554 (5th ed. 2006) (citing *In re Silicone Gel Breast Implants Product Liab. Litig.*, 877 F. Supp. at 1447).

584. Antunes, *supra* note 9, at 218 (emphasis in original).

Latin American civil law jurisdictions, on the other hand, have widely criticized the idea of making the controlling entity liable for the debts of the controlled companies, based on the mere element of control alone.<sup>585</sup> The idea of piercing the veil in the corporate context has arisen around the concepts of “*grupo económico*” [economic group],<sup>586</sup> “*unidad económica*” [economic unit],<sup>587</sup> “*conjunto económico*” [economic group], “*conglomerado económico*” [economic conglomerate],<sup>588</sup> and *grupo empresarial*<sup>589</sup> [entrepreneurial group]. These terms refer, in general, to the reality of corporate entities that possess the same domicile, common directors and controlling shareholders, whose assets are confused, and that act “in the market under the logic of a single entity.”<sup>590</sup>

In 1971, the Supreme Court of Argentina pierced the veil of a union that had declared bankruptcy for the purpose of evading its social security obligations, terminated its legal existence, and reconstituted itself under another legal personality.<sup>591</sup> In that case,

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585. Guadarrama, *supra* note 402, at 70.

586. *See Reglamento de Propiedad Indirecta, Vinculación y Grupo Económico* [Regulations of the Indirect Property, Connections, and Economic Group of Peru] Resolución CONASEV N 090-2005-EF/94.10 art. 7 (Gaceta Jurídica del Perú [Official Gazette]), Dec. 28, 2005 (Art. 7 defines economic groups as “the group of legal entities, whatever their activities or social purpose, subject to the control of the same natural person, or the same group of natural persons.”).

587. *See, e.g., LEY ORGÁNICA DEL TRABAJO* [C. ORGANIC LAB. L.] art. 177 (Venez.), available at <http://www.tsj.gov.ve/legislacion/lot.html> (“La determinación definitiva de los beneficios de una empresa se hará atendiendo al concepto de unidad económica de la misma, aún en los casos en que ésta aparezca dividida en diferentes explotaciones o con personerías jurídicas distintas u organizada en diferentes departamentos, agencias o sucursales, para los cuales se lleve contabilidad separada” [“The final determination of the profits of a company shall be made in accordance with the concept of economic unity of the same company, even in cases where the company is divided for different purposes or separated in different legal entities, or organized in different departments, agencies or branches each keeping its own accounting books.”]).

588. ORTIZ, *supra* note 456, at 40-41.

589. ENRIQUE ALCALDE, LA SOCIEDAD ANÓNIMA. AUTONOMÍA PRIVADA, INTERÉS SOCIAL Y CONFLICTOS DE INTERÉS [THE STOCK CORPORATION. PRIVATE AUTONOMY, SOCIAL INTEREST, AND CONFLICTS OF INTEREST] 172 (2007) (citing Art. 96 of the *Ley de Mercado de Valores* [Securities Markets Law], which defines *grupos empresariales* as “el conjunto de entidades que presentan vínculos de tal naturaleza en su propiedad, administración o responsabilidad crediticia, que hacen presumir que la actuación económica y financiera de sus integrantes está guiada por los intereses comunes del grupo o subordinada a éstos, o que existen riesgos financieros comunes en los créditos que se les otorgan o en la adquisición de valores que emiten” [“the group of entities that are connected in their ownership, management or credit responsibility, which raises the presumption that economic and financial performance of their members is guided by the common interests of the group or subordinate to them, or that there exist common financial risks in the credits that are granted to them, or in the acquisition of securities issued by them”]).

590. PERRETTI, *supra* note 199, at 54, 57, 59-60.

591. Decision of *Sala D* of the National Chamber on Civil Matters of Argentina, March 16, 1971, cited in LÓPEZ, *supra* note 99, at 232-33.



the Supreme Court pierced the veil of the newly constituted union to hold the extinct union liable and to avoid a mockery of the law.<sup>592</sup>

The first recorded judicial decision in Argentina that applied veil piercing doctrine to the area of economic groups came in the *Compañía Swift* case in 1973.<sup>593</sup> The Supreme Court of Argentina alluded to the concept of an “economic reality” to hold two companies reciprocally liable.<sup>594</sup> These companies were legally independent and separate, but in *reality* they were economically “unified”<sup>595</sup> in such a way that the court stated that “it is no longer possible to distinguish the assets of each company due to the fact that these companies have confused their assets.”<sup>596</sup> The theory of the economic unit established by the Supreme Court of Argentina in *Compañía Swift* was pioneering in that it did not include any requirements of “fraud or misuse of the corporate structure.”<sup>597</sup> Accordingly, it created a strict liability scheme for companies belonging to the same economic group or unit.

However, the Supreme Court reversed the *Compañía Swift* decision in 1976, while still using the “instrumentality, *alter ego* and agency concepts of [the] corporate veil theory in the United States.”<sup>598</sup> The court required, in addition, proof of fraud or negligence by the defendant corporation. Thus, it deviated from the strict liability rule established by the *Compañía Swift* court in 1973.<sup>599</sup>

In 1976, Argentina passed the Law on the Employment Contract. Article 31 contained an explicit recognition of the veil piercing doctrine based on the concept of economic groups in the context of labor law. Specifically, article 31 states that:

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592. *Id.*

593. *Compañía Swift de La Plata, S.A. Frigorífica s/ convocatoria de acreedores* [1973-19] JURISPRUDENCIA ARGENTINA 579, 151 REVISTA JURIDICA ARGENTINA-LA LEY 516 (1973), *cited in* Michael W. Gordon, *Argentine Jurisprudence: Deltec Update*, 11 LAW AM. 43, 43 (1979).

594. *Id.*

595. Decision of the Supreme Court of Justice of Argentina Parke Davis Argentina S.A.I.C. (Parke Davis), 268 FALLOS 415 (1973), *cited in* Pardinas, *supra* note 209, at 428.

596. *Compañía Swift de La Plata, S.A. Frigorífica s/ convocatoria de acreedores* [1973-19] JURISPRUDENCIA ARGENTINA 579, 151 REVISTA JURIDICA ARGENTINA-LA LEY 516 (1973), *cited in* Gordon, *supra* note 593.

597. Gordon, *supra* note 593, at 43 (“[T]he decision established the theory of the economic unit, or *unidad económica*”) (citation omitted).

598. *Id.* at 53–54, 64–74 (analyzing the *La Esperanza* decision of 1976, C-154-LVII, Bankruptcy Proceeding under CÓD. PROC. CIV. Y COM. [Civil and Commercial Procedure Code] art. 250 (Arg.)).

599. Pardinas, *supra* note 209, at 431 (internal citation omitted).

Whenever one or more companies, even if each of them has its own separate legal personality, or are under the direction, control, or management of others, or otherwise are so related as to constitute a permanent economic group, for purposes of the obligations contracted by each with its workers and with social security agencies, each of them will be jointly and severally liable when fraudulent maneuvers or reckless management have taken place.<sup>600</sup>

In 1981, the Supreme Court of Argentina ratified the principle of veil piercing in a case involving the commingling of the assets of related companies in the context of economic groups.<sup>601</sup> However, in 2006, a commercial trial judge for the city of Buenos Aires refused to apply the veil piercing theory based on the judge's lack of an express legal authority to do so.<sup>602</sup> The court ended up issuing a decision that produced the same effects as veil piercing, but based on traditional civil law theories.<sup>603</sup>

In 1992, the Costa Rican Supreme Court issued a decision concerning the application of the labor law principle of reality within the context of economic groups. This principle is based on the assumption that the reality of the control of a corporation's affairs by someone else—either a natural person or a legal entity—cannot be trumped by fictitious entities created to shield the controller from compliance with his legal obligations.<sup>604</sup> Therefore, piercing the veil is a technique used in labor law within the setting of economic groups seeking to establish the truth above and beyond the corporate structures and strictures utilized in a given case. In turn, in a case decided in 1992, the Supreme Court of Costa Rica stated that:

What should prevail is the primacy of the principle of the reality, and it is enough to prove the existence of an economic community or a group of juristic or natural persons who operate[] together in order to hold liable . . . everyone for the

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600. CÓDIGO DE CONTRATO DE TRABAJO [Employment Contract Law], art. 31 (Arg.).

601. Corte Suprema de Justicia de la Nación [CSJN] [National Supreme Court of Justice], 28/12/81, "Industria Ford, S.A. c. Ford Motor de Venezuela S.A./Decision," cited in PERRETTI, *supra* note 199, at 157.

602. *Juzgado Nacional de Primera Instancia en lo Comercial No. 16* [National Trial Court in Commercial Matters No. 16], 10/05/06, *Simancas, María Angélica c/Crosby, Ronald Kenneth y otro s/ordinario* (Arg.).

603. *Id.*

604. Irureta, *supra* note 383, at 245, 259.

worker's provisions. In these situations, it is convenient to go beyond the company's formal appearances, to reach . . . reality and not deny the exercise of the rights of the worker. It is clear that the transformation suffered by the company can be detrimental to the worker when is carried [out] by management without bargaining with the workers, who were not even informed about the changes in the company. This is because of the application of another principle: the Good Faith principle, which constitutes all the legal system and which is expressed in . . . article 19 of the already mentioned Code,<sup>605</sup> which establishes that the employment contract binds the parties to everything expressed in it, as well as that it binds the parties to the consequences derived from the contract according to good faith, equity, and the use and custom of the law.<sup>606</sup>

Chile also offers an example of the so-called "single economic unit" theory. According to this judge-made doctrine, when two different companies share the same assets, operate under the same management structure, and pursue a common economic goal, it is fitting for the court to consider them as a sole unit for purposes of liability allocation<sup>607</sup>—namely for veil piercing objectives. This theory took statutory form in 2001 when Chile passed Law 19,759,<sup>608</sup> which amended article 478 of the Labor Code and provides strict liability for the employers who defraud labor and social security laws.<sup>609</sup> Under article 478, paragraph 1, when "[e]mployers . . . simulate the hiring of workers through third parties . . . the employer and third parties shall be jointly and severally liable for the labor and social security rights corresponding to the worker."<sup>610</sup> This provision can be classified among legal regulations aimed at preventing the fraud of the law by evading labor and social security obligations. In particular, the law applies in situations where the defendant attempts to elude these liabilities

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605. LEY DEL TRABAJO [C. LAB. L.] ART 19 (Costa Rica).

606. Vote No. 236 of the Second Chamber of San José de Costa Rica, Supreme Court of Justice, Oct. 2, 1992, §§ 5–6.

607. Corte de Apelaciones de Santiago [C. Apel.] [Court of Appeals of Santiago], 6/6/1991, R.D y J. y G.T. (Chile) [Review of Law and Jurisprudence and Gazette of the Courts], Vol. LXXXVIII, 3rd Sec., 84-85 June 6, 1991, *cited in* Irureta, *supra* note 383, at 266.

608. LEY NO. 19759, Septiembre 27, 2001, Diario Oficial [D.O.] (Chile), *available at* <http://www.leychile.cl/Navegar?idNorma=207436&buscar=codigo+del+trabajo>.

609. Irureta, *supra* note 383, at 259.

610. CÓDIGO DEL TRABAJO [CÓD. TRAB.] art 478, para 1 (Chile).

through the mechanism of worker sub-contracting and spinning off companies in which the role of “employer” is delegated to the company at the bottom of the corporate conglomerate, which usually holds meager capital and is almost always utterly undercapitalized.<sup>611</sup> In that context, the reform of article 478 constitutes an expression of the so-called “principle of the primacy of reality” in labor law,<sup>612</sup> which applies to economic conglomerates.

In 2007, the Chilean Appellate Court for Punta Arenas reaffirmed the labor law “reality” principle in a groundbreaking decision on veil piercing. The court emphasized that “the modern trend—to avoid abuses—is to analyze the principle of primacy of reality, and the piercing the veil doctrine.”<sup>613</sup> The court centered its analysis on the concept of using the corporate form to perpetrate fraud and abuse against third parties. In addition, the court stated that the veil piercing doctrine “is founded in reasons of equity, good faith, transparency in legal traffic, prevention of *simulación*, and the penalization of fraud.”<sup>614</sup> In an extremely interesting line of reasoning for a civil law jurisdiction, the court expressly recognized that the constitution and the law force judges to decide cases even where there is a lack of an explicit statutory regulation on a particular situation, and therefore, when asked to decide veil piercing cases, courts have a legal duty to decide them, even if no express law regulates the case.<sup>615</sup>

The reality of the domination or control of one entity by another has also been broadly analyzed and regulated in Europe. In Germany, contracts of domination are available for related government companies to determine their status in a particular business venture, particularly when dealing with reciprocal indemnifications for vicarious liability.<sup>616</sup>

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611. LÓPEZ, *supra* note 99, at 372–73, & 373 n.137 (mentioning Art. 4 of Law 16,744 on Labor Accidents and Professional Illnesses of Chile).

612. See Decision of the Labor Magistrature No. 2 of Gijón, Dec. 3, 1983 (referring in the case of Spain to the principle of “authentic entrepreneurial reality,”—that is, who controls the company, and how that control is exercised, the identification of the place where the core corporate decisions are made, and of whom, in definitive, the workers depend, beyond and besides what corporate structures are used for organizational purposes), *cited in* DE ANGEL YAGÜEZ, *supra* note 395, at 165, 161–91 (reviewing case law related to the application of the veil piercing doctrine within the framework of the “corporate unit” principle).

613. Corte de Apelaciones de Punta Arenas [C. Apel.] [Court of Appeals of Punta Arenas], Rol de la causa: No. 230-2007 § 4 (Chile).

614. *Id.*

615. *Id.* § 14.

616. ORTIZ, *supra* note 456, at 15–18. See also HURTADO, *supra* note 386, at 27 (indicating that in Germany, the veil piercing doctrine is called *durchgriff der juristischen person*).

In the case of Venezuela, the Regulations of the Organic Labor Law provide joint and several liability among employers who compose a group of companies, for labor or social security obligations owed to their workers.<sup>617</sup> In 2004, the Constitutional Chamber of the Supreme Tribunal of Justice of Venezuela refused to uphold the decision of a lower court that had pierced the veil in a case in which an “economic group” acted as defendant.<sup>618</sup> However, the lack of scientific rigor in the court’s explanation of the veil piercing doctrine has been criticized in Venezuela.<sup>619</sup> Criticisms focus on the following: fact that the court has offered no explanation of the veil piercing doctrine; no reference is made to the foundations of the theory; different expressions of the doctrine are treated equally; there is a mistaken use of the concept of “equity” in Venezuelan law; there is confusion in the use of the concept of fraud; and no application of the *simulación* theory is made in veil piercing cases.<sup>620</sup>

In Peru, the veil has been judicially pierced with frequency in cases involving economic groups, principally in labor matters,<sup>621</sup>

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617. Decreto 3,235, *Reglamento de la Ley Orgánica del Trabajo* [Regulations of the Organic Labor Law] of Venezuela, GACETA OFICIAL [OFFICIAL GAZETTE], art. 21, Jan. 25, 1999, available at <http://www.gobiernoenlinea.ve/docMgr/sharedfiles/reglamentoleyorgtrabajo.pdf>.

618. Decision of the Constitutional Chamber of the Supreme Tribunal of Justice of Venezuela, May 14, 2004 (reverses the Decision issued by the *Juzgado Superior en lo Civil, Mercantil, del Tránsito, del Trabajo y de Protección del Niño y del Adolescente de la Circunscripción Judicial del Estado Vargas* [Superior Court in Civil, Commerce, Traffic, Labor, and Children and Adolescent Protection of the Judicial District of the State of Vargas], Dec. 26, 2002, available at <http://www.tecniouris.com/venezuela/hemeroteca/historico/sentencia-sobre-el-velo-corporativo-supuestos-de-procedencia-2041.html>.

619. See generally Omar García, *Levantamiento del Velo Corporativo: Una Aproximación Global a La Doctrina del Desconocimiento de la Personalidad Jurídica de las Sociedades Mercantiles*, in ENSAYOS DE DERECHO MERCANTIL, LIBRO HOMENAJE A JORGE ENRIQUE NÚÑEZ, COLECCIÓN TRIBUNAL SUPREMO DE JUSTICIA (2004). See also Allan Brewer-Carías, *La Ilegítima Despersonalización de las Sociedades, la Ilegal Distorsión del Régimen de la Responsabilidad Societaria y la Violación del Debido Proceso en la Jurisprudencia de la Sala Constitucional de Venezuela* [The Illegitimate Disregard of the Corporate Veil, the Illegal Distortion of the Corporate Liability Regimen, and the Violation of the Due Process in the Jurisprudence of the Constitutional Chamber of Venezuela] (Presentation prepared for the *Congreso Internacional sobre la Despersonalización Societaria y el Régimen de la Responsabilidad*, Pontifical Javeriana University, Academia Colombiana de Jurisprudencia, Consejo Superior de la Judicatura, Bogotá, July 28-30, 2004), at 27-31.

620. Julio Rodríguez, *Mitos y Realidades de la Llamada Teoría del Levantamiento del Velo Corporativo* [Myths and Realities of the So-Called Lifting the Corporate Veil Theory], BOLETÍN DE LA ACADEMIA DE CIENCIAS POLÍTICAS Y SOCIALES [Bulletin of the Academy of Political and Social Science], Vol. 144 January-December 2006, at 303-04, available at [http://aciropol.msinfo.info/bases/biblo/texto/boletin/2006/BolACPS\\_2006\\_144\\_299-322.pdf](http://aciropol.msinfo.info/bases/biblo/texto/boletin/2006/BolACPS_2006_144_299-322.pdf).

621. SAAVEDRA, *supra* note 375, at 157.

even if judicial decisions do not explicitly mention the veil piercing doctrine.<sup>622</sup>

## 2. *Uni-Personal Companies and Veil Piercing*

The sole proprietorship, a “business owned directly by one person,”<sup>623</sup> is “the most popular business organization form in the United States, particularly for small start-up ventures.”<sup>624</sup> In this type of organization, the “legal identity of the sole proprietorship and its owner are one and the same [since] there is no business entity to form.”<sup>625</sup> The financial risks posed by this form of business are based on the unlimited liability of its owner and are usually mitigated through insurance<sup>626</sup> or contractually.

In the case of civil law jurisdictions, the benefit of limited liability has expanded to other institutions beyond the traditional multi-person or collective corporate form over past decades. In fact, the first law on individual limited liability companies (“ILLCs”) was passed in Liechtenstein on November 5, 1925,<sup>627</sup> thus eliminating the need of a plurality of members in order to gain the benefit of limited liability. The French Law 85-697 of July 11, 1985 amended article 1832 of the French Civil Code and several provisions of the Commercial Companies Law, creating the uni-personal limited liability company (“UPLLC”)<sup>628</sup> and the agricul-

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622. GUERRA, *supra* note 408, at 436 (“En materia laboral es una práctica recurrir a la Doctrina del levantamiento del velo societario, aún cuando no se haga expresa mención a ella” [“It is a practice in labor matters to resort to the piercing the veil doctrine, even if no express mention of it is made [in judicial decisions]”).

623. SODERQUIST ET AL., *supra* note 335, at 41.

624. *Id.*

625. *Id.*

626. Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1, 21 (1994) (discussing the interactions between limited liability, piercing the veil, and tort insurance). *See also* Easterbrook & Fischel, *supra* note 172, at 101–03 (analyzing “insurance as an alternative to limited liability”).

627. Alberto Aramouni, *Empresa Individual de Responsabilidad Limitada*, in FRANCISCO JAVIER VELÁSQUEZ CABELLO, LA EMPRESA INDIVIDUAL DE RESPONSABILIDAD LIMITADA, NECESIDAD DE CONSAGRACIÓN LEGAL O SÓLO UN TÓPICO DE INTERÉS DOGMÁTICO [THE INDIVIDUAL LIMITED LIABILITY COMPANY, THE NEED OF STATUTORY REGULATION OR JUST A TOPIC OF DOGMATIC INTEREST] 196 (2000), available at <http://www.juridicas.unam.mx/publica/librev/rev/revdpriv/cont/8/dtr/dtr2.pdf>.

628. This is called “*Enterprise unipersonnelle à responsabilité limitée*” [Uni-Personal Limited Liability Company], in Dobson, *supra* note 400, at 842. There are also other examples in the civil law world where uni-personal limited liability enterprises have been created. That is in the case of Spain, where Law 2 of March 23, 1995, regulating *Sociedades de Responsabilidad Limitada* [Limited Liability Companies], available at [http://noticias.juridicas.com/base\\_datos/Derogadas/r8-12-1995.html](http://noticias.juridicas.com/base_datos/Derogadas/r8-12-1995.html), created the *sociedad unipersonal de responsabilidad limitada* [uni-personal limited liability company] (Chapter

tural exploitation company of limited liability.<sup>629</sup> In fact, article 36-2 of the French Civil Code, added by Law 85-697 of 1985, provides that:

A physical person cannot be an associated member of more than one limited liability company. A limited liability company cannot have, as a sole member, another limited liability company composed by a sole person. In the case of violation of the preceding provisions any interested party may request the dissolution of companies irregularly constituted. When the irregularity results from the meeting in a sole person of all of the parties to a company that has had more than one member, the complaint for the dissolution can only be filed after one year from that date.<sup>630</sup>

In Spain, the Limited Liability Companies Law (*Ley de Sociedades de Responsabilidad Limitada*) of March 23, 1995, contains a whole chapter (Chapter XI) on the “Uni-Personal Limited Liability Company” (“UPLLC”).<sup>631</sup> Prior to passage of this law, the General Directorate of Registration had issued an opinion in 1957 stating that “companies with a sole shareholder preserve their full efficacy and there is no expiration term for the subsistence of such situation.”<sup>632</sup>

The Spanish Limited Liability Companies Law has greatly influenced the creation of similar companies throughout Latin America. Articles 125 to 129 of that law contain the following main provisions: article 125 defines UPLLC’s as those “a) constituted by a sole member, whether a natural or legal person; or b) constituted by two or more members when all of the shares have become owned by a sole member.”<sup>633</sup> Article 125 also adds that “[c]ompany contributions belonging to the uni-personal company are considered [to be] property of the sole member.”<sup>634</sup> Article 126 refers to the publicity of the UPLLC, stating that the declaration of its constitution is:

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XI), and also the “*sociedad anónima unipersonal*” [uni-personal stock corporation] (Article 311).

629. Aramouni, *supra* note 627, at 198.

630. *Id.*

631. See Spanish Law 2 of March 23, 1995, *supra* note 628.

632. Aramouni, *supra* note 627, at 200.

633. Spanish Law 2 of March 23, 1995, *supra* note 628, at art. 125.

634. *Id.*

[A] consequence of the fact that all of the company shares have become owned by a sole member, the loss of such situation or the change of the sole member as a result of the transfer of one or all of the contributions, shall be recorded in a notarized deed to be registered in the Commercial Register. The registration shall expressly mention the identity of the sole member.<sup>635</sup>

It further declares that, “[a]s long as the situation of one-person subsists, the company shall expressly register its uni-personal status in all its documentation, correspondence, order forms and invoices, as well as in all advertisements to be published pursuant to legal or statutory provisions.”<sup>636</sup>

Article 127, in turn, deals with the decisions taken by the sole member in the following terms:

In the uni-personal limited liability company the sole member shall execute the powers of the General Board, and in that case such decisions shall be recorded in the minutes, under his signature or that of his representative, and such signatures may be executed and formalized by the member himself or by the administrators of the company.<sup>637</sup>

Article 128, on the “[h]iring of the sole member of the uni-personal company,” provides that:

The contracts executed between the sole member and the company shall be recorded in writing or in the documentary form determined by the Law in accordance with the nature of such instruments, and shall be re-written into a company log-book that shall be legalized in accordance to the minute books of the company. Express and specific reference to these contracts shall be made in the annual report, with indication of the nature and conditions thereof.<sup>638</sup>

Finally, article 129, referring to the “[e]ffects of supervening uni-personal status,” expounds as follows:

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635. *Id.* art. 126.

636. *Id.*

637. *Id.* art. 127.

638. Spanish Law 2 of March 23, 1995, *supra* note 631, at art. 128.



If after six months after the acquisition by the company of its uni-personal status this circumstance has not been entered in the Commerce Register, the sole member shall be personally, jointly, and severally liable for debts incurred during the period of sole proprietorship. Once the uni-personal status is recorded, the sole member shall not be liable for ulterior debts.<sup>639</sup>

This trend, which led to the creation of *empresas individuales de responsabilidad limitada* (individual limited liability companies), was heavily spearheaded by the French,<sup>640</sup> which was followed by the Spanish,<sup>641</sup> and then rapidly expanded into the rest of Latin America, where ILLCs began to be statutorily created.<sup>642</sup> The rationale behind the creation of ILLCs is based on the following ideas. First, a sole person may devote a particular set of assets to a specific goal without the need of constituting a collective corporation; thus, there is no need of a contract to create an ILLC. Second, it allows for the shielding of family property from third parties such as creditors or tort plaintiffs. Finally, it provides access to the legal market to a broad section of the population at a lower cost, without the need to create a multi-person corporation.<sup>643</sup>

However, important differences exist between the *empresa uni-personal de responsabilidad limitada* (uni-personal company of limited liability, UPLLC) and the *empresa individual de responsabilidad limitada* (individual limited liability company, ILLC).<sup>644</sup> It is worth mentioning that not all civil law jurists agree on the wisdom and even the lawfulness of creating one-person-no-liability-attached corporations.<sup>645</sup>

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639. *Id.* art. 129.

640. *Id.* (“We have seen in comparative law the possibility of creating companies with one shareholder only, and the most telling model that of the French law of 1985.”), available at <http://www.juridicas.unam.mx/publica/librev/rev/revdpriv/cont/8/dtr/dtr2.pdf>.

641. See CARMEN BOLDÓ RODA, *DOCTRINA DEL LEVANTAMIENTO DEL VELO EN EL DERECHO ESPAÑOL* (Aranzadi, 3rd Ed., Navarra, 2000) for a comprehensive treatment of the veil piercing doctrine in Spain.

642. BORDA, *supra* note 129, at 27 (calling the *Empresa unipersonal de responsabilidad limitada* the “maximum expression of the fiction of the corporation”).

643. Aramouni, *supra* note 627, at 191.

644. See Ley 21, 621 *de la Empresa Individual de Responsabilidad Limitada* [Law on Individual Limited Liability Companies] of Peru, Sept. 14, 1976 (Article 3 provides that “[L]a responsabilidad de la Empresa está limitada a su patrimonio. El Titular de la Empresa no responde personalmente por las obligaciones de ésta.” [The liability of an [individual limited liability company] is limited to its assets. The owner of the company is not personally liable for the debts of the company.]).

645. See generally FEDERICO DE CASTRO, *LA SOCIEDAD ANÓNIMA Y LA DEFORMACIÓN DEL CONCEPTO DE PERSONA JURÍDICA* [THE STOCK CORPORATION AND THE DEFORMATION OF THE

In either case, the differences between the UPLLC and the ILLC relate to the incorporation, operational, and accounting burdens that affect the UPLLC, but are not restricted to only those aspects.<sup>646</sup> Many examples of current Latin American ILLCs can be found. El Salvador incorporated the ILLC into the Commerce Code.<sup>647</sup> Articles 600 to 622 regulate an ILLC, which state that the benefit of limited liability is lost when: (a) the name of the company does not include the suffix "ILLC";<sup>648</sup> (b) the constituting deed is not registered in the Register of Commerce;<sup>649</sup> and (c) there is fraud or violation of the law.<sup>650</sup> In Costa Rica, article 5 of Law 4327 of 1969 amended article 961 of the Commerce Code, providing that in case of a criminal conviction of the shareholders for fraudulent or negligent bankruptcy, any of the creditors may request the judge to declare the bankruptcy of all of the shareholders and impose unlimited liability on them.<sup>651</sup> In Paraguay, Law 1034 of 1983 of Merchants created the ILLC.<sup>652</sup> Article 15 provides that any physical person may constitute an ILLC and, for that purpose, his personal assets shall be separated from that of the ILLC.<sup>653</sup> Limited liability is also attributed to the individual member, and the law allows veil piercing in cases of fraud or violations of the law by the sole member.<sup>654</sup> The Uruguayan Chamber of Deputies reviewed in 1990 a bill creating the Uruguayan ILLC.<sup>655</sup> Interestingly, article 14 of this bill authorized the piercing of the bill in the following situations:

The entrepreneur shall have unlimited liability for all the obligations of the company, with all his personal patrimony, in case of fraud, or in the following cases:

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CONCEPT OF LEGAL PERSONALITY] (1949) (declaring the individual limited liability company an "outright legalization of fraud"), *cited in* DÍAZ, *supra* note 436, at 171.

646. Aramouni, *supra* note 627, at 195.

647. CÓDIGO DE COMERICO [CÓD. COM.] arts. 600-22 (July 31, 1970) (El Sal.), *available at* <http://content.glin.gov/summary/114077>.

648. *Id.* art. 601, para 4.

649. *Id.* art. 608.

650. *Id.* art. 615.

651. LEY 4327 repealing Arts. 563 to 651 of Title VIII, Book II, of the Code of Civil Procedures, LA GACETA [OFFICIAL GAZETTE], Feb. 25, 1969, (Costa Rica) *available at* <http://content.glin.gov/summary/145248>.

652. Ley 1034 del Comerciante [Law of Merchants], promulgated as an Original Document of the Congress, Dec. 16, 1983, (Para.) *available at* <http://content.glin.gov/summary/19565>.

653. *Id.* art. 15.

654. *Id.*

655. Aramouni, *supra* note 627, at 201-05.

- a) If the company does not maintain accounting books in the manner prescribed by the law;
- b) If no annual balances are maintained;
- c) If company assets are used for purposes other than corporate purposes;
- d) If personal withdrawals are made in an amount higher than that permitted by the law, or if company assets are used for the personal benefit of the shareholder/s;
- e) If the reserve fund provided in the law is not formed.<sup>656</sup>

The bill recognized a clear separation between the ILLC and the single shareholder, in the terms of article 16, as follows:

The bankruptcy of the individual limited liability company does not cause the bankruptcy of the entrepreneur, or vice versa. In case of bankruptcy of the entrepreneur, if the individual limited liability company does not have a third party as a manager, the bankruptcy judge must appoint a substitute in lieu of the bankrupt member for the duration of his disqualification.<sup>657</sup>

Undoubtedly, the main feature of ILLC's in Latin America is the absolute shield it provides to the single shareholder (or owner) of this novel type of business association.

### 3. *Passive and Active Participation in Corporate Affairs*

Control and domination of corporate business, policies, and finances are essential aspects for the determination of liability. U.S. courts have pierced the corporate veil when there is no separate mind between the entity and its shareholders; when the defendant used his control to commit fraud or wrong resulting in a violation of a legal provision against the plaintiff's rights; and when there is causation between the defendant's actions and the injury caused to the plaintiff.<sup>658</sup> These aspects have not been sufficiently analyzed by courts in Latin America, where the predomi-

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656. *Id.* at 204.

657. *Id.* at 205.

658. Gevurtz, *supra* note 444, at 862.

nant legal culture still disfavors liberal piercing of the corporate veil.

## VI. THE INTERACTIONS OF LAW, ECONOMICS, AND PHILOSOPHY IN A COMPARATIVE ANALYSIS OF VEIL PIERCING IN THE UNITED STATES AND LATIN AMERICA

### A. *Doctrinal Treatment of Veil Piercing in Latin America*

One of the first theoretical developments of the veil piercing doctrine in Latin America took place in 1964, when Chilean Professor Manuel Vargas proposed the novel concept of the removal of the corporate veil in Chilean law.<sup>659</sup> In Brazil, it was Professor Ruben Requião who first proposed the piercing the veil doctrine.<sup>660</sup> In general, scholarly analysis in Brazil has revolved around the idea that grounds for piercing are bad faith in the use of a corporation and evidence of fraud, abuse of law, or the violation of a law.<sup>661</sup>

There are few legislative developments in Latin America concerning the veil piercing doctrine.<sup>662</sup> The limited instances where it has been allowed have been under the guise of an ultimate measure applicable in extreme cases<sup>663</sup> and in default of direct,<sup>664</sup> legal remedies.<sup>665</sup>

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659. LÓPEZ, *supra* note 503, at 418.

660. *See generally* Fabio Ulhoa Coelho, *A Desconsideracao da Personalidade Juridica* [Disregarding the Legal Personality] (São Paulo, 1989), *cited in* LÓPEZ, *supra* note 503, at 121.

661. LÓPEZ, *supra* note 503, at 120.

662. *See generally* Leonelli et al., *supra* note 488, at 23 (“[E]sta doctrina en Chile no tiene consagración legal.” [“This doctrine has no statutory regulation in Chile.”]).

663. PERRETTI, *supra* note 199, at 50 (stating that the piercing the veil theory must be “exceptional, when there are no other legal mechanisms through which avoid the protection of the abuse”).

664. Carlos Quiroga, *El Uso Abusivo de la Responsabilidad Limitada. Protección de los Acreedores de una Sociedad Anónima Frente al Uso Abusivo de la Responsabilidad Limitada de los Socios, sin Afectar la Subjetividad Jurídica de la Sociedad* [The Abusive Use of Limited Liability. Protection of Creditors of a Stock Corporation In Face of the Abusive Use of the Shareholders’ Limited Liability, without Affecting the Legal Subjectivity of the Corporation] (2004) (excerpts from J.D. dissertation, Peru’s Trujillo National University), (*available at*, [http://www.teleley.com/articulos/art\\_leva\\_velo\\_soc.pdf](http://www.teleley.com/articulos/art_leva_velo_soc.pdf)) (commenting that in Peru, the “disregard of the legal personality causes the loss of the benefit of limited liability, but not of the . . . existence of the legal entity”).

665. LÓPEZ, *supra* note 99, at 80. *See also* HURTADO, *supra* note 386, at 70.

*B. Statutory Reforms of Veil Piercing*

In 1940, the Mexican legislature attempted to repeal the “Law establishing the Requirements for the Public Sale of Shares of Limited Liability Companies.”<sup>666</sup> When issuing this bill, the Supreme Court of Mexico issued a brief commentary on the veil piercing theory that is worth transcribing. It states that:

In practice, the privileges enjoyed by the legal entities were not only used in lawful ways, but sometimes were unlawfully used to achieve abusive conducts constituting frauds and transactions generating a detriment to rights of creditors, third persons, the public assets and to the society. This negative aspect justifies the necessity of the implementation of measures and correct instruments in order to know the actual beginning and the actual aim of the unlawful acts. This is done to avoid the unlawful using of the privileges of these companies. So, using these instruments, besides the external shape adopted by the company, the law tries to go inside the volitional acts to make clear which are the actual interests and economic effects pursued by the wrongdoer. This should be done to put a limit to the frauds and abuses committed by the legal entity in the basis of the articles 2180, 2181 and 2182 of the Federal Civil Code. To that effect it could be done an absolute separation between the legal entity and each one of the shareholders and their assets, as well as analyze their aims, strategies, incentives, results and activity, to find an actual identity between them with a certain common aim. Then it has to be reviewed whether it is possible to establish the existence of a conduct pattern behind the deceptiveness of a diversity of legal entities. This is what holds the “veil piercing theory” . . . .<sup>667</sup>

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666. See Walter Frisch, *La Abrogación de la Ley que Establece los Requisitos para la Venta al Público de Acciones de Sociedades Anónimas* [The Repeal of the Law Establishing Requirements for the Sale to the Public of Shares of Stock Corporations], in *Biblioteca Jurídica Virtual del Instituto de Investigaciones Jurídicas* [Virtual Legal Library of the Legal Research Institute] at the National U. of Mexico, available at <http://www.juridicas.unam.mx/publica/librev/rev/revdpriv/cont/1/dtr/dtr5.pdf>.

667. *Tribunales Colegiados de Circuito N° 21150 de Sentencias Ejecutorias*, 1 de Octubre de 2008, *Suprema corte de Justicia de la Nación* [SCJN] [Supreme Court], *Sentencia Ejecutoria de Tribunales Colegiados de Circuito, Amparo en Revisión 479/2006*, Yoli de Acapulco, S.A. de C.V. 18 de junio de 2008, available at <http://tribunales-colegiados.vlex.com.mx/vid/sentencia-ejecutoria-amparo-revision-52061811>.

However, the “veil piercing doctrine is mostly unknown” in present-day Mexico.<sup>668</sup> The only case of statutory regulation on the doctrine occurs under the federal tax code.<sup>669</sup> In this case, any unpaid taxes owed by the company may be collected from the shareholders individually, but they are “responsible in proportion to their percentage participation in the capital stock.”<sup>670</sup>

In Uruguay, Law 16,060 of 1989, article 189, provides that: “[t]he legal personality of the company may be disregarded when the legal personality is used in fraud of the law, to violate the public order, or with fraud and in prejudice of the rights of its members, shareholders, or third parties.”<sup>671</sup> Article 190, paragraph 3 states that, “[i]n no case shall the disregard of the legal personality affect third parties in good faith.”<sup>672</sup>

Colombia’s Law 142 of 1994, article 37, provides the following on the “[d]isregard of the legal personality:

For purposes of analyzing the legality of acts and contracts of public utilities, regulatory commissions, the superintendence and other people affected by the incompatibilities or disabilities created by this law, account must be taken of who they are, in essence, of their real beneficiaries and not only of those who formally dictate or celebrate such acts and contracts. Therefore, administrative and judicial authorities will privilege the legal result that is obtained when considering the real beneficiary, without prejudice to the right of the persons to prove that they act in pursuit of their own interests and not to defraud the law.”<sup>673</sup>

Colombia’s Law 190 of 1995 contained sweeping legal reforms aimed at improving ethics within government ranks and eliminat-

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668. Remarks of Carlos Loperena, panelist, in *Product Liability Claims on Both Sides of the Border*. (Moderator Michael W. Gordon), 8 U.S.-MEX. L.J. 123, 129 (2000).

669. *Id.*

670. *Id.*

671. LEY 16,060 DE SOCIEDADES COMERCIALES [Law on Commercial Companies] (Uru.), Nov. 1, 1989 *available at* <http://www.parlamento.gub.uy/leyes/AccesoTextoLey.asp?Ley=16060&Anchor=>

672. *Id.* art. 190, para. 3.

673. Cited in Germán Gama Chirolla & Alejandro García de Brigard, *La Constitución de 1991 Frente al Código de Comercio: Consecuencias, Implicaciones y Efectos de la Entrada en Vigencia de la Constitución Política de 1991 desde la Perspectiva del Derecho Mercantil*, 84 & n.127 (Javeriana University’s Law School, Colombia, 2005), *available at* <http://www.javeriana.edu.co/biblos/tesis/derecho/dere7/DEFINITIVA/TESIS%2031.pdf>.

ing corruption.<sup>674</sup> Article 44 provides that “judicial authorities may lift the corporate veil from legal entities when necessary to determine the true beneficiary of the activities performed by these entities.”<sup>675</sup> This is an exceptional situation where the direct translation of “piercing the veil” (*levantando el velo*) has been used to build this doctrine. According to its decision of August 19, 1999, the Colombian Council of State held that:

If the formal structure of the legal entity is used abusively, the judge may disregard it to make the anti-juridical result sought fail [and thus] to break . . . the radical separation between the legal entity and its members. This abuse takes place when the legal entity is used to make a mockery of the law, violate obligations, for illicit purposes, and in general to defraud.<sup>676</sup>

The 1999 Constitution of Venezuela contemplates in its fifth transitory provision, No. 10, “the extension of the principle of solidarity [joint and several liability] on directors, or consultants [so that they] respond with their [personal] assets in case of validating tax crimes.”<sup>677</sup> The expression “solidarity” in the Venezuelan Constitution refers to the joint and several liability of the aforementioned persons in case of tax crimes. Other than these scarce legal developments, the veil piercing doctrine has yet to find a solid place in the statutory legal frameworks in Latin America.

### C. *Proposals for a Future Regulation of Veil Piercing in Latin America*

Veil piercing is a legal doctrine created in the United States. The limited statistical studies conducted in that country show that certain courts have been particularly generous in granting veil piercing to plaintiffs.<sup>678</sup> In fact, an examination of statistics by

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674. Ley 190 published in Diario Oficial [Official Gazette] on June 6, 1995, *por la cual se dictan normas tendientes a preservar la moralidad en la Administración Pública y se fijan disposiciones con el fin de erradicar la corrupción administrativa* [Law issuing provisions aimed at preserving morality in the Public Administration, and establishing provisions to eradicate administrative corruption], available at <http://www.alcaldiabogota.gov.co/sisjur/normas/Norma1.jsp?i=321>.

675. *Id.* art. 44.

676. *Pastrana Sierra v. Municipio de San Juan de Betulia (Sucre)*, Decision of the Colombian Council of State’s Administrative Contentious Chamber, 3rd Sec., Santa Fe of Bogota, Aug. 19, 1999, *cited in* SAAVEDRA, *supra* note 375, at 179 (alteration in original).

677. CONST. OF VENEZUELA (1999).

678. *See, e.g.,* Oh, *supra* note 8, at 90.

Professor Peter Oh for the period 1958-2006 found that the most common grounds for corporate veil cases were “commingling, control or domination, injustice or unfairness, fraud or misrepresentation, and inadequate capitalization.”<sup>679</sup> He also found that New York’s state courts “pierce 42.76% of the time.”<sup>680</sup> Another recent study conducted by Professor Matheson included over 4000 veil piercing cases and determined that “substantive piercing in the parent-subsidary context occurs approximately half as often as piercing does generally.”<sup>681</sup>

Other comparative examples concerning civil law jurisdictions include Spain, where a survey covering cases from 1984-1998 found that the Supreme Court of Spain pierced the veil in fifty-two of a total of seventy-four cases presented or 70.2 percent of the total.<sup>682</sup> No known studies or surveys exist on the topic concerning Latin American countries. Therefore, it is not possible to draw numerical comparisons between the U.S. experience and that of civil law jurisdictions in Latin America.

That being the case, proposals to reform the veil piercing theory in Latin America rest mostly on doctrinal elaborations. However, it is a daunting task to try to mold any reform proposals modeled after the contours of the theory as developed in U.S. law, because in this system no straightforward, uniform, predictable rule and no single determinative factor for veil piercing exists.<sup>683</sup>

Several ideas to reform veil piercing have been advanced in the United States. For example, Professor Hamilton advocates the reform of the theory based on four pillars: (i) the “notions of simple justice and fairness;” (ii) the “desire to retain reasonable procedures and avoid substantive tangles;” (iii) the “desire to protect potential creditors and minority shareholders;” and (iv) the respect of shareholders’ “election of corporateness . . . .”<sup>684</sup>

Another U.S. legal scholar has proposed allowing limited liability as long as the shareholders have managed “the business in a financially responsible manner.”<sup>685</sup> This statement does not elaborate on an overall reformulation of the theory, but it is reflective of strong trends of thinking among the U.S. legal community con-

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679. *Id.*

680. *Id.* at 120 (citation omitted).

681. Matheson, *supra* note 15, at 1114.

682. HURTADO, *supra* note 386, at 177-79.

683. Krendl & Krendl, *supra* note 1, at 16.

684. Hamilton, *supra* note 121, at 1008-09.

685. Millon, *supra* note 169, at 1359.



cerning the very concept of corporations, limited liability, shareholders, and business in general.

With respect to Spanish law, proposals have been offered to deal with the situations that currently trigger judicial action based on the veil piercing doctrine.<sup>686</sup> One author has proposed that Spain make amendments as follows: that the burden of proof (*onus probandi*) be altered, thus charging the defendant corporation or corporations in a situation of alleged abusive domination (related companies or *grupo económico*) with the duty to prove that no fraud has been committed through the use of the corporate shield.<sup>687</sup> This proposal would probably amount to a reception in toto of the common law alter ego doctrine.

In Latin America, authors have also been actively conceiving ways to improve the legal treatment of veil piercing.<sup>688</sup> It has been suggested in Peru that legislation on veil piercing is necessary and that the appropriate standard should be “when the effects of maintaining the legal personality [corporate veil] would be intolerable for the Law.”<sup>689</sup> Yet another author has proposed a model amendment to the Peruvian Civil Code along the lines of the following:

1. The legal entity is a legal person different from its members; 2. None of its members or not even all of them possess a right to the assets of the legal entity, and are not obliged to pay its debts, unless there is a legal exception; and 3. The judge may hold the members liable when in the exercise of a right they have unduly used the formal structure of the legal entity, or have used it with fraud to the law.<sup>690</sup>

In Venezuela, there are proposals to extend the liability of cooperative members in the case of fraud against third parties, the hiding of the actual economic and financial situation of the cooperative, noncompliance with legal obligations, or tax evasion.<sup>691</sup> Another author has proposed an amendment to the Guatemalan Civil Code to incorporate the veil piercing doctrine in that country, which would include the following elements:

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686. See DÍAZ, *supra* note 436, at 187–95.

687. ORTIZ, *supra* note 456, at 38.

688. See, e.g., GUERRA, *supra* note 408, at 447.

689. *Id.*

690. Saavedra, *supra* note 435, at 13.

691. Bello, *supra* note 497, at 132.

-All government and quasi-government entities would be excluded from the amendment.

-The key “objective” factor to disregard the veil would be “the effective control by one or more of the members of the legal entity or by third parties who impose on that entity a decisive influence.” (Article 10 of the proposal).

-The control must be absolute and such that “the will of the legal entity is really the will of such members or third parties.” (Article 12 of the proposal).

-Presumptions of absolute control should include: the taking of strategic decisions by the members or third parties; the existence of an economic conglomerate; and the identity of the majority shareholders, among others. (Article 13 of the proposal).

-The “subjective” factor must be the abuse of the corporate entity to defraud third parties, the law in general, or the violation of mandatory norms. (Article 14 of the proposal); and,

-Presumptions of the existence of a fraud of third parties or the law should also be included. (Articles 18-20 of the proposal).<sup>692</sup>

Still another Latin American author has stated that new regulations on veil piercing in civil law jurisdictions should be substantive as well as procedural, thus ensuring its application across all branches of law.<sup>693</sup> Further, it is argued that regulations should be built upon the notion of fraud and that judges should be given broad latitude to apply them.<sup>694</sup> Whatever the case, the veil piercing theory should certainly be applied with prudence in Latin America, in order to avoid unnecessarily upsetting the essential legal bases of those systems and preserving the ability to do business according to a predictable legal framework.

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692. This is called “*Ley de Desestimación de la Personalidad Jurídica Societaria*” [Law on the Disregard of the Corporate Personality], cited in VILLEDA, *supra* note 373, at 103-11.

693. PERRETTI, *supra* note 385, at 127 (“[T]he doctrine must be applied prudently since its indiscriminate application, lightly and without restraint, may lead to dispense with the formal structure of corporations, or to disregard it in situations where it would be inappropriate, with grave damage to the law, and the certainty and security of juridical relationships.”).

694. *Id.*

D. *The “Entidad de Control” or “Control Entity” as a Framework for Veil Piercing in the Parent-Subsidiary Context in Latin America*

In the United States, there are pressures for a “more expansive, if not unlimited, parent liability in the parent-subsubsidiary context [that would] impose a form of ‘enterprise liability.’”<sup>695</sup> To that effect, the “single business entity”<sup>696</sup> and the “control entity”<sup>697</sup> theories have been devised. The control entity doctrine has found fertile ground in some quarters in Latin America to find a solution to the problematic situation generated by the veil-piercing phenomenon. This approach is rooted in a juridical notion that would make liability reside at the center where decisions are made in the corporate context. In this way, it is argued that a direct connection between control and responsibility would be fitting and enforceable. It is further stated that this focus would be in complete harmony with the traditional civil law principle that those involved in a tortious action or omission are the ones that must bear the consequences thereof.<sup>698</sup> But one must not lose perspective that the discussion about the reformation of veil piercing in both the United States and Latin America is really a discussion about the very notion of corporations, limited liability, shareholders, and investment as the basis of the current market-based capitalistic order.

E. *The Philosophical and Economic Interactions for Veil Piercing Reform in the United States and Latin America*

This brief survey of the current status of the veil piercing theory in the United States and in Latin American civil law countries undoubtedly presents more questions than answers. The veil piercing theory has gained solid ground in the United States, but the determination of its specific contours and its future remains highly controversial. Meanwhile, the theory has made some interesting inroads in selected Latin American jurisdictions, which have been “borrowing” law from the United States and, to a certain extent, from Spanish law. But taken as a whole, the devel-

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695. Matheson, *supra* note 15, at 1103. See also Carney, *supra* note 48, at 667 (reviewing the relationship between the issue of limited liability in the context of subsidiaries and enterprise liability).

696. Matheson, *supra* note 15, at 1103 (citation omitted).

697. Rosillo, *supra* note 380, at 244.

698. *Id.*

opment of the veil piercing doctrine is still at its nascent stages in the Latin American region.

The doctrinal debate on the merits—and dangers—of the veil piercing theory in Latin America does not occur in a vacuum. Quite the opposite is true. In this day and age, where multinational corporations operate under different legal systems in a global context, the reality is that the whole concept of corporate “ownership” has experienced enormous changes. Institutional owners (financial institutions, insurance companies, mutual funds, equity ventures, and other anonymous groups) have emerged ever more powerful in their capacity to act as “owners” of what are oftentimes gargantuan multinational corporations. These new controllers, in most cases, are very far removed from managerial responsibilities, which are regularly entrusted to professional managers.<sup>699</sup> Often, these “owners” are located in different jurisdictions and sometimes in no jurisdiction in particular. This is the reality of today’s multinational corporations.

In this setting, the discussion about veil piercing revolves around the idea of the true nature of the corporation, which remains a highly debatable topic. There are two proposed theories to explain the essence of corporations. One would view the corporation as a “‘society of shares’ [where the] shareholder [is] the central player.”<sup>700</sup> The other position sees the corporation as a “‘society of interests,’ [which] favors a balanced mediation among various stakeholders . . . such as employees, customers, suppliers, the broader community, and shareholders.”<sup>701</sup> In this scheme of things, the first—the shareholder-centered model<sup>702</sup>—which was developed after World War II, is criticized for being unable to muster synergies from all stakeholders.<sup>703</sup> The shareholder model thus suffers from an endemic unsustainability.<sup>704</sup> It can be asserted that denying the full economic reward to individual entrepreneurship—by means of redistributing capital and profits through veil piercing—would be tantamount to reducing the business morale and creativity of entrepreneurs willing to face risks. To coun-

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699. Reader, *supra* note 156, at 201.

700. Michael Naughton, *The Corporation as a Community of Work: Understanding the Firm within the Catholic Social Tradition*, 4 AVE MARIA L. REV. 33, 34 (2006).

701. *Id.* at 35.

702. Hansmann & Kraakman, *supra* note 112, at 441 (calling the model the “standard shareholder-oriented model of the corporate form”).

703. *Id.* at 468.

704. Naughton, *supra* note 700, at 60.

teract this criticism, and in order to reduce the negative impacts of the shareholder model, more stringent protections for minority shareholders are proposed.<sup>705</sup>

In many senses, it is at this crux where the notion of an ethical dimension of veil piercing would serve as a lighthouse for those navigating in the rough waters of the modern corporate world.<sup>706</sup> The view of the corporation as a community of means has a degree of support among legal scholars in the United States. In fact, Professor Bainbridge states that “the firm [is] not . . . an entity, but simply . . . a legal fiction representing the complex set of contractual relationships between many constituencies providing, or serving as, inputs for the corporation’s productive processes.”<sup>707</sup> While judicial discretion remains an important element to “monitor opportunism on the part of the corporate shareholder,”<sup>708</sup> it “cannot effectively function as [the sole] source of judicial restraint in an area of law such as veil piercing.”<sup>709</sup>

Perhaps at the core of the discussion regarding the nature of the modern corporation lies another, deeper issue, which is what one author calls “the crisis of the corporate form.”<sup>710</sup> Certainly, ours is not the first epoch to witness a major crisis of what lies behind the modern corporate form—that is, limited liability.<sup>711</sup> Ultimately, the discussion around the veil cannot be devoid of the ethical dimensions surrounding the corporate form in the capitalistic world that a purely pragmatic, positivist perspective is incapable of furnishing. In other words, the question centers on how a reformulation of the concept of limited liability would affect the free flow of goods and services, new investment ventures, and the expansion of economic development in an increasingly globalized world, particularly taking into consideration the influence of U.S. law on veil piercing in Latin America.

In the United States, tension has existed for decades between those who call for the total abolishment of limited liability and its replacement with unlimited liability and those calling these proposals anathema. There are even eclectic approaches, which have

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705. Hansmann & Kraakman, *supra* note 112, at 468.

706. Naughton, *supra* note 700, at 64.

707. Bainbridge, *supra* note 16, at 485.

708. Miller, *supra* note 164, at 138 (citation omitted).

709. *Id.* at 138.

710. See Perrot, *supra* note 47, at 108 (stating that “the dominant ideology on limited liability of the century . . . ended in 1960”).

711. See Barnes, *supra* note 76, at 14 (pointing to another author who in 1936 wrote that by that year, “limited liability suddenly became extremely unpopular”).

suggested the allocation of liability among related corporations.<sup>712</sup> Accordingly, and from a purely pragmatic viewpoint, veil piercing is nothing but a partial and random abolishment of the corporate veil on a case-by-case basis.

Nevertheless, much confusion still exists among those who criticize limited liability. In fact, some assume that the alternative to limited liability is unlimited joint and several liability, while others assume that it is pro rata liability.<sup>713</sup> While the first prevailed in England until 1855, the latter did so in California until 1931.<sup>714</sup> But, as Professor Booth points out, “even with unlimited liability, creditors would only go after the biggest shareholders.”<sup>715</sup>

Practical and thorny issues emerge if liability were to be imposed on shareholders indiscriminately. Not all of them are equally active in the management and administration of the corporation. More often than not, in publicly traded companies, the great majority of shareholders are completely inactive.<sup>716</sup> In the case of the United States, if unlimited liability were imposed on foreign shareholders, additional jurisdictional problems would ensue,<sup>717</sup> including impacts on international relations in the form of potential retaliatory measures against American investors overseas.<sup>718</sup> The issue of the recognition of U.S. judgments and awards by foreign countries would also posit incremental challenges to the United States.

Another weighty argument has been raised against the proposal for an indiscriminate application of veil piercing, which consists of an alteration of the presumption of limited liability and the substitution of its opposite—that of the nonexistence of the corporate

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712. Antunes, *supra* note 9, at 228 (“There should be a flexible and hybrid system of liability imputation.”).

713. Leebron, *supra* note 528, at 1609 (stating that “if a pro rata liability rule is applied, differing shareholder wealth is not likely to have a significant effect on the value such shareholders attach to their shares” and that “[w]hile in theory the value of shares under the pro rata rule could depend on the individual wealth of the shareholder, this is highly unlikely in practice”).

714. Blumberg, *supra* note 120, at 612, 627–28 (citation omitted).

715. Booth, *supra* note 163, at 152 (citation omitted).

716. Alexander, *supra* note 168, at 401 (citation omitted).

717. *Id.* at 429 (citing, *inter alia*, *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102, 114 (1987) (“[T]he Supreme Court has made it considerably more difficult to acquire jurisdiction over foreign defendants than over U.S. citizens.”); *see also Asahi Metal Indus. Co.*, 480 U.S. at 114 (“[T]he unique burdens placed upon one who must defend oneself in a foreign legal system should have significant weight in assessing the reasonableness of stretching the long arm of personal jurisdiction over national borders.”)).

718. Alexander, *supra* note 168, at 429 (citing *Hansmann & Kraakman*, *supra* note 112, at 1922).

shield. The so-called “democratic argument,” previously discussed, is presented as the counter-argument to this revolutionary scheme. This reasoning states that a debate on veil piercing must be aimed at striking a sound balance between the core values of justice in private legal relations and the overall sound functioning of the economy, both nationally and internationally. The question is thus presented in terms of whether “the costs of doing business are substantially different under a rule other than limited liability,”<sup>719</sup>—that is, unlimited liability. The answer is obviously in the affirmative. The reason being is that without limited liability protection, there would be a drastic reduction in the creation of “high-risk subsidiaries,”<sup>720</sup> which would, in turn, hurt the overall economy. Veil piercing would act as a risk-transfer mechanism in the case of investors and creditors, most likely damaging small investors who would become exposed to personal liability for acts, transactions, and risks that they were hardly aware of at the moment of purchasing their shares and for corporate activities over which they have no control. Eventually, there would be an overall movement toward more security in capital markets for the small investor, who would flee to investments with a much lower return. The economy as a whole would greatly suffer from this tendency.

Several rebuttals have been presented to the “democratic argument.” First, some have stated that increasing the demand for shareholders and directors to back up corporate undertakings—particularly those most exposed to risk—through the provision of personal guarantees or security interests in assets,<sup>721</sup> would reduce the alleged risk created by unlimited liability.<sup>722</sup> Consequently, the cost of obtaining credit without limited liability protection would not produce an advantage to the debtor corporation.<sup>723</sup>

Second, the lack of limited liability protection would not extend to innocent third parties such as tort victims and involuntary

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719. Meiners et al., *supra* note 155, at 359.

720. Leebron, *supra* note 528, at 1615–16 (referring to the oil exploration and pharmaceutical industries).

721. See Thompson, *supra* note 626, at 13 (citations omitted).

722. See Luis Pérez, *Remarks in John F. Molloy, Miami Conference Summary of Presentations*, 20 ARIZ. J. INT'L & COMP. L. 47, 59 (2003) (“In Argentina plaintiffs apply pressure in going after specific individuals. Piercing the corporate veil and getting through to the individual is a way of grabbing someone’s attention. In Latin America, there may be a little more use of naming officers and directors in suits than in the United States, where the corporate shield is used to keep officers and directors out of litigation.”).

723. Meiners et al., *supra* note 155, at 361.

creditors,<sup>724</sup> including “contract creditors of public corporations; tort creditors of public corporations; contract creditors of close corporations; and tort creditors of close corporations.”<sup>725</sup> These involuntary creditors, some argue, are protected not by corporate law, but by other branches of law. Labor and social security law, health and safety law, and antidiscrimination law protect workers. Consumers, in turn, are protected by “product safety regulation, warranty law, tort law governing product liability, antitrust law, and [the] mandatory disclosure of product contents and characteristics. For the public at large, it includes environmental law and the law of nuisance and mass torts.”<sup>726</sup> Third, a liberal removal of the veil would ensure that no one would be allowed to defraud third parties or to violate the law by abusing the corporate shield.

It is at this point that the discussion on the soundness and extent of the veil piercing doctrine, or movement, seems to hit a dead end. In fact, if liability were to be imposed within an economic group—as strong forces seem to be doing—based on the mere fact that they are “related” or “integrated,” then how could limited liability exist whatsoever if corporations were unable to create other corporations without being related to them? In other words, an all-out-attack on limited liability in the context of related companies—also called “sibling corporations”—<sup>727</sup> is simply a denial of their separateness and their ability to do business without fearing total liability exposure. Despite all the fireworks surrounding veil piercing in the United States, “traditional piercing of the corporate veil in its many forms and variations remains firmly in place in the United States.”<sup>728</sup>

In Latin America, procedural tools aimed at summarily dismissing frivolous requests for veil piercing should be proposed, perhaps along with a substantive reform on veil piercing, to prevent the previously discussed unwelcome effects. The reality in Latin America shows that most entrepreneurial ventures are started by small and medium-sized companies, and therefore, allowing a

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724. See Easterbrook & Fischel, *supra* note 172, at 107–09 (reviewing the situation of involuntary creditors vis-à-vis veil piercing).

725. Bainbridge, *supra* note 16, at 488.

726. Hansmann & Kraakman, *supra* note 112, at 444.

727. Leebron, *supra* note 528, at 1628 (citation omitted).

728. VANDEKERCKHOVE, *supra* note 7, at 94.



broad accessibility to veil piercing would seriously threaten the viability of such vital economic actors.<sup>729</sup>

Limited liability, not immunity from liability, should be the rule in Latin America. A strong argument in support of this approach is that in the context of globalization—that equal treatment should be rendered to multi-national companies which are subject to the veil piercing doctrine in their home jurisdictions. In lieu of statutory regulations, what is possible, and even likely to occur in Latin American countries, is the same thing that happened in the Argentinean *Compañía Swift* decision of 1973, where the judiciary advanced its own views on how to pierce the veil, especially when dealing with multinational corporations.<sup>730</sup> Also in Argentina, there is precedent that shows that after judicially sanctioned activity regarding veil piercing, legislative action has followed suit. In fact, it is worth repeating that only two months after the *Compañía Swift* decision, the new Foreign Investment Law of Argentina, article 31, established that “[l]iability resulting from obligations undertaken by a local company receiving the foreign investment shall be jointly and severally assumed by the foreign investor.”<sup>731</sup> In other words, the precedent exists in Latin America for the establishment of a statutory unlimited liability regime exclusively for foreign investors.

## VII. CONCLUSION

There are some specific topics that linger in a proposed reform of veil piercing in Latin America. They will be reviewed in turn.

First, the reality of the insufficiency of traditional Latin American civil law tort theories to tackle the perceived vices at which the veil piercing doctrine aims must be addressed. Most of the traditional legal theories produce the effect of nullifying the whole transaction affected with fraud or other vices. In the United States, instead, the approach to veil piercing is that the respective transaction survives the vice, but a person or entity other than that executing the transaction is ultimately held liable for its consequences.

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729. Díaz, *supra* note 95, at 389 (discussing the strategies followed by large corporations against small ones in Puerto Rico consisting of their “financial choking” by unnecessary protracted litigation, usually coupled with complaints against the shareholders personally using the corporate veil doctrine as a tool).

730. Gordon, *supra* note 593, at 45.

731. *Id.* at 46.

Second, most legal developments in the veil-piercing realm in Latin America have centered on two areas: fraud and the *de facto* corporation doctrine. In these situations, third parties gain the right to reach the shareholders to make them personally liable for corporate debts, thus bringing this theory closer to the U.S. veil piercing doctrine. But, overall, there has been little interest in Latin American legal circles for importing wholesale what is perceived to be a foreign institution (veil piercing). The wall erected against this approach pivots around the assumption that other traditional, existing civil law theories—such as the fraud of law and abuse of right—achieve the same results as the veil piercing doctrine.

Third, standing is another issue limiting the reach of traditional civil law theories. The general rule is that only parties with a direct interest in the transaction or occurrence—that interest being usually, if not always, an economic concern—are entitled to file an action to pierce the veil. Under the common law veil piercing doctrine, rules of standing have a wider reach.<sup>732</sup> Careful attention should thus be given to standing rules in an eventual reform of veil piercing in Latin America.

Fourth, more restrictive structural concepts related to the role of the judiciary and the rule of *stare decisis* in Latin American civil law jurisdictions impede a robust flourishing of the veil piercing doctrine in the absence of legislative activity. Given the different role—in fact, the diminished role—accorded to case law in civil law jurisdictions, it is very complicated to systematize judicial developments for any novel legal institution in Latin America.

The main idea for Latin America would be to ultimately transform the veil piercing theory into an independent, autonomous, legal remedy aimed not at wholly destroying the corporate veil, but at raising it exclusively in specific cases that merit it. It is important not to overlook the fact that a veil piercing doctrine thus expressed could be used as a mechanism for the redistribution of wealth in Latin American societies, especially when the veil piercing targets foreign companies. But, on the other hand, foreign investors should reasonably expect that in this new legal context, at least uniform criteria would be selected for the application

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732. Díaz, *supra* note 95, at 446 (discussing the comparison of standing rules between the veil piercing action and the *actio pauliana* or revoking writ, which seeks to void transactions made in detriment of third parties). See also *id.* at 844–46 (comparing the effects of veil piercing in the United States and the *actio pauliana*, a Roman law writ still in use in France and Argentina).

of a genuinely refurbished Latin American approach to veil piercing.

Finally, what should lie behind any reforms is a new philosophical perspective replacing the traditional views on the notion of the corporation with a notion centered more on ethical considerations that include the idea of a community of interests in its inner conception and performance. Until this happens, the drama of veil piercing, and its conundrum, shall stay with us for a very long time. Obviously, all of this will continue to happen until powerful actors with competent counsel find avenues to “ensure that their business is conducted in ways that limit veil piercing risk,”<sup>733</sup> even after statutory veil piercing reforms are passed. This is the reality of life, and this is the reality of law.

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733. Bainbridge, *supra* note 16, at 535.