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Shareholders' liability in the UK, Germany and the Netherlands: Is strict liability of shareholders reducing the effect of the corporate veil?

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I. Introduction

In these times of economic downturn, creditors of financially troubled companies try to find creative ways to collect their receivables. This includes attempts to hold shareholders of their debtors liable. This article will deal with the liability of the shareholders of a company for claims against it under UK, German and Dutch law. Although each of these jurisdictions recognizes the separate legal personality of a company, exceptions to this main rule exist. This article will explore in what situations and on what legal grounds the corporate veil may be pierced, and the legal effect of such piercing. In cases where the corporate veil is abused, all three jurisdictions allow a piercing of that veil. However, in situations in which creditors of a financially troubled or bankrupt subsidiary remain unpaid, it is less clear cut whether and to what extent piercing of the corporate veil will be allowed and what actions of the parent company may be required to avoid such piercing. In this respect the question arises whether shareholders' liability has developed to a strict liability; in other words can shareholders under certain circumstances be held liable without any fault on their side?

II. Main principle of the separate legal entity

As stated above, in the UK, Germany and the Netherlands a company is recognized as being a separate legal entity for whose debts its shareholders are in principle not liable.

In Germany and the Netherlands this has been laid down in legislation. Pursuant to § 13(2) of the GmbH Gesetz («GmbHG») and § 1(2) of the Ak-

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tienGesetz («AktG»), the creditors of a GmbH or AG only have recourse for their claims on such companies on the assets thereof.

The Dutch Civil Code («DCC») provides explicitly that shareholders of B. V.s and N. V.s are not personally liable for acts carried out in the name of the company and they are not obliged to contribute to the losses of the company over the amount that must be paid up on their shares (cf. Article 2:64/175(1) DCC).

In the UK, this principle cannot be found in legislation. However, its existence has been confirmed in case law. In the landmark case Salomon v A. Salomon & Co Ltd[1], the principle of limited liability was held to shield shareholders from claims made against the company in which they hold shares. The principle in Salomon is as put by LORD MACNAGTEN: *«the company is at a law a different person altogether from the subscribers to the memorandum»*. This principle was confirmed in Adams v Cape Industries[2], where the court commented: *«Our law, for better or worse, recognizes the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the right and liabilities which would normally attach to separate legal entities.»* The same court went on to state that *«[W]e do not accept as a matter of law that the Court is entitled to lift the corporate veil as against a defendant company which is a member of a corporate group merely because the corporate structure has been used so as to ensure that he legal liability (if any) in respect of particular future activities of the group [. . .] will fall on another member of the group rather than the defendant company.»* In Section 1(d) of the UK Companies Act 1985 it is stated that the liability of its members is limited according to the company's memorandum of association. Such limitation can be to the amount owing on the shares or to an amount agreed to be contributed by the members upon the winding up of the company. Pursuant to Section 2(3) of the UK Companies Act 1985, the memorandum of a company limited by shares must state that the company's liability is limited for the shareholders to take advantage of limited liability.

What does the concept of separate legal personality encompass? In all three jurisdictions it is recognized that a company can own property and assume rights and obligations. As a result of the fact that a subsidiary has a separate legal personality, its parent company has no interest in the subsidiary's assets and it cannot enforce the subsidiary's rights. Conversely the subsidiary cannot enforce the rights of its parent company or recover damages for wrongdoing to its parent company. Finally, a parent company cannot, in prin-

1 Salomon v A. Salomon & Co Ltd [1897] AC 22.
2 Adams v Cape Industries [1990] Ch 433.

ciple, be held liable for claims of third parties on its subsidiary. This article deals with the exceptions to the latter principle.

III. Shareholders' liability: the legal basis

1. Grounds for shareholders' liability

In the UK, Germany and the Netherlands, a company's shareholders may be held liable for its debts under certain circumstances. A distinction can be drawn between voluntary and involuntary liability.

a) Voluntary shareholders' liability

A parent company can voluntarily assume liability for debts of its subsidiary by entering into an agreement with the subsidiary's creditor(s) or by issuing, for example, a letter of comfort or *Patronatserklärung*. Furthermore, based on certain statutory provisions, a parent company can assume liability for certain legal acts of its subsidiary. Under Dutch law, for example, a parent company can voluntarily accept liability for legal acts of one or more group companies by filing a so called 403 statement, in which (for the purposes of the consolidation of the annual accounts of these companies) joint and several liability is accepted for any obligations arising from the legal acts of such group company or companies (cf. Article 2:403 of the DCC).

In Germany, the main principles of liability of shareholders of an AG have been laid down in legislation. Key term in this discussion is *«Verbundene Unternehmen»*. Pursuant to § 15 AktG, *«Verbundene Unternehmen»* are legally independent companies, one of which holds the majority of the other company and constitute e. g. a dependant (*«abhängig»*) and leading *(«herrschende»)* company or are parties to an *Unternehmensvertrag*. It follows from this provision, that German law makes a distinction between the situation in which the shareholder and the company have entered into an *Unternehmensvertrag* – which is referred to as a *Vertragskonzern* – and the situation in which such an agreement has not been entered into – which is referred to as a *faktischen Konzern*. One of the *Unternehmensverträge* is the so called *Beherrschungsvertrag*. § 291 AktG defines a *Beherrschungsvertrag* as an agreement pursuant to which an Aktiengesellschaft subordinates the management of its company to another company. In order to qualify for an *Organshaft* (fiscal unity), it is mandatory to have a *Beherrschungsvertrag* in place, which needs to be registered at the trade register[3]. When entering into a *Beherr-*

3 § 14.2 Körperschaftssteuergesetz.

schungsvertrag, the parent company voluntarily accepts the applicability of the statutory provisions of shareholders' liability.

In case two companies have entered into a *Beherrschungsvertrag*, the leading company is allowed to give instructions about the management of the company to the board of the dependant company. Unless the *Beherrschungsvertrag* states otherwise, instructions that have an adverse effect on the company can be issued, in case such instructions serve the interest of the leading company or of companies that are part of its group. See § 308 AktG.

During the term of the *Beherrschungsvertrag*, pursuant to § 302 AktG the leading company annually has to compensate the losses that may have been suffered by the dependant company. This is so called *Innenhaftung*: liability of the leading company towards the dependant company. Creditors of the dependant company do not have a direct claim on the leading company under § 302 AktG. In case the *Beherrschungsvertrag* is terminated, the creditors of the dependant company may request the leading company to provide security for their claims that have been determined. § 303 AktG provides for a special procedure in this respect. Pursuant to case law, in case of bankruptcy of a dependant AG, the creditors also have a direct claim on the shareholders for debts of the subsidiary based on an extensive interpretation of § 303 AktG.[4]

This article will only address the issues that arise in connection with the involuntarily liability of a parent company for the debts of a subsidiary. The criteria for the imposition of involuntary liability are laid down in legislation as well as in case law. The grounds for such liability can be divided into three categories.

b) Statutory liability

Firstly, legislation may specifically impose liability on the shareholder. In the UK, the relevant provisions are laid down in the Companies Act and the Insolvency Act. Section 24 of the UK Companies Act 1985 provides that *«if a company, other than a private company limited by shares or by guaranty, carries on business without having at least two members and does so for more than 6 months, a person who for the whole or any part of the period that is so carries on business after those 6 months: (a) is a member of the company and (b) knows that it is carrying on business with only one member, is liable (jointly and severally with the company) for the payment of the company's debts contracted during the period or, as the case may be, that part of it.»* In respect of the statutory shareholders' liability, Sections 213 (fraudulent trad-

4 BHGZ 95, p. 330, 347.

ing) and 214 (wrongful trading) of the UK Insolvency Act 1986 are also important. Pursuant to Section 213, any persons who were knowingly parties to the carrying on of any business of the company with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, may be found liable by a court to make such contributions (if any) to the company's assets as the court thinks proper. Simply being the sole shareholder of a company does not automatically mean that the criteria set out in Section 213 are met (cf. Augustus Barnett & Son Ltd).[5] To be *«a party to carrying on of business»* under section 213, positive steps must be taken. A mere omission to take steps is not enough. Re Maidstone Building Provisions Ltd[6]

Section 214 of the UK Insolvency Act attaches liability to directors and shadow directors of a failed company who knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and who did not take proper steps to minimize the potential loss to the company's creditors. Unlike under Section 213, there is no need to demonstrate fraudulent intentions in order to be liable for wrongful trading. A shareholder may be regarded as a shadow director if the company's directors are accustomed to act in accordance with its directions or instructions (cf. Section 251 of the UK Insolvency Act).

In the Netherlands, pursuant to Article 2:138/248(7) of the DCC, a person who has determined the policy of a N. V. or B. V. as if he were a director can be held liable by the liquidator of the company for the deficit in the bankrupt estate of such company, provided that there has been mismanagement and this was an important cause of the bankruptcy. Such a director-in-fact (in Dutch: *feitelijk beleidsbepaler*) may, under certain circumstances, include a parent company, if it has directly interfered with and put aside the subsidiary's actual board of directors.[8] Creditors of the bankrupt company, however, do not have a direct claim on the parent company on the basis of said provision.

The provisions set out in para. III.1.a) above with respect to the liability of shareholders of an AG under § 302 and 303 AktG in a *Vertragskonzern*, are not applicable to the *faktische Konzern*; the situation in which no *Beherrschungsvertrag* has been entered into. § 311(1) AktG provides with respect to the *faktische Konzern* that a leading company may not use its influence on a subsidiary to the detriment of such company, unless it will compensate the damage. Such compensation should be made at the end of the year in which such measures took place, failing which the leading company is liable for the damage which has been caused as a result thereof. See § 317(1) AktG. Such

5 Augustus Barnett & Son Ltd [1986] BCLC 17.

6 Maidstone Building Provisions Ltd [1971] 1 WLR 1085.

an obligation to compensation does not exist in case an *«ordentlicher und gewissenhafter»* manager of an independent company would have entered into such legal act or would have taken such a measure himself. Reference is made to § 317(2) AktG. § 317(4) in conj. with 309(4) AktG, provides creditors of the dependant company with a compensation claim of their own.

It is noted that the principles of liability of the shareholders of a GmbH have not been laid down in legislation.

In all three countries, shareholders' liability may arise from tax law or specific legislation (e. g. environmental laws), but this aspect falls outside the scope of this article.

c) Ignoring the legal personality

Secondly, liability may arise from ignoring the difference between the legal entity of the shareholder and its subsidiary, which results in substituting the subsidiary by its parent (*vereenzelviging* in Dutch and *Haftungsdurchgriff* in German). This results in the parent company being held fully liable for the acts of its subsidiary.

In the Netherlands, equation has in the past sometimes been accepted by lower courts, mostly in tax cases. However, although the Dutch Supreme Court has recognised that in extraordinary circumstances equation may be the best form to sanction abuse of the difference in identity between two legal persons[7], it rarely applies it. The fact alone that a parent company holds all shares in the subsidiary[8], or that the subsidiary is completely dependent on its parent, or that a subsidiary is being fully controlled by its parent, does not justify the conclusion that equation can be presumed. Even if the parent company and its subsidiary use the same address, logo, telephone number, letterhead and invoices, the Dutch Supreme Court considers this not sufficient for presuming equation.[9] The Dutch Supreme Court has only accepted (in principle) the identification of the parent with its subsidiary in one case, which related to the redistribution of powers in the parent which affected the business of the subsidiary: for the purposes of the Works Councils Act the shareholder may be equated with the subsidiary.[10] In a case concerning illegal profits gained through criminal acts, the Dutch Supreme Court ruled that the fact

7 HR 9 June 1995, NJ 1996, p. 213 (Citco/Krijger). Confirmed in 13 October 2000, NJ 2000, p. 698 (Rainbow). Rb. Arnhem, 18 February 2004, JOR 2004, p. 120 (Aerts/St. Waaldijk 8).

8 HR 15 January 1999, JOR 1999, p. 57.

9 13 October 2000, NJ 2000, p. 698 (Rainbow).

10 26 January 1994, NJ 1994, p. 545 (Heuga).

alone that a person is sole shareholder and director of a B. V. does not result in the profits qualifying as profits gained by that person.[11]

A similar result is reached in Germany by what is called *«Normzwecklehren»*, by a restrictive interpretation of § 13(2) GmbHG, pursuant to which the shareholder is denied from invoking the limitation of the recourse of creditors of a GmbH to its assets as laid down in § 13(2) GmbHG, resulting in the shareholder being liable for debts of the GmbH.[12] See para. IV.4. below. In this respect it is important to note that other than with respect to shareholders' liability of an AG, the liability of shareholders of a GmbH has not been laid down in legislation. The concept of liability of shareholders of a GmbH has been developed in case law. Initially the BundesGerichtsHof («BGH») applied the AG legislation on an analogous basis to the GmbH. This was referred to as the *«qualifizierte faktische Konzern»*. This term refers to the situation in which no *Beherrschungsvertrag* has been entered into, but the leading company (GmbH) influences the dependant company (GmbH) to its disadvantage, which has not been compensated by the leading company. Pursuant to this case law, § 302 and 303 AktG were applicable on the *qualifizierte faktische Konzern* by analogy.[13] However, in the *Bremer Vulkan* case, the BGH ruled that the statutory system of liability of shareholders of an AG is not the basis for the liability of – sole – shareholders of a GmbH.[14] In a more recent judgment of the BGH it was established that only in case of *«existenz vernichtende Eingriffe»* the corporate veil could be pierced. According to the BGH, it follows from § 13(2) GmbHG that shareholders have a direct obligation not to seriously endanger the capacity of the GmbH to fulfill its obligations. In case such obligation is breached, the shareholder cannot invoke the limited liability under said provision.[15]

d) Tort

Thirdly, and lastly, the shareholders' liability for debts of its subsidiary may be based on tort. In the UK, shareholders and its subsidiaries have been held liable as joint tortfeasors in cases where both the parent and its subsidiary owed a relevant duty of care or other obligation to a third party and were both responsible for a consequent loss suffered by that third party as a result of the

11 This was a case under Article 36e Dutch criminal code, the so called «Pluk ze wetgeving». HR 8 May 2001, NJ 2001, p. 507.

12 BGH ZIP 2002, p. 1578 (KBV).

13 BGHZ 95, p. 330 (Autokran); BGHZ 115, p. 187 (Video); BGHZ 122, p. 123 (TBB).

14 BGH, NJW 2001, p. 3622, 3623.

15 See footnote 12.

breach of the relevant duty or the failure to perform an obligation. Reference is made to *Stocznoia Gdanska v Latvian Shipping Co.*[16], in which a parent company was held liable for inducing a breach of contract by deliberately starving its subsidiary of funds in order to prevent it from fulfilling its obligations under a contract. For the parent to be liable in tort it would seem that there needs to be a specific instruction from a parent to subsidiary instructing it to breach a contract with a third party. Alternatively, there needs to be the requisite unlawfulness by the parent inducing the subsidiary to breach its contract with a third party.

In Germany, shareholders may be liable under § 826 BGB, which provides that a person who deliberately (in German «*vorsätzlich*») causes damage to another person, which is in violation with good morals (in German «*die guten Sitten*»), is obliged to pay damages to such person. It is noted that «*vorsätzlich*» is a high degree of culpability, and is not lightly applied. Authors who interpret the term *Durchgriffshaftung* in a restricted manner, opine that liability under § 826 BGB do not qualify as *Durchgriffshaftung*, because in that case the shareholder is held liable for independent unlawful acts of its own towards the creditors; the privilege of limited liability is not affected in that case.

In the Netherlands, liability on tort is based on Article 6:162 of the DCC which provides that a person is liable for damage it caused to another party as a result of its tortious act. In 1981, the Dutch Supreme Court first recognised that a shareholder can be liable towards a creditor of its subsidiary for an amount that supersedes its capital investment in the company arising out of a tort committed against this creditor.[17] Until today, the Dutch Supreme Court has only sanctioned piercing of the corporate veil by creditors of a subsidiary based on tort. It has stated that, as a principle, abusing the difference in identity between two legal persons constitutes a tort, obliging both legal persons and the one that is abusing these legal persons to pay damages caused to third parties as a result of this abuse.[18]

2. *The effects of piercing the corporate veil*

The effects of piercing the corporate veil vary. As set out above, violation of Sections 213 and 214 of the Insolvency Act 1986 (UK) and § 302 AktG results in an obligation on the part of the shareholder to contribute to the company's assets. Thus, creditors do not have a direct claim on the shareholder

16 Stocznoia Gdanska v Latvian Shipping Co. [2002] 2 Lloyd's Rep 436.

17 HR 25 September 1981, NJ 1982, p. 443 (Osby).

18 See footnote 9.

for compensation to be paid to them. In the Netherlands, when a subsidiary is substituted by its parent or in case of equation, the shareholder is directly liable towards the subsidiary's creditor for the subsidiary's debt. The same result is reached through the limiting interpretation of § 13(2) GmbHG. Finally, in case of tort, the creditor has a direct claim on the shareholder for damage suffered as a result of the tort.

IV. Circumstances that allow piercing the corporate veil

In general, in all three jurisdictions, the single fact that a shareholder provides a contribution to the policy and management of the subsidiary, or acts as the actual executive as if it were director of the subsidiary, does not suffice to establish liability of that shareholder based on tort. The same applies to instances where the parent company interferes with the operational management of the subsidiary, which does not automatically result in liability on the part of the parent company without personal culpability of the parent company or one of the parent company's directors.

1. One single economic entity

Although in all three jurisdictions creditors of subsidiaries have argued that the shareholder of a subsidiary is liable for its debts on the basis of the simple fact that all shares in the subsidiary are held by one party or that such companies effectively form one single economic entity, in general the courts do not accept this. This line of argument was adopted, for example, in *DHN Food Distributors Ltd and others v London Borough of Tower Hamlets*, where the UK court was willing to pierce the corporate veil for the benefit of a parent company on the grounds that a group of companies could be viewed as forming one single economic entity.[19] In *Adams v Cape Industries*[20], where the victims of a tort of a subsidiary tried to enforce a US judgment against that subsidiary in the UK against its shareholder, the argument that the companies should be treated as one group enterprise was rejected by the Court of Appeal. As set out in para. II. above, the court confirmed the principle first established in Salomon, i. e. that these companies were to be treated as separate legal entities. This approach was acknowledged in Polly Peck plc.[21]

19 DHN Food Distributors Ltd and others v London Borough of Tower Hamlets [1976] 3 All ER 462.

20 See footnote 2.

21 Polly Peck plc [1996] 2 All ER 433.

In the Netherlands, too, the simple fact that a parent company – or through its directors – is acting as director of its subsidiary, and as a director and/or sole shareholder determines the policy of its subsidiary with regard to its business activities and manages these activities, does not mean that these activities have thus become business activities of the parent company with the result that it may be held liable for all possible tortious acts.[22]

2. *Parent company is agent/trustee*

In the UK, it has been argued that the concept of agency can be used to pierce the corporate veil. According to this concept, anyone who instructs an agent bears a responsibility for any agreement that the agent contracts on their behalf and as a result shareholders could be liable for agreements entered into by its subsidiaries. This is particularly true, since an agent is not authorised to deviate from the instructions given to him. In *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen and Citizens of the City of Birmingham*[23], a six test catalogue was laid down for determining whether the agency principle applied in a parent/subsidiary relationship. The relevant tests were: Were the profits treated as the profits of the company? Were the persons conducting the business appointed by the parent company? Was the company the head and brain of the trading venture? Did the company govern the adventure, decide what should be done and what capital should be embarked on the venture? Did the company make the profits by its skill and direction? Was the company in effectual and constant control? In this particular case it was held on the facts that even though the subsidiary possessed a separate legal entity, this was not conclusive on the question of the right to claim. As the subsidiary company was not operating on its own behalf but on behalf of the parent company, the parent company was the party to claim compensation. Later, in *Carlton Communications plc and Another v The Football League*[24], it was made clear that the circumstances in which the agency principle operates as an exception to the limited liability rule are very limited: *«The fact that a company can in common parlance be said to carry on business on behalf of its shareholders does not make the company the agent of the shareholders»*.

22 HR 16 June 1995, NJ 1996, p. 214 (Bato's Erf).

23 Smith, Stone & Knight Ltd v Lord Mayor, Aldermen and Citizens of the City of Birmingham [1939] 4 All ER 116.

24 Carlton Communications plc and Another v The Football League [2002] EWHC 1650 (Comm).

3. *Use of the corporate veil to avoid contractual or other legal obligations/fraud/abuse*

As set out above, the UK Insolvency Act contains provisions (Sections 213 and 214) that expressly sanction fraudulent or wrongful trading. UK courts will also disregard the separate legal identity of the company if a company uses the corporate veil to avoid contractual or other legal obligations. An example of this is *Gilford Motor Co. v Horne*[25], where Horne was bound by a non-solicit clause in his contract, but attempted to circumvent this provision by incorporating a company that was not bound to this contract, in order to entice customers. The court ruled that *«[...] this company was formed as a device, a stratagem, in order to mask the effective carrying on of a business of [the defendant]»* and both Horne and his company were ordered to refrain from the acts described in the non-solicit clause. A similar judgment was rendered in *Jones v Lipman*.[26] In order to avoid his obligation to sell his house to Jones, Lipman sold and transferred his house to a company which he had incorporated. Nevertheless, on the same grounds as in *Gilford Motor Co. v Horne*, the court ordered both Lipman and his company to transfer the house to Jones. In Lipman it was said that «the defendant company was a cloak for the first defendant, who could compel a transfer of the land to the plaintiffs, and the court would accordingly decree specific performance against both defendants». In *Trustor AB v Smallbone and Others*[27], the court ruled that piercing the corporate veil is warranted if the company is used as a device or façade to conceal the true facts, thereby avoiding or concealing any liability of the individuals. However, the court also stated that the corporate veil should not be pierced merely because the court considers that justice so requires.

As indicated in para. 2 above, the mere fact that a corporate group has been structured in order to ensure that the legal liability (if any) in respect of particular future activities of the group will fall on one member of the group rather than another is not sufficient for piercing the corporate veil (cf. *Adams v Cape Industries*). This is different if the group structure is used to escape *past* or *current* obligations.

In cases similar to the UK cases *Gilford Motor Co. v Horne* and *Jones v Lipman*, the Dutch Supreme Court ruled that terminating the activities of one company and having the same activities continued by another company for no other reason than to disadvantage the tax authorities as a creditor or making recourse of this creditor impossible, constitutes a tort towards this credi-

25 Gilford Motor Co. v Horne [1933] Ch 935.

26 Jones v Lipman [1962] 1 All ER 422, [1962] 1 WLR 832.

27 Trustor AB v Smallbone and Others [2001] 3 All ER 987.

tor.[28] However, the amount of damages to be paid to this creditor is not necessarily the same amount as this creditor's claim.[29] This means that the damage cannot exceed the recourse the creditor would have had on the company if the tortious act had not taken place.

In *Roco v the State*, the Dutch Supreme Court ruled that tortious acts committed by one of the incorporators of a company in principle cannot be qualified as acts of tort of that company simply because this company continued the incorporator's business. However, if the continuation of the activities by the company had as its apparent goal the release from third party claims and creditors have been disadvantaged because their claims remain on the incorporator, whereas the whole business has been continued in the company, this may constitute a tort on the part of the company.[30]

In a case about director's liability, the Dutch Supreme Court ruled that transferring money from one group company to another, leaving the creditors of the first company unpaid, is a tortious act. In addition, the court ruled that the lawfulness and acceptability of a so-called split-up of the company into viable and non-viable units (in Dutch: *sterfhuisconstructie*) depends on whether the group's most important creditors have been consulted and have consented. If the split-up took place without consultation and consent, it constitutes a tort.[31] This piercing of the corporate veil, however, does not mean that if there are two companies with the same sole shareholder, whereby one of them has an equity surplus and the other an equity deficit, it can automatically be concluded that the shareholder is unwilling to pay debtors of the latter company.[32]

Although in German literature the *«Missbrauch des Institutes der juristischen Person»* has been acknowledged, in case law this principle has hardly been applied. In Germany in cases like *Gilford Motor Co. v Horne*, in which a GmbH would be used by a natural person to escape from his obligations under a non-compete clause, the most important remedy would be to establish whether pursuant to the intentions of the parties such an indirect breach of the

28 Recently, the Arnhem District Court ruled about a case involving the transfer of a debtor's house to a foundation, with the purpose of preventing the debtor's creditors from having recourse on this house. The District Court ruled that since the foundation and its board members cooperated in order to maintain this structure, which resulted in the debtors no longer being in a position to take direct recourse on the house, they acted tortiously. Rb. Arnhem 18 February 2004, JOR 2004, p. 120.

29 13 October 2000, NJ 2000, p. 698 (Rainbow), see also HR 25 September 1981, NJ 1982, p. 443, par. 5.

30 HR 3 November 1995, NJ 1996, p. 215 (Roco/Staat).

31 HR 26 October 2001, NJ 2002, p. 94 (B/Ontvanger).

32 See Advocaat Generaal L. Timmerman in HR 18 February 2005, JOR 2005, p. 115 (Kath. Schoolst. Wateringen).

non-compete clause would fall under the scope of the provision; in other words, through contract interpretation.[33] However, § 826 BGB could also be applied in case a shareholder incorporates a GmbH for the purpose to circumvent his personal obligations.[34]

4. *Undercapitalisation*

In general, under UK law there is no requirement for shareholders to capitalise a company. However, under certain circumstances a parent company can be held liable towards a third party in case of breach of the obligations by the subsidiary if such non-fulfilment was deliberately caused by the shareholder. In *Stocznoia Gdanska v Latvian Shipping Co*, for example, a parent company was held liable on the ground that it had deliberately starved its subsidiary of funds to prevent it from fulfilling its obligations under a contract because it did not wish to proceed with this contract.[35] In this particular case, the fact that the parent company had breached its undertaking towards the subsidiary's directors to keep it in funds also played a role. The parent was held liable for unlawfully inducing its subsidiary's breach of contract.

In Germany undercapitalization can be a basis for *Haftungsdurchgriff*. The main principle is that shareholders are not obliged to pay up further capital in case of lack of equity of a troubled company.[36]

However, in case the shareholders engage in extraordinary risky business to the detriment of the creditors, the corporate veil may be pierced. In case of such *«Unterkapitalisierung»* the legal ground for piercing the corporate veil is *«sittenwidrige vorsätzliche Schädigung»* on the basis of § 826 BGB. An example of a situation in which shareholders have been held liable is that the shareholders arranged the business of their company in a fashion that was so onesided to its disadvantage that the losses necessarily had to adversely affect the creditors, while profits would always be for the benefit of its shareholders.[37] In the *KBV*-case the BGH ruled that shareholders may not withdraw equity from the GmbH without taking into consideration the purpose of the equity as provided by law, preventing the GmbH from fulfilling all or part of its obligations. In such a situation, the shareholders lose their privilege of limited liability under § 13(2) GmbHG.

33 OGH SZ Bd. 34 (1961) Nr. 22, p. 65, 86.
34 RGZ 114, p. 68 (70 ff.).
35 Stocznoia Gdanska v Latvian Shipping Co [2002] 2 Lloyd's Rep 436.
36 BGHZ 90, p. 381, 388 ff. LM Nr. 5 zu par. 17 AktG = NJW 1984, p. 1893 = AG 1984, p. 181 «BuM/WestLB».
37 BGH, NJW 1979, p. 2104.

Another case in which the BundesGerichtsHof has pierced the corporate veil was in a case of *Vermögensvermischung* (mixing of estates). This occurs in case one can no longer distinguish between the estates of the company and its shareholders and this distinction cannot be made based on the accounts of the company and otherwise the accounts are unclear or the distinction between the estates has been blurred. Only the shareholders that are responsible for the mixing of the estates are liable towards the creditors. Minority shareholders can only be liable on this ground in case due to special circumstances they were able to determine these affairs of the company.[38]

In *Albada Jelgersma*[39], the Dutch Supreme Court held that a parent company which had interfered with the business of its subsidiary in an intensive manner, was obliged to take measures as soon as it knew or ought to have known that a supplier of its subsidiaries would be disadvantaged by lack of recourse for its supplies, if these supplies were to be continued. The Supreme Court stated that the parent company had a duty to either pay the suppliers or to ensure that its subsidiary ceased purchasing goods. These measures ought to have been taken after its internal auditor had reported that the balance sheet contained a substantial error, which would mean the end of the subsidiary.

In another case, the Dutch Supreme Court ruled that a parent company which managed its subsidiary from a financial perspective had committed an act of tort because from a certain point in time it failed to prevent the subsidiary's creditors from continuing to render services, even though the parent company knew that the services could no longer be paid and that the cash flow that came in with the subsidiary would not be for the benefit of these creditors.[40] The ruling states that (from a certain date) the parent company ought to have been involved in its subsidiary's business affairs and that it ought to have insisted on its subsidiary reporting to it. From that time on, the parent company ought to have warned the creditors that certain services rendered could not be paid for in full. It ought to have prevented new creditors and suppliers from entering into agreements with its subsidiary. The parent company ought to have ensured that the creditors were informed. If it had deemed that this was not its duty, it should have applied for a moratorium of payments of the subsidiary.

Pursuant to the Dutch Supreme Court judgment in *Nimox*[41], a shareholder may not have the company pay out dividend if it seriously has to reckon with the possibility that the subsidiary will not be able to pay all its creditors after

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38 BGHZ 95, p. 330, 333; BGHZ 125, p. 366, 368.
39 HR 19 February 1988, NJ 1988, p. 487 (Albada Jelgersma).
40 HR 21 December 2001, JOR 2002, p. 38 (Sobi/Hurks).
41 HR 8 November 1991, NJ 1992, p. 174 (Nimox).

such dividend payment. In *Osby*[42], the Dutch Supreme Court ruled that if a parent company owns all the shares in a subsidiary and provided a loan to the subsidiary and subsequently obtained security on all, or almost all assets of this subsidiary as a result of which no recourse remains for new creditors which have provided loans to the subsidiary after the parent company obtained the security, this may, under certain circumstances, constitute a tort on the part of the parent company against these creditors if the parent company fails to take into account the interests of the new creditors. The Supreme Court ruled that this is especially the case if the parent company had such insight into and control over the subsidiary's policy that it knew or ought to have known that new creditors could be disadvantaged by the lack of recourse, particularly in view of the amount of its receivables and the security obtained and the course of affairs in the subsidiary's business and nevertheless failed to have the creditors paid.

In line with subsequent case law of the Dutch Supreme Court, obtaining security on assets of a subsidiary may also be tortious to existing creditors of the subsidiary if the parent company seriously had to take into account that the subsidiary's creditors would suffer damage as a result. At any rate, having a subsidiary repay a due and payable debt to the parent company may be tortious if at the time of the repayment the possibility that other creditors of the subsidiary would remain unpaid upon liquidation of the subsidiary had to be seriously reckoned with.[43] However, if it only becomes clear after repayment to the parent company that the subsidiary has insufficient funds to pay its other creditors and at the time of the payment there was no specific indication of such deficit, the receipt of such repayment by the parent company is not unlawful.

Selective payment also formed the core of *Coral v Stalt*[44], where the subsidiary first paid all its trade creditors, except for one, and subsequently paid all the claims of its group companies. The Dutch Supreme Court ruled that if the subsidiary's board of directors knew or ought to have known that no recourse would remain for this creditor after payment of all the other creditors, and the parent company had been intensively involved in the subsidiary's course of affairs and had been instrumental in the termination of the subsidiary's business, the subsidiary as well as the parent company – by accomplishing or allowing this conduct – acted unlawfully towards this creditor.

42 HR 25 September 1981, NJ 1982, p. 443 (Osby).

43 HR 9 May 1986, 1986, p. 792 (Keulen/BLG); HR 8 November 1991, NJ 1992, p. 174 (Nimox).

44 HR 12 June 1998, NJ 1998, p. 727 (Coral/Stalt).

V. Summary and conclusion

In all three jurisdictions the main principle is that a company is a legal entity, separate from its shareholders and that in principle its shareholders are not liable for debts of the company. However, exceptions to this rule cause the corporate veil to be pierced. Involuntary liability of shareholders may be based on legislation, it may follow from ignoring the legal personality of the company or bypassing the privilege of the limited liability or shareholders' liability may be based on tort. In all jurisdictions, the court's decisions ultimately depend on the specific facts and circumstances of each case. When we compare similar cases in all three jurisdictions, we can conclude that, in terms of shareholders' liability, all the jurisdictions analysed in this article provide for some form of recourse for creditors of subsidiaries on its shareholder. In each country, when the corporate veil is pierced, the acts of the shareholders need to be culpable. Only in case shareholders voluntarily accept liability for debts of its subsidiaries, e. g. under Article 2:403 DCC or § 303 AktG, no such culpability is required. On the other side of the spectrum is the liability of shareholders based on fraud, e. g. section 213 UK Insolvency Act, or *«existenzvernichtende Eingriffe»*, on the basis of which shareholders of a GmbH are denied from invoking the privilege of limited liability under § 13(2) GmbHG. In all jurisdictions piercing the corporate veil is also a remedy for unlawful circumvention of contractual obligations.

The privilege of limited liability may, however, also be lost in case of a lower degree of culpability on the side of the shareholders, in particular when continuing a loss making business. In such situations, all three jurisdictions seem to have similar standards for what is called *«wrongful trading»* in the UK. See Article 213 UK Insolvency Act. It all comes down to whether the creditor knew or ought to have known that creditors would be disadvantaged. Cf. § 317(4) in conj. with 311 AktG. Still, some degree of intent is required; at any event the simple fact that a company is undercapitalized is not sufficient for the liability of its shareholders. In that respect one cannot state that involuntary shareholders' liability is merely a strict liability. For all three jurisdictions the consideration *«The court cannot lift the veil merely because it considers that justice so requires»* as held by a UK court in the *Trustor* case still stands.[45] In that respect, the corporate veil still offers protection to the shareholders.

45 See footnote 27.