

# Lifting the Corporate Veil is Necessary for a Developed Market. By: Dmitry Kafanov

The concept of *lifting the corporate veil* is one of the most controversial and discussed spheres of corporate law. Even at the very rise of legal entity understanding as a separate subject of social relations, main foreign legal scholars stated the possibility and practical value of lifting the fundamental principle of a legal entity, being limited liability principle.

The main problem of strictly formal use of legal entity's limited liability (that brings us more to a philosophical level than to a legal one) is justification and argumentation of instruments intended for limitation or violation of other members' rights, including fraud, withdrawal from responsibility, agents defraud or other deeds not in good faith in a free and fair community with equal rights for its members.

The stated problem shall be taken in consideration when questioning the practical value of *lifting the corporate veil* concept in general and its applicability in Russian legal practice in particular.

The Anglo-Saxon legal system has the most detailed and profound study of the named concept, terms of use for this legal institute and legal consequences of entity's limited liability neglecting. But English and American courts approaches to its use are quite different.

Basic principle, stating the company to be an independent unit with its own property was developed in the case *Salomon v Salomon & Co* in 1897. And even the general trial court (*Broderip v Salomon, 1895*) admitted the legal entity under consideration to have been created as a cover in order to escape liability, while the real owner of the company was to be held responsible in the case. At the same time the House of Lords unanimously turned out all the arguments supporting fraud, company's existence as an agent created by the real owner not in good faith, and stated all the claims related to the company to be made only in its address and by no means to its owners.

Until now English courts have been using this legal institute very unwillingly and only in rare cases, in spite of defining major points of the *lifting the corporate veil* concept.

American courts demonstrate quite a different way. *Lifting the corporate veil* concept was clearly defined in the case *United States v. Milwaukee Refrigeration Transit Co.*, 1905: "A corporation by a general rule shall be treated as a legal entity and until otherwise is proved; at the same time, in case of legal entity concept being used for public interests violation, excuse for law infringement, fraud concealing, defense of a crime, the law will treat that corporation as an association of people".

Later the concept of *lifting the corporate veil* was used by American courts rather often. For instance, 48.58% of 2,908 claims to lift the corporate veil, heard by federal and state courts from 1860 to 2006, were sustained (Peter B. Oh, *Veil-Piercing*, 2010).

Ironically the legal institute that suits more a collectivist society where social harmony and interaction between its members are a priority in comparison to individual rights and personal economic initiative, is better developed in a society celebrating individualism in all kinds of human activities. For example, the People's Republic of China legally introduced *lifting the corporate veil* only in 2006, comparing to Americans who have been using it for over a century.

This fact is worth studying in terms of profound social laws, but as an initial hypothesis we may state that societies with economic domination of members' individualism instead of an artificial creations that a legal entity is in fact, are not really interested in *lifting the corporate veil* since they have relations between real people who are more concerned with "keeping the face" than avoiding mutual liabilities via some legal tricks.

On the other hand, an individualist society with developed market needs *lifting the corporate veil* to control economic relations; it allows them to restrain illegal and dishonest use of limited liability principle working for legal entities.

To understand if *lifting the corporate veil* introduction undermines law-abiding market players, we shall study the terms defined by American courts when it is possible to hold company's real owner or owners liable.

There are several main conditions of court using the concept of *lifting the corporate veil*: company creation for fraud or deception, for illegal activities, for withdrawal from responsibility in case of law violation, for using company as a cover for its owners performing activity different from the stated one, for assets stripping, that violates creditors' or investors' rights and interests, for using company as an instrument when it only acts as an agent in its owners' interest.

As it is shown, all mentioned conditions can justify *lifting the corporate veil*. In other case it is hard to find a reasonable explanation why business owners with dishonest reasons, withdrawing from their responsibility, confusing their counterparts, shall have advantage over other market players by using immunity principle for limited liability of a legal entity.

Also when evaluating practical use of this concept introduction into Russian legal system, we shall understand that it is only a legal instrument protecting investors' and creditors' rights and to some extent guaranteeing protection for fair market players. So, categorical statements about the use of this instrument in corrupted court system of Russia, different economic reality, some political features have the same ground as a call to forbid axes because somebody somewhere was told to use it for a murder.

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