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Piercing the Corporate Veil in American and German Law - Liability of Individuals and Entities: A Comparative View

Carsten Alting

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PIERCING THE CORPORATE VEIL IN AMERICAN AND GERMAN LAW - LIABILITY OF INDIVIDUALS AND ENTITIES: A COMPARATIVE VIEW

*Carsten Altling**

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PIERCING THE CORPORATE VEIL IN AMERICAN AND GERMAN LAW - LIABILITY OF INDIVIDUALS AND ENTITIES: A COMPARATIVE VIEW

I. INTRODUCTION

The United States legal doctrine of "corporate veil" refers to the common concept of limited corporate liability under which the shareholders of a corporate entity are not personally liable for the entity's debts and obligations.¹ Similarly, the concept applies to limited liability companies² (LLCs) that have emerged in recent years.³ However, it is accepted and recognized that under particular circumstances the rule of limited liability will be abolished⁴ in favor of the corporation's creditors.⁵ This process is commonly referred to as piercing or lifting the veil or disregarding the entity.⁶ Today, there is no distinction between corporations and LLCs with respect to piercing the veil.⁷

German corporate law has a similar rule of general limited liability regarding obligations of an *Aktiengesellschaft*, stock corporation, and a *Gesellschaft mit beschränkter Haftung (GmbH)*, which is similar to a limited liability company.⁸ There exists a wide body of cases and literature which focus on when limited liability may be disregarded.⁹ This is referred to as "*Durchgriffshaftung*."¹⁰

1. E.g., REVISED MODEL BUSINESS CORP. ACT §§ 6.22, 2.02(b)(2)(v) (1994) [hereinafter RMBCA]. See also DEL. CODE ANN. tit. 8, § 102(b)(6) (1992); Cathy S. Krendl & James R. Krendl, *Piercing The Corporate Veil: Focusing the Inquiry*, 55 DEN. L.J. 1, 2 (1978).

2. E.g., MO. ANN. STAT. § 347.057 (Vernon Supp. 1994); Mark A. Sargent, *Limited Liability Company Handbook* § 1.03 (1993-94 ed.).

3. For an overview on LLCs see Sargent, *supra* note 2, at 1-7, 7-1; Michael Bosko, *The Best of Both Worlds: The Limited Liability Company*, 54 OHIO ST. L.J. 175, 181 (1993).

4. HENRY W. BALLANTINE, BALLANTINE ON CORPORATIONS Ch. X (rev. ed. 1946); 1 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41 (perm. ed. rev. vol. 1990); HENRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS §§ 146-48 (3d ed. 1983); STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1.01 (1991).

5. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 109 (1985); Harvey Gelb, *Piercing the Corporate Veil - The Undercapitalization Factor*, 59 CHI.-KENT. L. REV. 1, 2 (1982); Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1039 (1991) [hereinafter Thompson 1991]; Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1, 3, 5 (1994) [hereinafter Thompson 1994].

6. Professor Wormser was the first to use the term. See *infra* part II.A.1.

7. Sargent, *supra* note 2, at 4-7; Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 401-03 (1991); Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 442 & nn.536-57 (1992).

8. See AKTIENGESETZ [AktG] § 1, para. 1; GMBH-GESETZ [GmbHG] § 13, para. 2. Both provisions expressly state that only the assets of an entity are liable to creditors of the entity.

9. See HACHENBURG GROBKOMMENTAR, GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG (GMBHG) Anh. § 13, at 573-74 (Ulmer ed., 8th ed. 1992); KARSTEN SCHMIDT, GESELLSCHAFTSRECHT 186 (1991) [hereinafter SCHMIDT, GESELLR.]; FRANZ SCHOLZ, KOMMENTAR ZUM GMBH-GESETZ § 13, B., III., para. 4 (6th ed. 1983).

10. ADOLF BAUMBACH & ALFRED HUECK, GMBH-GESETZ § 13, m.no. 10 (15th ed. 1988); Helmut Coing, *Zum Problem des Sogenannten Durchgriffs bei Juristischen Personen*, 1977 NEUE JURISTISCHE WOCHEN-

Incorporation for the sole purpose of obtaining limited liability under the law of corporations or other entities is legitimate, and there are no grounds for the denial of any benefits connected with the principle of limited liability.¹¹ Accordingly, rules of piercing the veil, or *Durchgriffshaftung* operating in favor of a corporate creditor who seeks personal liability of a corporation's shareholders or members of a LLC,¹² can be applied only in exceptional cases.¹³ Furthermore, the doctrines have been promulgated in both countries by the courts and legal scholars and have no statutory basis.

German corporate law, in the context of affiliated entities, has a rather different approach to the issue of disregarding an entity's veil of limited liability. Here, the shareholders of an entity are other entities. Because of the different underlying circumstances,¹⁴ these situations have to be clearly distinguished from the fact patterns just mentioned in which the shareholders are individuals. The basic rules determining the question of shareholder liability when the shareholders are other entities are embodied in the German corporate law code, AktG sections 15-19 and 291-328.¹⁵ The German legal term most used in this context is "*Konzern*," which is defined in AktG section 18.¹⁶ Accordingly, this area of law is often referred to as "*Konzernrecht*." These terms will be used subsequently in the context of German law.

In contrast, the American law extends the equitable rules of piercing the veil to situations involving affiliated entities. As mentioned, the counterpart in German law is found in the legal notion referred to as *Durchgriffshaftung* which is applied to entities with individual shareholders. Accordingly, with respect to the question of shareholder liability, German law can serve as an example that has both equitable rules and statutory provisions, which are distinct from each other.

This paper compares rules for disregarding the principle of limited liability. Its primary focus is on affiliated entities. However, for the purpose of

SCHRIFT [NJW] 1793; HACHENBURG, *supra* note 9, at Anh. § 13, m.no. 1; MARCUS LUTTER & PETER HOMMELHOFF, GMBH-GESETZ: KOMMENTAR § 13, m.no. 8 (13th ed. 1991); SCHMIDT, GESELLR, *supra* note 9, at 200-301.

11. *New Jersey v. Ventron Corp.*, 468 A.2d 150, 164 (N.J. 1983); HENN, *supra* note 4, § 146.

12. This paper refers to the equity owners of a corporation or an LLC by the American legal terms, "shareholder" for corporations, e.g., RMBCA § 1.40 (22) and "member" for limited liability companies, e.g., MO. ANN. STAT. § 347.015 (11). The German terms are "Aktionaer" (AktG § 28) and "Gesellschafter" (GmbHG § 2, para. 2).

13. Krendl, *supra* note 1, at 7; SCHMIDT, GESELLR, *supra* note 9, at 187.

14. Corporate shareholders are not mere passive investors, but combine ownership of an entity with control. See Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, 298, 325-27 (1990) [hereinafter Blumberg, *Corporate Entity*].

15. Particularly important are §§ 302, 303, and 317. See SCHMIDT, GESELLR, *supra* note 9, at 203; HACHENBURG, *supra* note 9, at Anh. § 13, m.no. 47, Anh. § 30, m.nos. 30, 33; Ulrich Hübner, *Der Durchgriff bei Juristischen Personen im Europäischen Gesellschafts- und Unternehmensrecht*, 1978 JURISTEN ZEITUNG [JZ] 703, 706; HEINZ ROWEDDER, GMBHG: KOMMENTAR § 13, m.no. 30 (2d ed. 1990); Walter Stimpel, *Durchgriffstatbestaende bei der GmbH: Tatbestaende, Verlustausgleich, Ausfallhaftung*, in FESTSCHRIFT FÜR GOERDELER 603, 609 (1987). The rules are described in detail in the chapters on affiliated entities. Cf. *infra* part IV.B.3.b.ii to IV.B.3.c.

16. AktG §§ 291-28 are applicable to affiliated companies, which are defined in AktG §§ 15-19. Cf. *infra* part IV.B.3.b.ii.

understanding the American law and the different approaches taken by the two legal systems, it is necessary to first delineate the rules in general before describing the situation respecting parent-subsidary companies.

With regard to non-corporate shareholders, this paper makes clear that under both American and German law, piercing the veil becomes an issue in situations involving: (1) domination of a company, (2) undercapitalization of a company, and (3) commingling of the shareholder's and the company's assets or other disregard of corporate formalities. Contrary to the patterns regarding affiliated entities, it will be seen that the approaches in both jurisdictions are rather similar.

This paper distinguishes between individual and corporate shareholders. The rules in general and parent-subsidary situations in particular are dealt with in separate sections.

II. THEORIES AND APPROACHES TO PIERCING THE VEIL

A. American Law

1. General

The term "piercing the veil" was first coined by Professor Wormser in 1912.¹⁷ However, the principle of limited liability¹⁸ may be traced further back, although no exact date is available.¹⁹ For example, Massachusetts enacted five different statutes regulating shareholder liability between 1809 and 1830,²⁰ and by that time, the principle of limited liability was widely recognized in the United States.²¹ In the early case of *Wood v. Dummer*,²² the court approved the principle of limited liability. The shareholders of an incorporated bank withdrew all the assets of the entity by distributing extensive dividends, thereby leaving the creditors without any available funds. The court viewed the previously paid-in capital as a trust fund for the benefit of the bank's creditors and held the shareholders responsible for paying off their entity's debts up to the amount of dividends each of them had received.

In the early development of corporate law, courts were reluctant to award damages against corporations, and consequently, the veil was rarely lifted. An example of this is the 18th Century Mill Acts in New England, which stated that owners of land adjacent to mills could not claim damages if their property was flooded as a result of water storage and discharge. Although the statutes were

17. I. Maurice Wormser, *Piercing the Veil of Corporate Entity*, 12 COLUM. L. REV. 496 (1912); see *infra* part II.A.2.

18. For an historical overview, see Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 574, 577-605 (1986) [hereinafter Blumberg, *Limited Liability*]; see also *id.* at 587-95 (describing American law).

19. David S. Baker & V. Scott Killingsworth, *An American View through the Corporate Veil*, 6 INT'L BUS. LAW. 267 (1978); Blumberg, *Corporate Entity*, *supra* note 14, at 292.

20. Baker, *supra* note 19, at 268.

21. William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 847 (1982); Thompson 1994, *supra* note 5, at 9.

22. 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,944); Baker, *supra* note 19, at 268; Blumberg, *Limited Liability*, *supra* note 18, at 592; Hackney, *supra* note 21, at 848.

initially aimed at small-scale mills of the colonial time, they were also later applied to mill factories that flooded large tracts of land.²³

In approaching the problem of individual shareholder liability, it should first be noted that the courts developed, almost entirely, this area of law,²⁴ and therefore, uniform rules do not exist.²⁵ This situation has often been lamented by scholars. The lack of uniformity led Judge Cardozo to comment in *Berkey v. Third Ave. Railway Co.* that "the whole problem of the relations between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor."²⁶ Arthur Machen stated that, with respect to this legal problem, "no other guide is more desirable than sturdy common sense."²⁷ Additionally, Professor Latty wrote, "what the formula comes down to, once shorn of verbiage about control, instrumentality, agency and corporate entity, is that liability is imposed to reach an equitable result."²⁸

Although theories have been developed, as will be discussed, Judge Sanborn summarized the approach in *United States v. Milwaukee Refrigerator Transit Co.*²⁹ and described an approach to the problem:

If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, 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.³⁰

Before the focus is turned in depth to the issue of piercing the veil, piercing the veil must be distinguished from other situations in which owners of an entity may be held liable.³¹ For example, a shareholder may have committed tortious acts or may have incurred an individual obligation, rather than one of the entity, by causing a creditor to believe that he or she acted in his or her individual capacity and not on behalf of the company.³² These cases will not be decided based upon the corporate rules of piercing the veil because the shareholder incurred an individual liability. In contrast, piercing the veil applies to an entity's obligations for which the creditor seeks the personal liability of the owner.³³ However, piercing the veil does not generally question the legal

23. MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860*, 47-53 (1977); Baker, *supra* note 19, at 269.

24. Today, federal statutes exist which impose liability, especially in the context of corporate groups. See Blumberg, *Corporate Entity*, *supra* note 14, at 288-89, 298, 329-45, 355-59; cf. *infra* notes 566-67.

25. *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098, 1103 (5th Cir. 1973); FLETCHER, *supra* note 4, § 41.30; Baker, *supra* note 19, at 269; Antoinette Sedillo Lopez, Comment, *The Alter Ego Doctrine: Alternative Challenges to the Corporate Form*, 30 UCLA L. REV. 129, 139 (1982).

26. 155 N.E. 58, 61 (N.Y. 1926). For more details on this case see *infra* part II.A.2. PRESSER, *supra* note 4, § 1.03.

27. Baker, *supra* note 19, at 270; Arthur W. Machen, Jr., *Corporate Personality*, 24 HARV. L. REV. 253 (1911).

28. ELVIN R. LATTY, *SUBSIDIARIES AND AFFILIATED CORPORATIONS* 191 (1936).

29. 142 F.2d 247, 255 (Wis. 1905); HENN, *supra* note 4, at 346.

30. 142 F.2d at 255.

31. Krendl, *supra* note 1, at 2-3.

32. HENN, *supra* note 4, § 146.

33. *Id.*; Thompson 1994, *supra* note 5, at 9-10.

fiction of an entity's separate existence apart from the owners, but merely disregards this fiction for the purpose of the particular case at bar.³⁴

2. Theories

One of the approaches that has evolved is Professor Berle's enterprise entity theory.³⁵ Professor Berle saw a contradiction between economic reality and the legal organization of a business split into several separate entities held together by the parent corporation. Consequently, he stated that the parent should not only be liable for the subsidiary's debts, but also for all of the comprised assets available to a creditor of any of the enterprise's corporations.³⁶ This comes close to the German *Konzernrecht* according to which a dominating shareholder under certain circumstances generally has to assume the debts of the subsidiary.³⁷

One illustration is the well-known New York taxi-cab cases. The owners of many cabs incorporated only pairs of their cabs that could not be distinguished from each other.³⁸ Obviously, the shareholders tried to avoid having the liability incurred by the use of one cab from extending to all the other cabs in the fleet by incorporating in pairs. Individually, the cabs carried only the minimum amount of third-party insurance, which was often not sufficient to meet obligations incurred.

The courts rejected Berle's enterprise entity theory in the famous case of *Berkey v. Third Ave. Railway Co.*³⁹ In this case, a parent corporation owned several subsidiaries that operated a railway transportation system in Manhattan. The court refused to impose shareholder liability in favor of the plaintiff who as a passenger on one of the subsidiaries' streetcars, had been negligently injured.⁴⁰ In *Walkovszky v. Carlton*,⁴¹ another taxi-cab case, the court referred to Berle and concluded that, at most, liability could be extended to the enterprise not to the individual shareholders. However, given the words of the court, it is evident that even in this case, the court drew its conclusion from factors such as undercapitalization and intermingling of the corporation's affairs, rather than solely from artificially fragmenting an enterprise by incorporating its parts.⁴²

34. PHILLIP I. BLUMBERG, *THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS* 130-32 (1987) [hereinafter BLUMBERG, *SUBSTANTIVE LAW*]; Blumberg, *Corporate Entity*, *supra* note 14, at 290.

35. Adolf A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343 (1947).

36. As Berle stated, "the court may assign the liabilities of the paper fragment to the economic whole." *Id.* at 354. See Baker, *supra* note 19, at 271; Krendl, *supra* note 1, at 15.

37. See *infra* part IV.B.3.b.ii to IV.B.3.c.

38. *Walkovszky v. Carlton*, 223 N.E.2d 6 (N.Y. 1966); *Mull v. Colt Co.*, 31 F.R.D. 154 (S.D.N.Y. 1962); *Teller v. Clear Service Co.*, 173 N.Y.S.2d 183 (N.Y. Sup. Ct. 1958); *Mangan v. Terminal Transp. Sys., Inc.*, 286 N.Y.S. 666 (N.Y. App. Div. 1936). A good description of these cases is provided in *Teller*, 173 N.Y.S.2d at 187-90.

39. 155 N.E. 58, 61 (N.Y. 1926).

40. Judge Cardozo's result might have been influenced by the fact that personal shareholder liability would implicitly have subjected the shareholder to criminal prosecution and fines. *Id.* at 60; PRESSER, *supra* note 4, § 1.03, at 1-19 to 1-20; Krendl, *supra* note 1, at 10.

41. 223 N.E.2d at 8, 10.

42. *Id.* at 10.

Most other theories, as opposed to Professor Berle's enterprise entity theory, focus on the creditor's point of view. For example, Professor Wormser stated that the legal fiction of a corporation's separate existence is a state-conferred privilege that can be used only for legitimate purposes within its reasons and policies.⁴³ Accordingly, the veil should be pierced to achieve justice and to prevent shareholders from evading their legal obligations. Furthermore, Wormser believed the rules for disregarding this privilege could not be confined to statutory regulations because of the complexity of the relations involved.⁴⁴

Professor Wormser's thoughts may have come close to acceptance in California. Courts in California are believed to pierce the veil more readily than in other jurisdictions.⁴⁵ The courts apply a two-prong test,⁴⁶ commonly referred to as the "alter ego" doctrine.⁴⁷ This test requires: (1) a unity of interest between the shareholders and their entity so that a separation of them no longer exists and (2) an inequitable result would follow if the acts objected to by the creditors were only treated as those of the corporation.

A somewhat similar approach is taken by Professor Powell, who suggests applying a three-prong test, generally called the "instrumentality rule."⁴⁸ This rule was adopted for the first time in *Lowendahl v. Baltimore & Ohio R.R.*⁴⁹ The requirements of Powell's test are (1) control or complete domination of an entity, (2) fraud or wrong committed by the use of this control or domination, and (3) injury or loss suffered by the plaintiff caused by the aforesaid act.⁵⁰ The test was originally developed for parent-subsidiary situations, but many courts apply it to other situations involving the domination of an entity.⁵¹

Powell also offered a list of eleven key-factors⁵² to assist in determining when a corporate veil may be lifted. Other factors have been subsequently added.⁵³ Common features among these additional factors allow them to be grouped into three fact patterns. These are situations of control or domination,

43. I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 8-9 (1927); PRESSER, *supra* note 4, § 1.03, at 1-24.

44. PRESSER, *supra* note 4, § 1.03, at 1-26; WORMSER, *supra* note 43, at 37-38.

45. PRESSER, *supra* note 4, § 2.05, at 2-34.

46. *E.g.*, *Automotriz del Golfo de California S. A. de C. V. v. Resnick*, 306 P.2d 1, 3 (Cal. 1957); *Associated Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 813 (Cal. Dist. Ct. App. 1963).

47. BLUMBERG, SUBSTANTIVE LAW, *supra* note 34, § 6.03.

48. PRESSER, *supra* note 4, § 1.03, at 1-27; FREDERICK POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATIONS OF ITS SUBSIDIARY 4-6 (1931).

49. 287 N.Y.S. 62, 76 (N.Y. App. Div. 1936). *See Fisser v. International Bank*, 282 F.2d 231, 238 (2d Cir. 1960); BLUMBERG, SUBSTANTIVE LAW, *supra* note 34, at 112.

50. BLUMBERG, SUBSTANTIVE LAW, *supra* note 34, § 6.02, at 112-17; Krendl, *supra* note 1, at 15-22.

51. Krendl, *supra* note 1, at 24-27. "Stock ownership, however, is not an absolute requirement for piercing the veil. . . . [T]he dominant party must have some beneficial interest in the subservient corporation." *Id.* at 24.

52. PRESSER, *supra* note 4, § 1.03, at 1-29; Krendl, *supra* note 1, at 16-17.

53. *See Associated Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 813-14 (Cal. Dist. Ct. App. 1963); PRESSER, *supra* note 4, § 2.05, at 2-27; WORLD INVESTMENT REPORT, PARENT-AFFILIATE RELATIONS AND RESPONSIBILITIES 193, 195 (1993) [hereinafter WIR 1993].

undercapitalization, and commingling of assets or disregard of corporate formalities. It is within these contexts where issues of piercing the veil arise.⁵⁴

3. Summary

The doctrines of alter ego and instrumentality are the tests applied by most courts today and are often viewed as interchangeable.⁵⁵ Both of these tests have the common elements of control and fraud (injustice or unfairness perpetrated on the creditor). These elements are prevalent where domination, undercapitalization, commingling of assets, or disregard of corporate formalities appear. However, the existence of one of these criteria alone is often not sufficient to justify piercing the veil.⁵⁶ For example, most courts will refer to undercapitalization with respect to the element of fraud, wrongdoing, or injustice. Likewise, domination and commingling of assets or disregard of corporate formalities might establish the factor of control of an entity as the first prong.⁵⁷

In contrast to the alter ego doctrine, the instrumentality rule has an additional element of causation⁵⁸ regarding the loss suffered by the creditor. Insolvency of the debtor company may demonstrate this causation. However, insolvency is present in most cases involving the issue of piercing the veil, otherwise, the indebted entity would be able to meet its obligations. Accordingly, the courts generally do not include this element.⁵⁹

B. German law

1. General

After an extensive elaboration by Rolf Serick, the term *Durchgriffshaftung* was discussed emphatically by many commentators.⁶⁰ However, the courts had previously recognized that in certain circumstances a company's separate entity should be disregarded.⁶¹ Various legal scholars, in their discussions of the past

54. *Gallagher v. Reconco Builders, Inc.*, 415 N.E.2d 560, 564 (Ill. App. Ct. 1980); Thompson 1994, *supra* note 5, at 9.

55. *Consumer's Co-Op of Walworth County v. Olsen*, 419 N.W.2d 211, 217-18 (Wis. 1988); BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, § 6.01, at 11.

56. *Anderson v. Abbott*, 321 U.S. 349, 362 (1944); BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, § 6.03, at 122; PRESSER, *supra* note 4, § 1.05, at 1-44 to 1-45; Krendl, *supra* note 1, at 22. "[T]here appears to be no single determinative factor," accordingly, it is not appropriate to regard the factor of undercapitalization as a distinct doctrine, but rather as an important factor. *Id.* at 22.

57. *Laborers Clean-Up Contract Admin. Trust Fund v. Uriarte Clean-Up Serv., Inc.*, 736 F.2d 516, 524 (9th Cir. 1984); *Consumer's Co-op*, 419 N.W.2d at 217.

58. Causation is not required by those courts using the two-prong alter ego test. See *Vuitch v. Furr*, 482 A.2d 811, 816, 820 (D.C. 1984).

59. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, § 6.02, at 117.

60. ROLF SERICK, *RECHTSFORM UND REALITÄT JURISTISCHER PERSONEN* (1980). See HACHENBURG, *supra* note 9, at Anh. § 13, m.no. 27; SCHMIDT, GESELLR, *supra* note 9, at 190; *infra* part II.B.1.

61. Both the *Reichsgericht* (RG), and its successor the *Bundesgerichtshof* (BGH), recognized that a separate entity could be disregarded in numerous cases. See Judgment of Oct. 22, 1987, BGH, 102 Entscheidungen des Bundesgerichtshofes in Zivilsachen [BGHZ] 95, 103; Judgment of Nov. 7, 1957, BGH, 26 BGHZ 31, 37; Judgment of Jan. 30, 1956, BGH, 20 BGHZ 4, 11; Judgment of July 3, 1953, BGH, 10 BGHZ 205, 207; Judgment of Nov. 30, 1937, RG, 156 Entscheidungen des Reichsgerichts in Zivilsachen [RGZ] 271, 277; Judgment of Oct. 21, 1921, RG, 103 RGZ 64, 66; Judgment of June 22, 1920, RG, 99 RGZ 232, 234.

thirty-five years, have not provided specific requirements as to when a company's veil may be lifted. Mainly they have attempted to give a dogmatic justification for the imposition of liability on the owners of an entity.⁶²

As in American law,⁶³ there are many situations where a company's limited liability is disregarded on other legal grounds than that of piercing the veil.⁶⁴ This occurs where the behavior of an equity owner creates his or her individual liability.⁶⁵ For example, an entity's owner may be personally liable as a surety or guarantor for the entity's obligations. Alternatively, he or she may have concluded a contract in an individual capacity, rather than as shareholder or member of an entity.⁶⁶ Also, an entity's owner may be liable under the statutory provisions regarding civil torts if a creditor incurred detriments inflicted by tortious acts of the owner.⁶⁷

Durchgriffshaftung refers to situations not governed by statutory or other legal rules in which an entity's existence is disregarded and the owner is held individually liable for the obligations of the company.⁶⁸ This does not negate the legal entity itself even if the veil is pierced.⁶⁹

In general, owners will be individually liable for the company's debts only if bankruptcy proceedings are commenced.⁷⁰ Accordingly, *Durchgriffshaftung* is commonly understood as a complementary and ultima-ratio liability of a shareholder.⁷¹ From a creditor's point of view, a shareholder's individual liability resulting from piercing the veil does not become relevant until the debtor company faces financial hardship. Only under such a condition will the facts leading to a shareholder's liability typically become evident.

The federal *Bundesgerichtshof* is the highest court in civil matters. Germany has one jurisdiction consisting of courts on a state level (*Amtsgericht*, *Landesgericht*, and *Oberlandesgericht*) and the federal BGH.

62. See *infra* parts II.B.1 to II.B.2.

63. See *supra* part II.A.1.

64. Judgment of Dec. 14, 1959, BGH, 31 BGHZ 258, 271; Case Comment, 1977 NJW 1683. In this case, the court referred to several possible theories under which the plaintiff was seeking the defendant's personal liability. *Id.* HACHENBURG, *supra* note 9, at Anh. § 13, m.nos. 3-18; ROWEDDER, *supra* note 15, § 13, m.no. 25; SCHOLZ, *supra* note 9, § 13, m.nos. 26-35; SCHMIDT, GESELLR, *supra* note 9, at 194-99; Rudolf Nirk, *Zur Rechtsfolgenseite der Durchgriffshaftung*, in Festschrift für Walter Stimpel 449-54 (1985).

65. BAUMBACH, *supra* note 10, § 13, m.no. 14; HACHENBURG, *supra* note 9, at Anh. § 30, m.nos. 25-34; ROWEDDER, *supra* note 15, § 13, m.no. 25.

66. Where an owner or shareholder does not make clear that he or she acts on behalf of the entity, legal theories such as *venire contra factum proprium* or *culpa in contrahendo* may be applied. See PALANDT-HEINRICH, BÜRGERLICHES GESETZBUCH [BGB] § 242, m.nos. 55-57, § 276, m.nos. 65-103 (50th ed. 1991).

67. *Id.* §§ 823-826. For example, in *Architekten*, 1979 NJW 2104, the *Bundesgerichtshof* imposed personal liability on the defendant as the sole member and owner of a GmbH & Co.KG (a Co.KG is a limited partnership with a GmbH as a general partner. A limited partnership is referred to as a *Kommanditgesellschaft* (KG)). HANDELSGESETZBUCH [HGB] § 161. In *Architekten*, the Co.KG was inadequately capitalized. See *infra* note 173 and accompanying text.

68. BAUMBACH, *supra* note 10, § 13, m.no. 10; Hübner, *supra* note 15, at 703; LUTTER, *supra* note 10, § 13, m.no. 8; ROWEDDER, *supra* note 15, § 13, m.no. 24; SCHOLZ, *supra* note 9, § 13, m.no. 36.

69. SCHMIDT, GESELLR, *supra* note 9, at 190, 194.

70. HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 61; Case Comment, 1986 NJW 188, 192 [hereinafter *Autokran*, 1986 NJW 188]. This case is referred to as *Autokran* and is explained in more detail in the chapter on German *Konzernrecht*, *infra* note 510 and accompanying text. It involved the question of personal liability of the owner of 7 GmbHs that were dominated by him and that all were bankrupt. These GmbHs, therefore, were not able to pay debts owed to the plaintiff. *Id.*

71. Nirk, *supra* note 64, at 461-62.

2. Theories

a. Commentators: Serick, Rehbinder, and Müller-Freienfels

Among commentators,⁷² the most cited scholars are Serick,⁷³ Müller-Freienfels,⁷⁴ and Rehbinder.⁷⁵ However, they do not state prerequisites as to when shareholder liability can be imposed. Instead they offer dogmatic justifications if the legal entity is disregarded.

According to Serick, a shareholder or member of an entity may be personally liable where the entity's form has been abused, if the individual, for example, tries to circumvent statutory or contractual obligations or fraudulently causes damages to third parties.⁷⁶ Consequently, the theory subjectively requires an act of bad faith. A suggested alternative is to focus only on the owner's ascertainable behavior regardless of his intent.⁷⁷

Müller-Freienfels, on the other hand, focuses on particular statutory provisions: here, AktG section 1, paragraph 1, and GmbHG section 13, paragraph 2, that embody the principle of limited liability. He suggests denying application of these sections if the underlying purposes are frustrated.⁷⁸ This theory reduces the application of code provisions under certain circumstances and does so regardless of the shareholder's subjective intent.⁷⁹

Rehbinder's theory comes close to Müller-Freienfels'. Rehbinder's dogmatic justification for imposing shareholder liability is that separation of an entity and its owners would violate the legal system in general.⁸⁰

These theories are quite similar. They differ from each other, mainly with respect to a defendant's subjective intent and whether piercing the veil requires an intentional wrongdoing.

b. Courts

The judiciary⁸¹ normally does not adhere to any one of the above mentioned theories.⁸² The courts express reluctance to disregard the principle of limited liability.⁸³ A subjective theory of abuse, as represented by Serick, was

72. Helmut Haberlandt, *Zur Problematik der Durchgriffshaftung - Identität und Durchgriff*, 1980 *BETRIEBS-BERATER* 847, 848; Hübner, *supra* note 15, at 704; SCHMIDT, GESELLR, *supra* note 9, at 190-91; Nirk, *supra* note 64, at 455.

73. SERICK, *supra* note 60.

74. Wolfram Müller-Freienfels, *Zur Lehre vom sogenannten Durchgriff bei juristischen Personen im Privatrecht*, in *ARCHIV FÜR DIE CIVILISTISCHE PRAXIS* 522 (1957).

75. ECKARD REHBINDER, *KONZERNAUSSSENRECHT UND ALLGEMEINES PRIVATRECHT* 85-130 (1969); Eckard Rehbinder, *Zehn Jahre Rechtsprechung zum Durchgriff im Gesellschaftsrecht*, in *FESTSCHRIFT FÜR ROBERT FISCHER* 579, 579-603 (1979).

76. SCHMIDT, GESELLR, *supra* note 9, at 190; SCHOLZ, *supra* note 9, § 13, m.no. 20.

77. SCHMIDT, GESELLR, *supra* note 9, at 191.

78. *Id.*; HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 38; Hübner, *supra* note 15, at 704, 709; SCHOLZ, *supra* note 9, § 13, m.no. 24.

79. Coing, *supra* note 10, at 1794, 1796.

80. SCHMIDT, GESELLR, *supra* note 9, at 191.

81. For an overview of the decisions, see SCHOLZ, *supra* note 9, § 13 m.nos. 16, 17.

82. BAUMBACH, *supra* note 10, § 13, m.no. 11.

83. *Id.*

rejected because of its narrow focus.⁸⁴ The *Reichsgericht*, as the predecessor of the *Bundesgerichtshof*,⁸⁵ held that a shareholder and his company must be treated as one entity if, in reality, the economic needs and the facts force the judge to ignore the independence of the entity (discussing a GmbH) and its sole member.⁸⁶ The *Bundesgerichtshof* held that the corporate entity can be respected only when its use is consistent with the goals of the legal system.⁸⁷ It may be disregarded only in exceptional cases if required by serious reasons of equity and good faith.⁸⁸

3. Summary

The general statements of the courts are not very conclusive, but they make clear that piercing the veil is decided on a case by case basis.⁸⁹ Consequently, it is commonly agreed that the term *Durchgriffshaftung* does not represent a particular doctrine of law, rather it refers to the problem of personal liability, despite the principle of limited liability as laid down in AktG section 1, paragraph 1, and GmbHG section 13, paragraph 2.⁹⁰

However, as in American law, various fact patterns have evolved. Today it is recognized that they are characterized by either: (1) domination, (2) undercapitalization, or (3) commingling of assets or disregard of corporate formalities.⁹¹ With respect to the first category, German law has specific statutory provisions relating to liabilities within a group of companies, a *Konzern*, which are distinct from the rules of piercing the veil.

III. PIERCING THE VEIL - INDIVIDUAL SHAREHOLDERS

A. Domination of a Company

1. General

Initially, this section investigates whether domination and control justify disregard of the general principle of limited liability. Domination and control

84. Judgment of Jan. 30, 1956, BGH, 20 BGHZ 4, 13.

85. See *supra* note 61.

86. Judgment of June 22, 1920, RG, 99 RGZ 232, 236.

87. 20 BGHZ 4, 14.

88. Case Comment, 1977 NJW 1449, 1449 (citing other court decisions) [hereinafter 1977 NJW 1449]. See also *infra* note 178. In *Typenhaus*, the plaintiff had delivered glass to a GmbH which was in the construction business. The GmbH was formed by the defendant company as sole member and defaulted on the payments. The court refused to pierce the veil for the sole reason of undercapitalization. 1977 NJW 1449, 1450. However, this decision of the court's eighth panel was highly criticized. The second panel, which is normally competent in this area, also criticized the decision. Case Comment, 1977 NJW 1683, 1686 [hereinafter 1977 NJW 1683].

89. BAUMBACH, *supra* note 10, § 13, m.no. 10; ROWEDDER, *supra* note 15, § 13, m.no. 22; SCHOLZ, *supra* note 9, § 13, m.no. 17; Nirk, *supra* note 64, at 456-57.

90. BAUMBACH, *supra* note 10, § 13, m.no. 10; HACHENBURG, *supra* note 9, at Anh. § 13, m.nos. 1, 37; SCHMIDT, GESELLR, *supra* note 9, at 193-94; SCHOLZ, *supra* note 9, § 13, m.no. 25; Nirk, *supra* note 64, at 453.

91. LUTTER, *supra* note 10, § 13, m.nos. 9-14; SCHMIDT, GESELLR, *supra* note 9, at 200; Nirk, *supra* note 64, at 453-54; Karsten Schmidt, *Zur Durchgriffsfestigkeit der GmbH*, 1994 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 837, 838 (1994) [hereinafter Schmidt, *Zur Durchgriffsfestigkeit*]; Stimpel, *supra* note 15, at 607-10.

are certainly the most obvious factors in determining the question of piercing an entity's veil. Thus, both are part of the alter ego and the instrumentality rule.⁹²

Control of an entity can occur in two ways. First, one or more individuals may dominate a company by being the sole or majority owners. Second, an entity may be part of a group of affiliated companies, where it is dominated as a so-called subsidiary by another company, usually named the parent, holding all or the majority of the stock of the subsidiary. Situations involving parent-subsubsidiary companies are the main focus of this paper and are described in detail in a separate section.⁹³ The following pages scrutinize the issue of piercing the veil in the context of individuals as owners of an entity.

2. American law

Courts and commentators generally agree that an individual's mere domination of an entity does not justify disregarding limited liability obtained under corporate law.⁹⁴ This is also true with respect to one-shareholder corporations,⁹⁵ which are not regarded as being against public policy.⁹⁶ Therefore, piercing the veil occurs only if additional factors are shown to a court.⁹⁷ Following the approach of the alter ego and the instrumentality doctrines that are applied in most jurisdictions,⁹⁸ the legal entity will only be disregarded upon the further proof of fraud, inequity, or the like. This may be indicated where a corporation is undercapitalized or conducted on an individual basis rather than a corporate basis, where the shareholders commingle personal and corporate assets or neglect corporate formalities.

Although incorporation by one or just a few shareholders is legitimate, the issue of piercing the veil becomes relevant, aside from parent-subsubsidiary situations, only in the context of one-shareholder or closely held corporations.⁹⁹ The closeness of management and control of an entity in these contexts makes it much easier for the shareholders to manipulate their entity's conduct. Additionally, they are not controlled by other equity owners and may be more inclined to disregard the interests of the subsidiary and creditors. Conversely, shareholders in public corporations are usually passive investors, not involved in the management of the entity. No case is known in which the legal entity fiction of a public corporation has been lifted with liability imposed on the passive shareholders.¹⁰⁰

92. Krendl, *supra* note 1, at 25-27.

93. *Cf.* part III.D.

94. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, § 6.02, at 114; HENN, *supra* note 4, § 147, at 353; Gelb, *supra* note 5, at 8-9.

95. *See, e.g.*, RMBCA § 2.01 (allowing incorporation by only one person).

96. *Amsted Indus., Inc. v. Pollak Indus., Inc.*, 382 N.E.2d 393, 397 (Ill. App. Ct. 1978); BALLANTINE, *supra* note 4, § 128.

97. FLETCHER, *supra* note 4, § 41.35; HENN, *supra* note 4, § 147.

98. *See supra* part II.A.2.

99. Thompson 1991, *supra* note 5, at 1039, 1047.

100. Blumberg, *Corporate Entity*, *supra* note 14, at 289; Easterbrook, *supra* note 5, at 109-10.

3. German law

Domination of an entity by its owners occurs where sole or majority ownership is found. Sole domination, however, is not permitted under AktG section 2, which requires a minimum of five shareholders for incorporation. On the contrary, sole ownership is often found in a GmbH subject to the pertaining provisions,¹⁰¹ where there is no longer a dispute regarding its legality.¹⁰²

Sole or majority ownership alone does not justify disregard of the principle of limited liability,¹⁰³ even where the owner as *Geschaefstfuehrer*¹⁰⁴ is also managing the company.¹⁰⁵ On the other hand, abuse of the legal entity fiction to the detriment of the entity's creditors' will presumably occur more often under these circumstances because there is no mutual control by the owners.

Although the rules of piercing the veil do not differentiate between the number of an entity's owners, in reality they are applied more successfully to sole ownership entities. In this context, relevant factors such as undercapitalization and commingling of assets, as mentioned above, carries more weight.¹⁰⁶ Nonetheless, disregarding the legal entity will be permitted only if other factors, such as those described in the following chapters, can be attached to the entity owners' conduct.

B. Undercapitalization

1. American law

a. General

American courts and legal scholars often state that undercapitalization is a very important factor in determining whether or not to pierce an entity's veil of limited liability.¹⁰⁷ Undercapitalization is most often mentioned in connection

101. For example, GmbHG § 1 expressly states that one or several persons can be members of a GmbH.

102. Formerly, one-member GmbHs were criticized by some authors. Cf. SCHMIDT, GESELLR, *supra* note 9, at 1020-21.

103. LUTTER, *supra* note 10, § 13, m.no. 14; SCHMIDT, GESELLR, *supra* note 9, at 203.

104. See GmbHG § 35, para. 1; see also *infra* note 411.

105. SCHMIDT, GESELLR, *supra* note 9, at 1034.

106. ROWEDDER, *supra* note 15, § 13, m.no. 24.

107. *Anderson v. Abbott*, 321 U.S. 349, 362 (1944); *Lowell Staats Mining Co. v. Pioneer Uravan, Inc.*, 878 F.2d 1259, 1263 (10th Cir. 1989). *McCracken v. Olson Co.*, 500 N.E.2d 487, 491, 492 (Ill. App. Ct. 1986). The plaintiff tax attorney pierced the veil after he performed legal services for the corporation. The defendant was the sole owner of the corporation and was engaged in seventeen corporations with assets totaling \$75 million. However, the debtor corporation was capitalized with only \$1,000,000 and the defendant had commingled personal and corporate assets and had disregarded corporate formalities. *Id.* *Gallagher v. Reconco Builders, Inc.*, 415 N.E.2d 560, 564-654 (Ill. App. Ct. 1980) The court pierced the veil where the sole owner of a corporation having assets of no more than \$1,000 violated obligations amounting to about \$31,000 arising out of a construction contract with the plaintiff and the corporation. The court found corporate formalities had been disregarded and as to the element of unfairness, it was sufficient that the defendant had made false financial statements to other creditors in order to obtain more funds. *Id.* *Amsted Indus., Inc. v. Pollack Indus., Inc.*, 382 N.E.2d 393, 399 (Ill. App. Ct. 1978); *Service Iron Foundry, Inc. v. M. A. Bell Co.*, 588 P.2d 463, 473, 475 (Kan. Ct. App. 1978); LATTY, *supra* note 28, at 120, 121; Gelb, *supra* note 5, at 2, 3; Hackney, *supra* note 21, at 859; Krendl, *supra* note 1, at 34-38; Thompson 1991, *supra* note 5, at 1065; see *infra* part III.B.2.d.

with the prong requiring a showing of fraud, injustice, or unfairness.¹⁰⁸ The undercapitalization factor is especially relevant since most states have no statutory minimum stated capital, thus leaving piercing the veil as the only protection for corporate creditors.¹⁰⁹ However, the statutes' silence on this issue does not mean that inadequate capitalization is tolerated or without any impact.¹¹⁰ It is recognized that insufficient capitalization is a problem beyond the capacity of statutes. Accordingly, a minimum stated capital is not prescribed in most jurisdictions.

Furthermore, mere undercapitalization alone is not sufficient to justify piercing the veil.¹¹¹ In the various theoretical approaches,¹¹² it generally is necessary from a creditor's point of view to show some fraud, injustice, unfairness, or wrongdoing on the part of the corporate defendant.¹¹³ Thus, there has to be a misuse of the corporate form that may be shown by a shareholder's misrepresentation as to his corporation's capital.¹¹⁴

An additional reason for requiring elements beyond undercapitalization may be that corporate law generally permits investor shareholders to limit their liability, whereas a theory of piercing the veil subjects the shareholders to unlimited liability.¹¹⁵ Accordingly, the shareholders are not only liable to the extent of their investment, which might justify personal liability solely for the reason of undercapitalization. In contrast, by applying rules of piercing the veil the owner will be liable for the full amount owed by the company; this liability is not limited by the amount of his investment capital.

A situation, although similar to piercing the veil, must be clearly distinguished. This situation arises when a shareholder has made a loan to the corporation or has any other claim against the company. This claim will be subordinated to other corporate creditors in bankruptcy proceedings if the corporation is undercapitalized.¹¹⁶ This is true where the shareholder received

108. See *supra* part II.A.2.

109. E.g., RMBCA §§ 2.02, 6.01, cmt. to § 6.21; DEL. CODE ANN. tit. 8, §§ 102, 151 (1992); Gelb, *supra* note 5, at 3 n.12.

110. Hackney, *supra* note 21, at 852-54, 857.

111. *Gartner v. Snyder*, 607 F.2d 582, 586, 588 (2d Cir. 1979); *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 687 (4th Cir. 1976); *Fisser v. International Bank*, 282 F.2d 231, 240 (2d Cir. 1960); *Associated Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 816 (Cal. Dist. Ct. App. 1963); *Consumer's Co-Op of Walworth County v. Olsen*, 419 N.W.2d 211, 216, 217 (Wis. 1988); FLETCHER, *supra* note 4, § 41.30; PRESSER, *supra* note 4, § 1.05 at 1-45, § 2.05, at 2-19; Gelb, *supra* note 5, at 12; Hackney, *supra* note 21, at 884, 885; Krendl, *supra* note 1, at 37-38; *Should Shareholders be Personally Liable for the Torts of Their Corporations?*, 76 YALE L.J. 1190, 1193-94 (1967).

112. See *supra* part II.A.2.

113. *Lowell Staats Mining Co. v. Pioneer Uravan, Inc.*, 878 F.2d 1259, 1264 (10th Cir. 1989); *DeWitt Truck Brokers*, 540 F.2d at 687; *Gallagher v. Reonco Builders, Inc.*, 415 N.E.2d 560, 565 (Ill. App. Ct. 1980); FLETCHER, *supra* note 4, § 41.30; Blumberg, *Corporate Entity*, *supra* note 14, at 361 n.317.

114. Hackney, *supra* note 21, at 865.

115. *Id.* at 887-88.

116. This rule is referred to as the "Deep Rock" doctrine and was applied in *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (1939). See also *Costello v. Fazio*, 256 F.2d 903, 909, 910 (9th Cir. 1958) A shareholder converted capital contributions into loans that the court subsequently subordinated to general creditor claims. *Id.* *Tanzi v. Fiberglass Swimming Pools, Inc.*, 414 A.2d 484, 488, 489 (R.I. 1980); FLETCHER, *supra* note 4, § 41.55; Gelb, *supra* note 5, at 17; Hackney, *supra* note 21, at 859, 879-83.

something from the company without giving adequate consideration.¹¹⁷ In such a situation, the rules of fraudulent conveyances oblige the shareholder to give back to the company what was previously received. Although theories of piercing the veil do not apply here, a court might consider the same factors deemed to be necessary for piercing the corporate veil.¹¹⁸

b. Definition

Undercapitalization in the context of piercing the veil refers to the net assets¹¹⁹ of a company that are available to satisfy creditors.¹²⁰ Formulas used by the courts state that the capital of a corporation should not be "inadequate," "grossly inadequate," "purely nominal."¹²¹ Additionally, "shareholders should in good faith put at the risk of the business unencumbered capital adequate for its prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege."¹²²

The amount of capital deemed to be sufficient cannot be determined precisely by shareholders. In order to avoid personal liability, they should make an investment which gives their business a reasonable chance.¹²³ In this context, the magnitude of the business and the corporate undertaking,¹²⁴ including its prospective liabilities arising from contract and tort, must be examined and anticipated by the shareholders. However, shareholders are not guarantors of their business with respect to creditors. Therefore the capital does not have to provide for the enterprise's likelihood of success.¹²⁵

To illustrate, the courts found undercapitalization in cases with capital of \$3,000 and annual gross revenues of \$200,000;¹²⁶ capital of \$5,000 with \$150,000 in monthly revenues;¹²⁷ and where the capital of \$10,000 faced

117. HENN, *supra* note 4, § 147, at 354.

118. *Consumer's Co-Op of Walworth County v. Olsen*, 419 N.W.2d 211, 215 (Wis. 1988); Hackney, *supra* note 21, at 854-60.

119. Net assets are distinguished from capital. For example, insurance benefitting third parties might also be considered. See Gelb, *supra* note 5, at 12, 13.

120. Easterbrook, *supra* note 5, at 113; Hackney, *supra* note 21, at 890.

121. *Baird Ward Printing Co. v. Great Recipes Publishing Assoc.*, 811 F.2d 305, 308 (6th Cir. 1987). The court found no undercapitalization where a corporation, acting as a general partner in a limited partnership, had debts amounting to \$700,000 and was initially capitalized with \$50,000 and later with \$250,000. *Id.*; *Northern Illinois Gas Co. v. Total Energy Leasing Corp.*, 502 F. Supp. 412, 417 (N.D. Ill. E.D. 1980); Gelb, *supra* note 5, at 14.

122. *Consumer's Co-Op*, 419 N.W.2d at 216; BALLANTINE, *supra* note 4, § 129, at 303.

123. Hackney, *supra* note 21, at 892.

124. *Anderson v. Abbott*, 321 U.S. 349, 362 (1944).

125. Hackney, *supra* note 21, at 897, 898.

126. *Tanzi v. Fiberglass Swimming Pools, Inc.*, 414 A.2d 484, 490 (R.I. 1980). Additionally, the court found complete control and for these reasons the court viewed loans the shareholder had given to his company as equity contributions rather than bona fide loans. It also disallowed the shareholder to demand repayment when his company went bankrupt. *Id.* at 488.

127. *Automotriz del Golfo de California S.A. de C.V. v. Resnick*, 306 P.2d 1, 4 (Cal. 1957). The court pierced the veil where the plaintiff had sold cars to the incorporated defendants. Despite the gross monthly revenues, the defendants did not follow any corporate formalities, nor had they issued stock. *Id.*

several millions of dollars in annual income.¹²⁸ In *Washington National Corp. v. Thomas*,¹²⁹ the court pierced the subsidiary's veil that had capital of \$150,000, but received \$100,000 annually from the parent corporation in order to pay off its debts.¹³⁰

Generally, companies are not required to look for experts' advice on how much capital is adequate for their venture. However, in *Sabine Towing & Transportation Co. v. Merit Ventures, Inc.*,¹³¹ the court disregarded the principle of limited liability because the subsidiary had put up only \$300,000 in capital when the president, before hired, advised the parent to equip the subsidiary with \$800,000 in capital.¹³² Consequently, the court concluded that the parent was bound by the expertise of its own president, who was the only person having knowledge of the subsidiary's business of marine transportation.

c. Voluntary and Involuntary Creditors

In piercing the veil cases, courts often distinguish between tort and contract creditors. Since contract creditors voluntarily entered into a contract with an undercapitalized company they may not assert wrongdoing because they had the chance to investigate the financial situation of the prospective debtor.¹³³ This argument is applicable to sophisticated creditors, such as banks or business people, who are expected to know the practice in a particular industry.¹³⁴ Tort creditors, without previous opportunities to inspect a debtor's background, will more likely prevail when trying to pierce a company's veil.¹³⁵ The distinction will become clear in the following cases.

In *United States v. Jon-T Chemicals, Inc.*,¹³⁶ the court reasoned that a tort creditor had involuntarily assumed his position. Therefore, the creditor was not required to show fraudulent practices on the part of the defendant parent corporation, in addition to showing undercapitalization.¹³⁷

In *Abraham v. Lake Forest, Inc.*,¹³⁸ the plaintiff entered into a land-option contract with a subsidiary which had been founded by the parent for the sole purpose of this transaction. When the subsidiary defaulted on contractual payments, it only had capital of \$1,000 and faced debts of \$790,000 which were incurred in this transaction. While the court found undercapitalization, it did not

128. *United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 694 (5th Cir. 1985).

129. 570 P.2d 1268 (Ariz. Ct. App. 1977).

130. *Id.* at 1274. In addition, the court found that the subsidiary "deliberately was programmed to lose large sums of money" and thus was dependent upon the parent. According to the court, injustice would result if the parent was able to avoid liability. *Id.*

131. 575 F. Supp. 1442 (E.D. Tex. 1983).

132. *Id.* at 1447.

133. Gelb, *supra* note 5, at 10 n.43; Krendl, *supra* note 1, at 45, 46; Thompson 1994, *supra* note 5, at 12, 13. Some courts expressly apply the doctrines of estoppel and waiver. *Cf. infra* note 139.

134. Hackney, *supra* note 21, at 861-62; Gelb, *supra* note 5, at 13.

135. FLETCHER, *supra* note 4, § 41.85, at 712; Hackney, *supra* note 21, at 901; *Should Shareholders be Personally Liable for the Torts of Their Corporations?*, *supra* note 111, at 1196, 1198 (suggesting unlimited liability of active shareholders in closely held corporations where the corporation is found to be undercapitalized).

136. 768 F.2d 686 (5th Cir. 1985).

137. *Id.* at 692. *See also* *Edwards Co. v. Monogram Indus., Inc.*, 730 F.2d 977, 982 (5th Cir. 1984).

138. 377 So. 2d 465 (La. Ct. App. 1980).

pierce the subsidiary's veil concluding that the plaintiff was a voluntary creditor with the knowledge that subsidiaries often are incorporated for singular projects. The plaintiff had not relied on the financial stability of the debtor, but rather on the success of the intended construction project. Similar reasons were given in *Bostwick-Braun Co. v. Szews*¹³⁹ and *Brunswick Corp. v. Waxman*.¹⁴⁰ Both cases involved situations of undercapitalization where the veil was not lifted.

In *Sabine Towing & Transportation Co. v. Merit Ventures, Inc.*,¹⁴¹ the court pierced a subsidiary's veil where it had entered into a contract with the creditor for the use of several of the creditor's ships. Although the subsidiary had capital of \$300,000, it was undercapitalized¹⁴² compared to its business. Consequently, it obtained bank loans for which the parent company pledged securities.¹⁴³ Shortly before the subsidiary went bankrupt, the parent caused the subsidiary to make payments to the bank, relieving the parent's debt to the bank.¹⁴⁴ The parent also obtained the \$300,000¹⁴⁵ it had loaned to the subsidiary for capital. The court held that the parent dealt unjustly with the subsidiary's creditors. Consequently the court granted the creditors payment from the parent corporation.¹⁴⁶

Again, in *Washington National Corp. v. Thomas*,¹⁴⁷ a contract creditor pierced an undercapitalized subsidiary's veil. Because of other contracts with corporations of the same group, the company never really had a chance to make any profits. Therefore, liability was imposed on the parent that assumed the subsidiary's debts. Otherwise, "the corporate fiction would work grave injustice upon the appellees [creditors]."¹⁴⁸

Courts may distinguish between various contract creditors holding that certain contract creditors, being commercially inexperienced, such as workers, employees, consumers, small-scale vendors, and utilities required to serve every customer, lack sufficient bargaining power and should be treated as involuntary

139. 645 F. Supp. 221, 226 (W.D. Wis. 1986) The court held that the plaintiff knowingly entered into a contract with his debtor corporation. Furthermore, the plaintiff had failed to exercise the opportunity to inspect the corporation's financial sheets which he contractually had been entitled to, and at the same time, had continued doing business with the debtor corporation. *Id.* It is noteworthy that the court applied the doctrines of estoppel and waiver to the plaintiff's behavior and concluded that he thus was precluded from asserting the corporation's undercapitalization. *Id.* at 226-27. This was affirmed in *Consumer's Co-op* where a creditor extended credit to the debtor corporation despite his knowledge of the financial problems of the debtor corporation and the extension was against its own policies. 419 N.W.2d 211, 212, 213, 216, 221 (Wis. 1988) (quoting *Bostwick-Braun Co.*, 645 F. Supp. at 226.

140. 599 F.2d 34 (2d Cir. 1979). The court decided that piercing the veil would not accomplish justice or fairness since the creditor entered into a contract with the debtor corporation with knowledge of all the circumstances. The debtor corporation, which had no significant assets, and furthermore, had been formed for the sole purpose to assume the buyer obligations in this contract for the sale of bowling alleys. *Id.* at 36.

141. 575 F. Supp. 1442 (E.D. Tex. 1983); see also *supra* part III.B.1.b.

142. 575 F. Supp. at 1447.

143. *Id.* at 1445.

144. *Id.* at 1448.

145. *Id.*

146. *Id.* The court finally awarded damages amounting to more than \$2.1 million. *Id.* at 1450.

147. 570 P.2d 1268 (Ariz. Ct. App. 1977); see also *supra* part III.B.1.b.

148. *Washington Nat'l Corp.*, 570 P.2d at 1274.

tort creditors.¹⁴⁹ Additionally, thorough investigation into the financial stability of a prospective debtor may be too expensive or time-consuming for a prospective creditor.¹⁵⁰ The showing of fraudulent practices or wrongdoing, in addition to undercapitalization, will be less important with respect to these creditors.

d. Legal Consequences

Courts piercing the corporate veil hold liable only those shareholders who actively engaged in their corporation's management.¹⁵¹ Thus, an application of piercing the veil rules is usually not considered relevant with respect to passive investors and publicly held corporations. Generally, disregard of the entity occurs only in the context of closely held or one-shareholder companies where the shareholder conducts the business, rather than being merely a passive investor.¹⁵²

Finally, although capitalization of an entity can be adequate at the beginning of its existence, shareholders might fail to increase the capital and thus do not adapt to changed circumstances when the business has significantly grown.¹⁵³ A court may consider these cases of subsequent undercapitalization as equally relevant.¹⁵⁴

2. German law

a. General

Undercapitalization is the traditional fact pattern where piercing the veil is discussed.¹⁵⁵ There is general agreement that in certain circumstances involving undercapitalization, the limited liability of a corporation should be disregarded and shareholders held personally liable.¹⁵⁶

149. *Consumer's Co-Op of Walworth County v. Olsen*, 419 N.W.2d 211, 217 n.3 (Wis. 1988); BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 77-78; FLETCHER, *supra* note 4, § 41.85, at 712; Blumberg, *Limited Liability*, *supra* note 18, at 618; Gelb, *supra* note 5, at 13; Hackney, *supra* note 21, at 863-64.

150. Easterbrook, *supra* note 5, at 113.

151. Gelb, *supra* note 5, at 18-20; Hackney, *supra* note 21, at 876, 877; *Should Shareholders Be Personally Liable for the Torts of Their Corporations?*, *supra* note 111, at 1190, 1196-97; Thompson 1994, *supra* note 5, at 4, 10, 29.

152. Easterbrook, *supra* note 5, at 109, 110; Hackney, *supra* note 21, at 877; Thompson 1991, *supra* note 5, at 1039, 1047.

153. This notion is not accepted in all jurisdictions and was rejected by the court in *Consumer's Co-op*, 419 N.W.2d at 218-19. However, the court did not decide this question. It applied the doctrines of estoppel and waiver and held that the contract creditor was precluded from bringing such an assertion because it had extended credit to the corporation when the corporation was already indebted to the contract creditor. *Id.* at 221-22.

154. *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 686-87 (4th Cir. 1976); Gelb, *supra* note 5, at 15, 18; Hackney, *supra* note 21, at 898, 899.

155. ROWEDDER, *supra* note 15, § 13, m.no 27.

156. BAUMBACH, *supra* note 10, § 13, m.no. 15; HACHENBURG, *supra* note 9, at Anh. § 13, m.nos. 13, 48, Anh. § 30, m.no. 2; LUTTER, *supra* note 10, § 13, m.no. 9; SCHMIDT, GESELLR, *supra* note 9, at 206, para. b, 208, para. c; SCHOLZ, *supra* note 9, § 13, m.nos. 38-44; Nirk, *supra* note 64, at 454; Stimpel, *supra* note 15, at 607; Hans Thuemmel, *Piercing the Corporate Veil - Germany*, 6 INT'L BUS. LAW. 282, 285 (1978).

Contrary to American jurisdictions, German corporate law requires a minimum stated capital of DM 100,000 for an *Aktiengesellschaft* and DM 50,000 for a GmbH.¹⁵⁷ There is no requirement to find a business with sufficient capital.¹⁵⁸

There is general agreement among economists that the minimum capital adequate for a particular business cannot be determined with sufficient certainty. Accordingly, the legislature has not approved a flexible stated capital requirement based on size and other factors of a business.¹⁵⁹ However, the provisions of the AktG and the GmbH do not allow equity owners, having complied with the statutory minimum requirements, to allocate all further financial risks to their company's creditors.¹⁶⁰

b. Definition of Undercapitalization

As a consequence of the statutory minimum requirements, most commentators distinguish between nominal and material, or qualified, undercapitalization.¹⁶¹ Nominal undercapitalization refers to situations where the statutes' minimum requirements are not met. Material undercapitalization describes patterns in which the owners have invested insufficient amounts beyond these requirements. In regard to material undercapitalization, a formula first used by Ulmer is widely accepted. Under this formula, material undercapitalization is present when the financial equipment of a corporation, including loans given by the shareholders, is insufficient when compared to its business. This is measured by the nature and magnitude of the business.¹⁶²

In contrast, nominal undercapitalization refers to a violation of the minimum capital requirements of the AktG and the GmbHG.¹⁶³ The typical situation, however, is that owners have provided their company with loans, rather than equity capital. Consequently, the loans in bankruptcy proceedings are viewed as stated capital. A lender-shareholder's claim is subordinate to other creditors, and the lender-shareholder has no right to demand payments on the loan.¹⁶⁴ A similar subordination rule exists with respect to an *Aktiengesellschaft*. However,

157. See GmbHG § 5, para. 2; AktG § 7.

158. HACHENBURG, *supra* note 9, at Anh. § 30, m.nos. 10, 50; Ulrich Kahler, *Die Haftung des Gesellschafters im Falle der Unterkapitalisierung einer GmbH*, 1985 BETRIEBS-BERATER 1429, 1433; Karsten Schmidt, *Die Eigenkapitalausstattung der Unternehmen als Rechtspolitisches Problem*, 1984 JZ 771, 777, para. 1 [hereinafter Schmidt, *Die Eigenkapitalausstattung*].

159. HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 6; SCHMIDT, GESELLR, *supra* note 9, at 205; Kahler, *supra* note 158, at 1430, para. 2(b); Schmidt, *Die Eigenkapitalausstattung*, *supra* note 158, at 777.

160. HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 2.

161. HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 9; SCHMIDT, GESELLR, *supra* note 9, at 206; Kahler, *supra* note 158, at 1433; Schmidt, *Die Eigenkapitalausstattung*, *supra* note 158, at 777; Karsten Schmidt, *Insolvenzrisiko und Gesellschaftsrechtliche Haftung*, 1985 JZ 301, 304 [hereinafter Schmidt, *Insolvenzrisiko*].

162. HACHENBURG, *supra* note 9, at Anh. § 30, m.nos. 16, 18; Kahler, *supra* note 158, at 1430; SCHMIDT, GESELLR, *supra* note 9, at 206.

163. Schmidt, *Insolvenzrisiko*, *supra* note 161, at 304, para. 1.

164. HACHENBURG, *supra* note 9, at Anh. § 30, m.nos. 5, 6, 21; Schmidt, *Die Eigenkapitalausstattung*, *supra* note 158, at 777. The applicable provisions are GmbHG §§ 32 (a)-(b). These sections state that a member cannot claim repayment on a loan during bankruptcy proceedings or the member must return to the GmbH any loan payment received during the year prior to the proceedings. Furthermore, GmbHG §§ 30-32 state that amounts necessary to preserve the stated capital shall not be returned to the members or the GmbH.

because of different circumstances,¹⁶⁵ it is required that the shareholder have an "entrepreneurial interest." This interest is shown by holding twenty-five percent or more of the shares.¹⁶⁶ The justification for this threshold is that a share of twenty-five percent gives the owner, under certain circumstances, a decisive voice on important corporate issues that the shareholders' assembly decides with a qualified majority. The size of a share implies that the shareholder is interested in the company to an extent justifying the subordination of a claim for repayment. Cases involving nominal undercapitalization are not decided by theories of piercing the veil and are not pursued further here.

The following cases illustrate the standard for material undercapitalization. Although some of the cases involve entity forms other than a GmbH, this does not have an impact on the definition of material undercapitalization.

The *Oberlandesgericht Hamburg*¹⁶⁷ rejected the liability of shareholders for undercapitalization where two publishers had formed a GmbH for the purpose of editing a new magazine.¹⁶⁸ In addition to the statutory minimum stated capital of DM 50,000, they provided the company with a loan of DM 700,000. The amount of DM 750,000 was sufficient for publication of the initial three editions of the magazine. However, the enterprise was unsuccessful and filed for bankruptcy. The amount of capital was insufficient to satisfy the plaintiff's claim. Consequently, the plaintiff alleged that the shareholders were personally liable. The court rejected the claim, reasoning that DM 750,000 was sufficient to meet all the expenses incurred by the initial editions. Further, it could be reasonably expected that the magazine's success or failure could be predictable after three editions. Taking into account the shareholders' loans, the court found no material undercapitalization. This decision was later cited with approval by the *Bundesgerichtshof* in connection with another case.¹⁶⁹

The *Bundessozialgericht*¹⁷⁰ affirmed qualified undercapitalization in a case¹⁷¹ where the sole shareholder of a GmbH and Co.KG¹⁷² applied for a state benefit to enable creation of new jobs within the company. In his application, the shareholder promised to invest more than DM 700,000 and hire fifteen additional employees. Soon after he obtained the state support of DM 120,000, his company filed for bankruptcy. The court found that the company conducted business of more than DM 1 million per year, but did not have capital

165. For example, the minimum capital (DM 100,000) is higher and there is no sole ownership. Compare *supra* part III.A.2 with *supra* part III.B.1.d. Moreover, the AktG provides for strict rules for the distribution of corporate gains and the procurement and preservation of the stated capital. See SCHMIDT, GESELLR, *supra* note 9, at 738.

166. Case Comment, 1984 NJW 1893 [hereinafter 1984 NJW 1893]; HEINER DRÜKE, DIE HAFTUNG DER MUTTERGESELLSCHAFT FÜR SCHULDEN DER TOCHTERGESELLSCHAFT, EINE UNTERSUCHUNG NACH DEUTSCHEM UND US-AMERIKANISCHEM RECHT 31 (1990); SCHMIDT, GESELLR, *supra* note 9, at 736-37.

167. *Oberlandesgericht* [OLG] signifies a trial court for selected criminal matters and a court of appeals. See also *supra* note 61.

168. Case Comment, 1973 BETRIEBS-BERATER 1231.

169. Commentary, 1977 WERTPAPIER-MITTEILUNGEN 73, 75.

170. The federal *Bundessozialgericht* [BSG] is the highest court of appeals in civil welfare affairs.

171. Case Comment, 1984 NJW 2117.

172. See HANDELSGESETZBUCH [HGB] § 161. A Co.KG is a limited partnership with a GmbH as the general partner. This limited partnership is called a *Kommanditgesellschaft*.

sufficient to meet any obligations without additional revenues. Accordingly, the court allowed the state to receive a repayment of the money because the company did not use the money as stated in the application. For reasons of material undercapitalization, the court held the shareholder personally responsible for the obligations of the limited partnership.

In *Architekten*, the *Bundesgerichtshof*¹⁷³ held there was material undercapitalization where two shareholders formed a GmbH and Co.KG.¹⁷⁴ The shareholders provided the company with capital of DM 30,000¹⁷⁵ in order to contract for the building of forty-one apartments at a fixed price of DM 2,050,000. Because of sharply increasing prices for land, it soon became clear that the fixed price would be insufficient to cover all the expenses. Due to the magnitude of the undertaking, it was equally evident that the investment capital of DM 30,000 would not satisfy claims of all creditors. The court imposed personal liability on the shareholders. However, the court technically did not apply a doctrine of piercing the veil, but based its decision on a statutory provision relating to civil torts (BGB § 826)¹⁷⁶ and concluded the shareholders had acted in bad faith.¹⁷⁷

In *Typenhaus*,¹⁷⁸ the same court refused to impose liability on a company's owner for his clearly undercapitalized GmbH. The court held that mere undercapitalization alone was insufficient to pierce the veil. However, the eighth panel of the *Bundesgerichtshof* rendered this decision. Normally this panel does not decide cases involving corporate and commercial law. Consequently, the second panel, which is generally competent in this area of law, criticized the decision in a later case.¹⁷⁹

The only case¹⁸⁰ in which the *Bundesgerichtshof* disregarded an entity's limited liability based on a theory of piercing the veil involved members of an "eingetragener Verein."¹⁸¹ The members were held liable and were required to pay the increase in rent owed by the association. However, this case is inconclusive¹⁸² because the situation was unusual in that it involved a *Verein*, which, generally pursues no business and is not required to have a stated capital.

c. Legal Consequences

i. Initial and Subsequent Undercapitalization

If the veil is pierced for reasons of undercapitalization, it is well settled that all equity owners are liable. Liability extends to the creditor as opposed to the

173. Case Comment, 1979 NJW 2104 [hereinafter 1979 NJW 2104].

174. See *supra* note 172.

175. The statutory minimum then required stated capital of a GmbH to be DM 20,000 for a general partner plus two times DM 5,000 in the owners' capacity as limited partners.

176. BGB § 826.

177. 1979 NJW 2104, *supra* note 173, at 2105.

178. 1977 NJW 1449, *supra* note 88, at 1450.

179. 1977 NJW 1683, *supra* note 88, at 1686; HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 46.

180. Judgment of July 8, 1970, BGH, 54 BGHZ 222, 222.

181. See BGB §§ 21, 55. A "Verein" can be described as an association of its members who generally are not personally liable for debts of the Verein. See SCHMIDT, GESELLR, *supra* note 9, at 547, 563.

182. HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 43.

entity. Furthermore, liability is not limited to the extent of undercapitalization.¹⁸³ As in American law, a differentiating standard is applied to cases of subsequent undercapitalization where a company initially has sufficient capital but fails to increase the stated capital after its business has significantly enlarged.¹⁸⁴ Here, only active owners participating in the company's management are held liable.

ii. Voluntary and Involuntary Creditors

Courts in Germany have not yet addressed the distinction between voluntary and involuntary creditors as is done in most American jurisdictions.¹⁸⁵ Therefore, a contract creditor may also pierce the corporate veil. However, commentators recognize this problem, and the courts may follow them. Therefore, a creditor, knowing the financial condition of the debtor company, and voluntarily entering into a contract, may not receive a court's approval for imposing shareholder liability, even if inadequate capitalization is clearly present.¹⁸⁶

d. Summary

The object of adequate capitalization is to ensure that the financial equipment of a company is not subject merely to the discretion of the shareholders. The shareholders are not permitted to allocate all financial risks to the company's creditors.¹⁸⁷ However, a creditor has a substantial burden to overcome if it wishes to pierce a company's veil because of material undercapitalization.

The cases show, in the absence of specific statutory rules, that clear stringent case law has not been developed by the *Bundesgerichtshof* and the other highest federal courts in Germany. Therefore, undercapitalization may or may not be sufficient for imposing shareholder liability. According to the dicta of the *Bundesgerichtshof*¹⁸⁸ concerning the decision of the eighth panel in *Typenhaus*,¹⁸⁹ the court may disregard an entity's limited liability solely because of material undercapitalization. If the stated capital, although sufficient to meet the statutory minimum, factually does not provide security for the prospective creditors, the underlying purpose of the statutes regarding the procurement and preservation of equity capital would not be fulfilled.¹⁹⁰

183. HACHENBURG, *supra* note 9, at Anh. § 30, m.nos. 52(a), 60, 62; SCHMIDT, GESELLR, *supra* note 9, at 208, para. bb (the author disagrees and argues for a company's claim against the owners); Nirk, *supra* note 64, at 462.

184. HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 22, 60; LUTTER, *supra* note 10, § 13, m.no. 9; Stimpel, *supra* note 15, at 609, 612. See *supra* part III.B.1.c (discussing the American law in this context).

185. See *supra* parts III.B.1.b-c.

186. DRÜKE, *supra* note 166, at 51-59; HACHENBURG, *supra* note 9, at Anh. § 30, m.no. 65; LUTTER, *supra* note 10, § 13, m.no. 9; Kahler, *supra* note 158, at 1433.

187. Judgment of Dec. 14, 1959, BGH, 31 BGHZ 258, 268; DRÜKE, *supra* note 166, at 33.

188. 1977 NJW 1683, *supra* note 88, at 1686, para. b.

189. 1977 NJW 1449, *supra* note 88, at 1450.

190. HACHENBURG, *supra* note 9, at Anh. § 30, m.nos. 11, 52. See *supra* note 164 (providing a description of these provisions).

C. *Commingling of Assets and Disregard of Corporate Formalities*

1. American Law

Although there is no exact distinction between commingling of assets and disregard of corporate formalities,¹⁹¹ the cases prove that two different fact patterns are involved. First, there are situations where assets can no longer be clearly assigned to either the shareholders or their company. These situations are referred to as commingling of assets. Second, there are situations where the separate identity of equity owners and their company is not evident. For the purpose of this paper these situations are referred to as disregard of corporate formalities.

a. Commingling of Assets

i. Definition

Generally, singular transfers of assets or goods between owners and their corporation do not justify piercing the veil, even if the transfer is below market price or if no compensation is received by the corporation. What is required is a commingling of the corporate books, records, and accounts, creating the impression of a unity of a shareholder and his entity.¹⁹²

If the impression is given that certain items belong to an entity which in fact belong to the shareholder, the shareholder is precluded from asserting ownership in bankruptcy proceedings and the assets are treated as corporate property.¹⁹³ Equally, a shareholder receiving corporate assets, without giving adequate consideration to the corporation is not subject to piercing the veil. She or he must, however, return the goods back to the corporation under the rules of fraudulent conveyance law, if the corporation goes bankrupt.¹⁹⁴ The following cases provide some illustrations.

In *Penick v. Frank E. Basil, Inc.*,¹⁹⁵ the court refused to pierce a subsidiary's veil where an employee, claiming wrongful termination of an employment contract, also sued the parent corporation. The court argued that transactions between the two companies were at arm's length; both maintained separate financial records and there was no commingling or diversion of assets.¹⁹⁶

Similarly, in *Amsted Industries, Inc. v. Pollak Industries, Inc.*,¹⁹⁷ the court refused to pierce the veil. Here, two closely held corporations were dominated by the same individual shareholder, had the same address, telephone number,

191. FLETCHER, *supra* note 4, § 41.30, at 663.

192. *Id.* § 41.50, at 700.

193. *In re Kaiser*, 791 F.2d 73 (7th Cir. 1986). A bankruptcy trustee brought suit against shareholders of a corporation, which owned an amusement park constructed on land personally belonging to the shareholders. The court allowed the plaintiff's claim and treated the land as corporate property because the shareholders, in a disclosure statement, had listed the land as corporate property. *Id.* at 76.

194. *Lowell Staats Mining Co. v. Pioneer Uravan, Inc.*, 878 F.2d 1259, 1265 (10th Cir. 1989); BALLANTINE, *supra* note 4, § 131, at 304; BLUMBERG, *SUBSTANTIVE LAW, supra* note 34, § 20.04., at 506-07.

195. 579 F. Supp. 160 (D.C. 1984).

196. *Id.* at 166.

197. 382 N.E.2d 393 (Ill. App. Ct. 1978).

office, and managing employees. However, the books, accounts, etc. of both corporations were clearly distinguishable from each other.

ii. Detriments to the creditor

Under the theories applied by most courts, a creditor plaintiff must also show the element of fraud or injustice.¹⁹⁸ The mere commingling of assets is insufficient for piercing the corporate veil.¹⁹⁹

In *Vuitch v. Furr*,²⁰⁰ the court found that the affairs of a clinic and a hospital, separately incorporated, but owned by the same doctor, had been confused. Therefore, the court used the alter ego doctrine's²⁰¹ first prong of unity of interest.²⁰² The court further required the plaintiff, who had suffered injuries during her treatment at the clinic, to show some unfairness or injustice perpetrated by the use of the corporate form. The court found certain statutory violations as to overnight policies to be sufficient in this regard.²⁰³ The court held that injustice and unfairness could also be shown by factors other than undercapitalization or insolvency.²⁰⁴

In *In re Palmer Trading, Inc.*,²⁰⁵ a bankruptcy trustee wanted to impose liability on a corporation affiliated with the debtor corporation to claim a tax refund the former corporation had obtained. The trustee was unsuccessful because the court found that the debtor corporation had benefitted from the transactions with the affiliated corporation.²⁰⁶ The court also rejected the assumption that the presence of commingling of assets, per se, would be disadvantageous to a corporate creditor.²⁰⁷

In most cases, courts neglect the element of causation as the third prong of the instrumentality rule.²⁰⁸ Causation requires that the harm to the creditor be the result of the transactions by the defendant owners.²⁰⁹ In contrast, the court in *In re Palmer Trading, Inc.* seems to have applied a stricter theory by underlining the importance of this factor.²¹⁰ However, the creditor sought to impose liability on an affiliated company rather than on the parent,²¹¹ a situation which lacks the vertical chain of command between a parent and a subsidiary. In such a context, it is more likely that commingling of assets is not disadvantageous to a creditor's debtor corporation because no domination by the

198. See *supra* notes 55-71 and accompanying text. Most courts use the doctrines of alter ego or instrumentality to pierce the corporate veil.

199. *Lowell Staats Mining Co. v. Pioneer Uranium, Inc.*, 878 F.2d 1259, 1264 (10th Cir. 1989).

200. 482 A.2d 811 (D.C. 1984).

201. See *supra* notes 46-54 and accompanying text.

202. *Vuitch*, 482 A.2d at 817.

203. *Id.* at 819. The clinic was licensed as an ambulatory center and kept patients overnight.

204. *Id.* at 819.

205. 695 F.2d 1012 (7th Cir. 1983).

206. *Id.* at 1016-17.

207. *Id.* at 1017.

208. See *supra* notes 48-54 and accompanying text.

209. See *supra* notes 48-50 and accompanying text.

210. *In re Palmer Trading, Inc.*, 695 F.2d 1012 (7th Cir. 1983).

211. Two subsidiaries can be regarded as standing next to each other on the same level. It can be said that piercing the veil, in such a context, is applied horizontally. In contrast, if liability of a parent entity is sought, the corporate veil is pierced vertically.

parent is involved. Typically however, where a creditor claims the dominating shareholder's liability, it is clearer that the transactions were to the debtor entity's disadvantage. Therefore, in the present case, the court had reasons for strictly applying the element of causation. However, the court had already rejected the plaintiff's claim because he could not show the element of fraud.

iii. Voluntary and Involuntary Creditors

Courts normally do not differentiate between the various kinds of creditors. The corporation will be liable to contract and tort creditors alike.²¹² Here even contract creditors are not able to distinguish between corporate and shareholder's assets.²¹³

iv. Horizontal and Vertical Liability

A parent corporation will not be liable under a theory of piercing the veil if there is a clear line separating it from its subsidiaries.²¹⁴ However, several subsidiaries will be subject to mutual liability if their assets are indistinguishable from each other.²¹⁵ Limited liability will be disregarded only to the extent a creditor could reasonably have the false impression of the ownership of the entity. Accordingly, limited liability can be disregarded horizontally or vertically, depending on whether liability of another subsidiary or the parent company is sought.²¹⁶

b. Disregard of Corporate Formalities

i. Fact Patterns

Shareholder liability may also be imposed where a creditor was misled as to the identity of the debtor corporation²¹⁷ and thus had reason to believe that it dealt with one company, rather than with several or with an entirely different company.²¹⁸ For example, two corporations might not be distinguishable if they have similar names, though this factor alone is often insufficient.²¹⁹

In *Morgan Bros., Inc. v. Haskell Corp.*,²²⁰ the court pierced the veil. The plaintiff, in a third-party complaint, stated that he ordered goods from "Hanson's Pipe and Supply Company of Arizona" and was answered by "Hanson, Inc." when he claimed for warranties. Both companies had the same address and management people. The court found that "Hanson, Inc." was the parent

212. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, §§ 19.09.2, 19.09.3.

213. *Id.* § 20.04.

214. *Amsted Indus., Inc. v. Pollak Indus., Inc.*, 382 N.E. 2d 393, 397 (Ill. App. Ct. 1978).

215. *Hackney*, *supra* note 21, at 878.

216. *See supra* note 210 and accompanying text.

217. *McFerren v. Universal Coatings, Inc.*, 430 So. 2d 350, 352 (La. 1983). In this case, the plaintiff brought suit on a contract for the installation of an ice skating surface against the debtor corporation and another corporation, where the other corporation was in the same business and not clearly separated by their common president during the negotiations. *Id.*

218. *Id.* at 353 (citing *A-A-A Foundations, Inc. v. Elite Homes, Inc.*, 217 So. 2d 666 (La. Ct. App. 1969)).

219. *Divco-Wayne Sales Financial Corp. v. Martin Vehicle Sales, Inc.*, 195 N.E.2d 287, 289, 290 (Ill. App. Ct. 1963) (quoting *Sexton & Co. v. Library Plaza Hotel Corp.*, 270 Ill.App. 107, 110 (Ill. App. Ct. 1933)).

220. 604 P.2d 1294 (Wash. Ct. App. 1979).

corporation of the company with which the plaintiff had contracted. Because of the similar appearance of parent and subsidiary corporation, the court granted the plaintiff's claim against the parent.²²¹

A plaintiff was successful in *My Bread Baking Co. v. Cumberland Farms, Inc.*²²² The plaintiff delivered baking goods to several retail dairy stores where he had installed his own racks. The case involved the conversion of these racks. The stores were all incorporated and held by the same shareholder family, which owned a milk plant that sold its products in the same stores. The family was represented in all business affairs by the same member that had negotiated with the plaintiff.²²³ In addition to the local stores, the court imposed liability on the milk company although it had no ownership interest in the stores. Since the stores and the milk company operated under the same name, the court held that the businesses were indistinguishable from each other.²²⁴

ii. Extent of Liability

Only those creditors affected by the misperception of a debtor corporation's appearance and identity are allowed to pierce the veil. Without relying on these circumstances, tort creditors will not prevail in these cases.

For example, in *Wiedemann v. Cunard Line, Ltd.*,²²⁵ a tort creditor suffered injuries at a beach while on vacation and brought a claim against the cruise company whose ship took him to the holiday location. The plaintiff creditor alleged that the cruise company's advertisements had given rise to the perception that it was also responsible for the maintenance of the hotel and beach which were actually owned by another corporation. The court held that, although one might have been misled by the defendant's advertisements, this did not have any relation to the damages the plaintiff involuntarily incurred.²²⁶ For the same reason, the fact that the defendant cruise company and the company owning the hotel and the beach had the same parent corporation was irrelevant and did not make the defendant liable for the tortious acts of the other subsidiary.

Courts do not clearly distinguish between fact patterns involving commingling of assets and disregarding corporate formalities. In both situations, a creditor is misled by false impressions relating to the entity. Thus, a court will only allow a horizontal application of piercing the veil if corporate formalities were disregarded among the subsidiaries without the parent's involvement.

2. German Law

Commentators generally distinguish between *Vermögensvermischung* and *Sphaerenvermischung*. *Vermögensvermischung* is where corporate and

221. *Id.* at 1298.

222. 233 N.E.2d 748 (Mass. 1968).

223. *Id.* at 749-50.

224. *Id.* at 752, 753.

225. 380 N.E.2d 932 (Ill. App. Ct. 1978).

226. *Id.* at 938, 939.

individual assets are indistinguishable. *Sphaerenvermischung* is where the identity of the company is unclear.²²⁷

a. Commingling of Assets - *Vermögensvermischung*

i. Definition

The *Bundesgerichtshof* stated in an early case that an entity's limited liability might be disregarded because personal and corporate assets or spheres were commingled.²²⁸ However, this was only in dictum. In the case at bar, the court denied the shareholder's liability.

Previously, the *Oberlandesgericht Karlsruhe* in another case, disregarded a corporation's limited liability because its sole shareholder stated personal assets, consisting of a personal loan and several houses as belonging to the GmbH, which was actually bankrupt.²²⁹ The court concluded that the shareholder had not separated the two different spheres and, therefore, could not assert his personal ownership. The court regarded the individual and the company as one entity.

The *Bundesgerichtshof*, in a more recent case, held that a shareholder's liability requires that assets cannot be clearly assigned to either the company or its shareholders.²³⁰ Therefore, it is necessary that the company's books and records are so unclear that a distinction is impossible.

Consequently, singular asset transfers between a company and its shareholders are insufficient to justify shareholder liability.²³¹ However, assets which cannot be clearly assigned to either a shareholder or the company may be subject to extended liability and a shareholder may be precluded from asserting ownership.²³² Equally, piercing the veil will not occur where a shareholder receives assets that belong to the company. In such a situation, however, the company may have a claim against the shareholder for returning the items to the company if the original transfer rendered the company's stated capital inadequate to meet its obligations.²³³

Imposition of shareholder liability, on the other hand, requires that the shareholder's and the company's ownership are indistinguishable. A court will

227. BAUMBACH, *supra* note 10, § 13, m.no. 15; LUTTER, *supra* note 10, § 13, m.nos. 11, 12; ROWEDDER, *supra* note 15, § 13, m.no. 23; SCHMIDT, GESELLR, *supra* note 9, at 201-03; Nirk, *supra* note 64, at 453; Karsten Schmidt, *Zum Haftungsdurchgriff wegen Sphärenvermischung und zur Haftungsverfassung im GmbH-Konzern*, 1985 BETRIEBS-BERATER 2074, 2075-76 [hereinafter Schmidt, *Zum Haftungsdurchgriff*].

228. Judgment of Nov. 29, 1956, BGH, 22 BGHZ 226.

229. 1943 DR 811.

230. Case Commentary, 1985 NJW 740 [hereinafter 1985 NJW 740]. This was confirmed by the same court. Commentary, 1994 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 867, 867-68. However, personal liability of the GmbH's member was denied because he did not control the entity. See also Schmidt, *Zur Durchgriffsfestigkeit*, *supra* note 91.

231. BAUMBACH, *supra* note 10, § 13, m.no. 15.

232. SCHMIDT, GESELLR, *supra* note 9, at 201-02; Schmidt, *Zum Haftungsdurchgriff*, *supra* note 227, at 2075.

233. See GmbHG §§ 30-31, para. 1; 1985 NJW 740, *supra* note 230; Schmidt, *Zum Haftungsdurchgriff*, *supra* note 227, at 2076; HACHENBURG, *supra* note 9, at Anh. § 13, m.no. 50; Stimpel, *supra* note 15, at 615. This rule is also applicable to an *Aktiengesellschaft* unless the transfer was a regular distribution of corporate profits; Cf. AktG § 58, para. 4.

pierce the corporate veil only if the transfers between a shareholder and the company cannot be traced by viewing the books and records.²³⁴ This was affirmed by the *Bundesgerichtshof* in a decision²³⁵ which has become famous with respect to *Konzernrecht*, the law of affiliated companies.²³⁶ Therefore, the decision of the *Oberlandesgericht Karlsruhe* mentioned above might have a narrower holding today; according to which, the creditor would only be able to seek satisfaction with respect to the assets previously listed in the company's financial sheets. Generally, shareholder liability will depend upon the extent that the assets have been commingled, unless the company's books and records make a distinction impossible which will justify piercing the veil.

ii. Voluntary and Involuntary Creditors

German courts to date have not made a distinction between tort and contract creditors. Therefore, individual liability extends to all creditors whether or not they relied on the corporate appearance regarding its assets. A denial of personal liability with respect to a tort creditor would unjustly enrich a shareholder.

iii. Extent of Liability

German courts have neither focused on whether the corporate veil should only be lifted for the imposition of vertical shareholder liability nor whether it could be disregarded in a situation involving several subsidiaries.²³⁷ However, commentators²³⁸ have addressed the distinction between lifting the corporate veil vertically or horizontally. Following the American approach, they suggest horizontal liability if the assets of subsidiaries were commingled. Consequently, a creditor should be allowed to sue those subsidiary companies, whose assets were not kept separate from the indebted company. The underlying shareholders should not be liable in such a situation. Moreover, a creditor should not be permitted to claim liability against other affiliated entities or owners if the debtor company benefitted from transfers between the entities.

Contrary to the preceding, a parent company will be liable for its subsidiary's debts if a creditor was unable to distinguish clearly between the extent of their ownership. In this situation, the corporate veil would be lifted vertically.

234. Schmidt, *Zum Haftungsdurchgriff*, *supra* note 227, at 2076; Stimpel, *supra* note 15, at 606; LUTTER, *supra* note 10, § 13, m.no. 11; ROWEDDER, *supra* note 15, § 13, m.no. 28.

235. Judgment of Sept. 16, 1986, BGH, 95 BGHZ 330, 333 (holding the owner of several GmbHs personally liable).

236. See *infra* notes 483-554 and accompanying text.

237. In *Autokran*, the *Bundesgerichtshof* concluded the defendant, as sole member of several affiliated GmbHs, was not liable for reasons of commingling personal and companies' assets. The court did not inquire whether the 7 GmbHs were liable for each others' debts. 95 BGHZ 33. Cf. *infra* note 510.

238. E.g., HACHENBURG, *supra* note 9, at Anh. § 13, m.no. 51; Stimpel, *supra* note 15, at 607.

b. Disregard of Corporate Formalities - *Sphaerenvermischung*

i. Definition

A court might also pierce a company's veil where the shareholder and corporation disregard corporate formalities, leading a creditor to misperceive the corporation's identity.²³⁹ This may be the case where a parent and its subsidiary use similar names, staff, rooms, or addresses.²⁴⁰ It is unclear that a creditor is factually dealing with two or several entities. Likewise there is no clear line as to what a corporation and its shareholder own in situations of commingling of assets.²⁴¹

The *Oberlandesgericht Nuernberg* heard a case where a negotiable instrument bore both the signature of a sole proprietor and the GmbH's stamp.²⁴² The signor, who was also the sole member of the GmbH, was not authorized to sign the instrument.²⁴³ However, he operated the sole proprietorship under a quite similar name in the same office. When the creditor having a claim against the GmbH, seized the instrument to satisfy the claim. The signor alleged personal ownership of the instrument, thus denying ownership of the GmbH. The court concluded that even if the signor had personally issued the instrument, and no obligation of the debtor GmbH existed, he nonetheless could not assert his individual ownership because he made no distinction between the conduct of his company and his personal business.

Considering the decisions of the *Bundesgerichtshof*,²⁴⁴ the *Oberlandesgericht Nuernberg's* holding does not seem to be consistent. The *Bundesgerichtshof* held that a corporation and its shareholders might be identified with each other where they did not follow the required formalities. It has been argued however, that the court dogmatically based its holding on a theory of misrepresentation.²⁴⁵ Consequently, a creditor should not be able to pierce the corporate veil if he did not rely on the company's appearance or similar circumstances. Therefore, the reasoning of the *Oberlandesgericht Nuernberg* should be rejected in that case because the GmbH's creditor had only dealt with the GmbH. It had no knowledge of the facts that the court deemed to be necessary to justify piercing the veil and, accordingly, did not rely on any misrepresentation.²⁴⁶ Nonetheless, the court correctly concluded that the instrument was issued by the

239. Schmidt, *Zum Haftungsdurchgriff*, *supra* note 227, at 2075; Nirk, *supra* note 64, at 453; LUTTER, *supra* note 10, § 13, m.no. 12.

240. SCHMIDT, GESELLR, *supra* note 9, at 202, 203.

241. See *infra* notes 257-69 and accompanying text.

242. Commentary, 1955 WERTPAPIER-MITTEILUNGEN 1566.

243. GmbHG § 37 states that the manager is subject to the owner's decision. In contrast to this rule, the member here was obviously not authorized to manage and represent the GmbH. The relationship between ownership and management is described in the context of *Konzernrecht*.

244. Judgment of Sept. 16, 1986, BGH, 95 BGHZ 330; 1985 NJW 740, *supra* note 230; see *infra* notes 259-61 and accompanying text.

245. See DRÜKE, *supra* note 166, at 82-83 (referring to the court's statement at the end of its decision); cf. 1985 NJW 740, *supra* note 230, at 741.

246. See DRÜKE, *supra* note 166, at 82.

company, the debtor GmbH. Accordingly, the GmbH's sole member had no individual rights as to the instrument and the creditor could seize it.

ii. Extent of Liability

If the dogmatic justification is based on a theory of misrepresentation, it follows that only a voluntary creditor should be able to pierce the veil. A tort creditor, not relying on perceptions as to the spheres of an entity and its owner, should not prevail in holding the owner personally liable.²⁴⁷ Liability should follow the extent to which there have been elements of misrepresentation and misleading of creditors.²⁴⁸ Thus, a company's sibling company may be liable for the former's debts if there was no clear distinction as to their particular spheres. If the parent corporation is clearly distinguishable from the subsidiaries, it will not be liable to their creditors and there will be only a horizontal expansion of liability. However, these questions have not been addressed by the courts.

D. Summary

The approaches taken by American and German law, with respect to the issue of shareholder liability, are rather similar. First, in both jurisdictions, the courts developed the rules of piercing the veil and *Durchgriffshaftung*, referring to the topic of shareholder liability for obligations of an entity, without statutory provisions. Second, the fact patterns of domination, undercapitalization, and commingling of personal and corporate assets, and disregard of corporate formalities dominate this context. Third, neither system regards the presence of only one of these patterns as sufficient in order to disregard the legal entity. However, considering the dicta mentioned by the *Bundesgerichtshof* in *Typenhaus*, German courts may pierce the veil where the entity is inadequately capitalized, although no case has been decided solely for this reason.²⁴⁹ Both legal systems agree that domination of an entity by itself does not justify disregarding the principle of limited liability. Accordingly, one-owner entities are permissible and are often found in both countries.

With respect to the factor of undercapitalization, there is a general difference between the jurisdictions. German law provides rules for the procurement and preservation of a stated minimum capital.²⁵⁰ In contrast American statutes require the owners to put up only small amounts. Consequently, owners under German law may be sued more often for returning stated capital or may have their claims for repayments of loans given to the entity instead of capital subordinated.²⁵¹ An American court will resort to piercing the veil rules in a similar context.

247. *Id.* at 86.

248. *Id.*

249. The second panel of the court criticized the eighth panel which previously held that inadequate capitalization is not sufficient. *See supra* notes 177, 178.

250. The minimum requirements are DM 100,000 for an *Aktiengesellschaft* (AktG § 7) and DM 50,000 for a GmbH (GmbHG § 5, par. 1). *See supra* note 157.

251. In American law this concept is referred to as the "Deep Rock" doctrine, *see supra* note 116. The German law is found in GmbHG §§ 30-32. *See supra* note 164.

The justification for the statutory lack of capital minimum requirements given by American commentators is that the problem of an adequate capitalization is one beyond the statutes. Although this is certainly true²⁵² as the German cases indicate it has to be conceded at the same time that capital requirements do provide shelter for corporate creditors. Especially, creditors are secured under the rules of the AktG which provide very strict and precise requirements as to the distribution of corporate gains and the procurement and preservation of the stated capital.²⁵³

It should be recalled that personal shareholder liability in both jurisdictions is an issue practically confined to non-public entities, i.e., mostly closely held corporations in the U.S. and GmbHs in Germany. Neither legal system knows of cases where the veil of a publicly held corporation or an *Aktiengesellschaft* has been disregarded.

Beyond the differences related to a stated minimum capital the rules are quite similar. The factor of an inadequate capitalization for purposes of disregarding a corporate entity will be considered by a court if the capital invested clearly does not accord with the magnitude of the business and its undertaking.

Finally, both legal systems recognize situations involving commingling of assets and disregarding corporate formalities as significant when deciding on the issue of piercing the veil. German law, however, draws a clearer distinction between these different patterns.

Although the main patterns in which the topic of piercing the veil arises are quite similar, the American legal system also focuses on issues the German law does not consider. For example, American courts often concentrate on the question whether or not a creditor voluntarily assumed his position. Furthermore, the relevant factors such as domination or undercapitalization might be weighed differently depending on a creditor's status and, in general, a contract creditor has to overcome more obstacles for stating a cause of action. Similarly, this is true with respect to the issue of lifting the veil horizontally or vertically which might become relevant in cases of commingling assets or disregarding formalities. German courts have yet to address these issues.

One relevant reason is that American courts have addressed the topic of shareholder liability in numerous cases. This may be illustrated by Professor Thompson's article as of 1991 cited several times in this paper.²⁵⁴ Pessor Thompson conducted a survey on the topic of piercing the veil which involved some 1,600 cases dealing with this issue.²⁵⁵ Professor Blumberg in his treatise on the law of corporate groups even listed some 5,500 cases the most of which are related to this issue.²⁵⁶

252. German commentators agree that it is impossible to determine the exact amount of stated capital that is sufficient in this respect. See *supra* notes 185-86 and accompanying text.

253. SCHMIDT, GESELLER, *supra* note 9, at 736, 737. The rules are embodied in AktG §§ 150-76, 179-81. The description of which cannot be achieved within the scope of this paper.

254. Thompson 1994, *supra* note 5, at 1 *passim*.

255. Thompson 1991, *supra* note 5, at 1044.

256. Blumberg, *Corporate Entity*, *supra* note 14, at 328 n.182.

In contrast, German courts have addressed the topic of piercing the veil only very rarely. One reason certainly can be tied to the differences of the judicial systems in both countries. Whereas the United States has its many state and federal jurisdictions, the German system has only one jurisdiction which consists of courts on various levels in the states and the federal *Bundesgerichtshof* as the final authority. The *Bundesgerichtshof* may have issued about 50 decisions which are related to this topic.²⁵⁷ These numbers reveal another main difference of the two legal systems.

With respect to features such as legal certainty, the prediction of the courts' decisions and their consistency, conclusive statements regarding a particular case can be made in neither country. Much like the United States, the presence of multiple jurisdictions, each apply different standards resulting in varying precedents, must be taken into account. Despite the pertaining differences it equally appears that German courts not yet have achieved more stringent rules determining the question of piercing the veil. Another reason presumably is that piercing the veil and *Durchgriffshaftung* are based on case law which inherently involves less legal certainty than statutory provisions providing definitions and rules. This analysis will be confirmed when describing the German rules referred to as *Konzernrecht* as a main part of the following chapter.²⁵⁸ That area of law is based on code provisions which provide rather clear prerequisites as to their application and the legal consequences.

IV. PIERCING THE VEIL - PARENT-SUBSIDIARY SITUATIONS

A. Introduction

Shareholder liability may also be at stake where a company is owned by one or several other companies that form a group of affiliated entities. The approaches undertaken by the American and the German laws are very different. American courts extend the application of the common law rules of piercing the veil. German courts are constrained by statutory provisions embodied in the AktG.²⁵⁹ These provisions are directly applicable to an *Aktiengesellschaft* (a corporation) dominated by other entities. While the AktG does not apply expressly to GmbHs, courts and commentators have extended the statute's application by analogy to a GmbH.²⁶⁰

Under AktG sections 302, 303, and 317, the controlling entity has to assume the subsidiary's liabilities and losses. Accordingly, these sections provide the general presumption that control by a parent company pursuing further business interests outside its subsidiary is disadvantageous and sufficient to justify the controlling entity's duty.²⁶¹ The parent company's liability exists regardless of whether the obligation of the dominated company arose out of contract or tort

257. See generally, SCHMIDT, GESELLR, *supra* note 9, at 187; SCHOLZ, *supra* note 9, § 13, m.nos. 16, 17.

258. *Infra* part IV.C.4.

259. The code provisions referred to in this introduction are described in more detail in the relevant context. See *infra* part IV.C.4.a-b.

260. Maximilian Schiessl, *The Liability of Corporations and Shareholders for the Capitalization and Obligations of Subsidiaries under German Law*, 7 J. INT'L L. BUS. 480, 496 (1986).

261. Peter Ulmer, *Gläubigerschutz im "qualifizierten" faktischen GmbH-Konzern*, 1986 NJW 1579, 1580.

or whether a creditor knew of the dominant relationship affecting the debtor company.

B. American Law

1. General

Domination of a corporation in the context of parent and subsidiary companies, impacting on the latter's creditors, may become relevant in two situations. First, a parent's domination and control over a subsidiary may entitle the latter's creditors to pierce its veil. Obviously, creditors derive a direct benefit in such a context.

Second, a parent company may violate fiduciary duties owed to the subsidiary causing an action for damages. There is an obvious benefit to the subsidiary's minority shareholders as residual corporate beneficiaries because their entity's assets are increased. Although piercing the veil is not involved because the claim for a violation of fiduciary duties is not based upon obligations incurred by the subsidiary, these situations also affect creditors of the subsidiary. Therefore, situations involving a claim against the parent for a violation of fiduciary duties are addressed before turning the focus to the subject of piercing the veil in the context of parent-subsidiary relations.

2. Violations of Duties Owed to a Subsidiary

The dogmatic justification for a parent corporation's and, in general, a majority shareholder's liability to the subsidiary is the violation of fiduciary duties. These include the duties of care and, in the context of affiliated entities, that of loyalty. It is recognized that a majority shareholder owes a fiduciary duty to the corporation and also to minority shareholders when exercising control.²⁶² Equally, a parent company that pursues other business interests outside the dominated corporation within a group of affiliated entities owes these fiduciary duties.²⁶³ Accordingly, the rules applicable to the majority-minority relationship are the same regardless of whether the corporation is independent or dominated by another company having additional business goals.²⁶⁴ Alternatively, if there is no minority shareholder, fiduciary duties do not exist.²⁶⁵

A parent's liability to a subsidiary corporation may arise in two situations. In the first group, only the rights of the minority, but not the rights of the subsidiary, are violated. For example, a majority shareholder may deprive the

262. *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 487-88, 492 (1919); *Banco de Desarrollo Agropecuario, S.A. v. Gibbs*, 709 F. Supp. 1302, 1306 (S.D.N.Y. 1989).

263. *In re Reading Co.*, 711 F.2d 509, 517 (3d Cir. 1983); *Mayflower Hotel Stockholders Protective Comm. v. Mayflower Hotel Corp.*, 173 F.2d 416, 420-23 (D.C. 1949); *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 595 (Del. 1986); *Singer v. Magnavox Co.*, 380 A.2d 969, 976-77 (Del. 1977); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. Ch. 1971); *Gabelli & Co. v. Liggett Group, Inc.*, 444 A.2d 261, 264 (Del. 1982). See *infra* note 266 (describing *Gabelli v. Liggett*); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939).

264. *Pepper v. Litton*, 308 U.S. 295, 306 (1939); *Mayflower*, 173 F.2d at 423; J. Bautz Bonanno, *The Protection of Minority Shareholders in a Konzern under German and United States Law*, 18 HARV. INT'L L.J. 151, 165 (1977).

265. *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171, 1174 (Del. 1988).

minority of its rights to dividends²⁶⁶ or may acquire the minority's shares at too low a price.²⁶⁷ The parent will be held liable to the minority shareholders but not to the subsidiary. As company creditors are not affected, these patterns are of no further interest here.

Second, a parent may violate its duties toward the subsidiary causing indirect damage to the minority shareholders whose shares decrease in value. In this case, the subsidiary is entitled to a claim. However, the shareholders may bring a derivative suit if the subsidiary itself does not act.²⁶⁸ The subsidiary's creditors benefit in a derivative suit because the assets of the debtor corporation are increased.²⁶⁹

The following fact patterns have evolved where a parent corporation might violate fiduciary duties to the subsidiary:

- the parent seizes a business opportunity of the subsidiary;²⁷⁰
- the overpriced transfers from the parent to the subsidiary;²⁷¹
- the subsidiary's exclusion of benefits received by a consolidated tax return of the two entities;²⁷²
- the withdrawal of capital from the subsidiary by extensive dividends.²⁷³

Courts have applied several fairness tests to evaluate whether fiduciary duties were violated. They include: the arm's length test, the lack-of-fraud test, the business judgment rule, and the intrinsic fairness test. These tests are briefly described in the following paragraphs.

The arm's length test,²⁷⁴ which places the burden of proof on the parent, may be applied to transactions between corporations and their directors or officers, and also between parent and subsidiary. The purpose is to determine whether performance and counter-performance are of similar value. In general, a price paid by the parent for goods or services received by the subsidiary is deemed to be fair if it would have been the same in the case of an independent corporation dealing with the parent.²⁷⁵ A court's finding will be relatively easy

266. *Gabelli & Co.*, 444 A.2d at 263. The plaintiff, a minority shareholder, alleged a breach of fiduciary duties by the directors and failure of declaring dividends, which occurred when the company was to merge into another corporation. Therefore, the plaintiff also asserted a breach of fiduciary duties by the prospective parent, a majority shareholder, for causing the board of directors not to declare a dividend. *Id.* Plaintiff failed to state a cause of action because it did not oppose the merger or the merger price. *Id.*

267. *Shivers v. Amerco*, 670 F.2d 826, 828 (9th Cir. 1982); *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 430 (Del. Ch. 1968).

268. *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (explaining that the complaining party must describe with particularity that they made demands on the board of directors, unless the party can show the demands would be futile); *see also Collie v. Becknell*, 762 P.2d 727, 731-32 (Colo. 1988).

269. *Massachusetts v. Davis*, 168 S.W.2d 216, 221 (Tex. 1942).

270. *Collie*, 762 P.2d at 730-31; *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 722 (Del. 1971) (holding that the plaintiff, as minority shareholder of a subsidiary, could not show that the opportunity exercised by the parent had come to the subsidiary).

271. *Gottesman v. General Motors Corp.*, 279 F. Supp. 361 (S.D.N.Y. 1967).

272. *Meyerson v. El Paso Natural Gas Co.*, 246 A.2d 789 (Del. 1967).

273. *Sinclair Oil Corp.*, 280 A.2d at 720-21.

274. *Bonanno*, *supra* note 264, at 166-69; Michael B. Goldberg, Note, *The Fiduciary Duty of Parent to Subsidiary Corporation*, 57 VA. L. REV. 1223, 1226-27 (1971).

275. *Pepper v. Litton*, 308 U.S. 295, 306 (1939); *Epstein v. United States*, 174 F.2d 754, 764 (6th Cir. 1949); *Gottesman*, 279 F. Supp. at 385 (S.D.N.Y.) (giving further references).

if it can resort to comparable market prices. For example, where the parent causes the subsidiary to provide the former with a loan, the parent would be obliged to pay interest at the applicable banks' prime rate or the effective rate, if higher.²⁷⁶ However, in many cases, there will be no applicable market price.²⁷⁷ Consequently, the courts have determined this test to be inapplicable to parent-subsidary transactions.²⁷⁸

In *Gottesman v. General Motors Corp.*,²⁷⁹ a minority shareholder of General Motors asserted that supply parts purchased from DuPont were overpriced. At the time, DuPont held twenty-three percent of the outstanding stock of General Motors and controlled six out of thirty-one, and later five out of thirty-four of the directorates.²⁸⁰ The court found that by virtue of its stock, DuPont had the power to control General Motors.²⁸¹ However, DuPont had not always sold parts to General Motors, and the latter's competitors purchased those parts instead. Also, General Motors purchased other parts from DuPont's competitors.²⁸² The court concluded that the parties dealt at arm's length,²⁸³ under market conditions, and that DuPont had not exercised its power to control²⁸⁴ and had not breached any fiduciary duties.²⁸⁵

Under the lack-of-fraud test, a majority shareholder's conduct is deemed to be fair to the subsidiary and its minority shareholders in the absence of fraud.²⁸⁶ A plaintiff must show that the defendant acted in bad faith to gain an advantage. The test is disadvantageous for a plaintiff because of the burden of proof required. Furthermore, it can be argued that bad faith is not an accurate requirement in these situations because mere control is often sufficient to cause damages to the subsidiary.²⁸⁷ The test applies little judicial scrutiny to the parent's conduct and thus a plaintiff is likely to fail.²⁸⁸ Under the lack of fraud test, some courts have developed a theory of constructive fraud,²⁸⁹ which disregards the element of bad faith if the parent corporation acted in a situation

276. *Maxwell v. Northwest Indus., Inc.*, 339 N.Y.S.2d 347, 355-56 (N.Y.C. 1972).

277. *Goldberg*, *supra* note 274, at 1227.

278. *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 886 (Del. 1970). "It is, of course, obvious that it is impossible, as between parent and subsidiary, to approximate what would have been agreed upon at arm's length." *Id.* *Meyerson v. El Paso Natural Gas Company*, 246 A.2d 789, 794 (Del. Ch. 1967).

279. 279 F. Supp. 361, 364 (S.D.N.Y. 1967).

280. *Id.* at 364-67.

281. *Id.* at 368.

282. *Id.* at 370, 375.

283. *Id.* at 385.

284. *Gottesman v. General Motors Corp.*, 279 F. Supp. 361, 379-80 (S.D.N.Y. 1967).

285. *Id.* at 384.

286. *Epstein v. United States*, 174 F.2d 754, 765-66 (6th Cir. 1949).

287. *Bonanno*, *supra* note 264, at 170; *Goldberg*, *supra* note 274, at 1229.

288. *Bonanno*, *supra* note 264, at 170; *Goldberg*, *supra* note 274, at 1229.

289. *Western Pac. R.R. v. Western Pac. R. Co.*, 197 F.2d 994, 1000 (9th Cir. 1952). In this case, a parent corporation, which had been dominated by its subsidiary, claimed compensation for benefits the subsidiary had received under a consolidated tax return filed by the parent. *Id.* at 998, 1001. The court rejected the claim and found that the governing agreement was fair because the subsidiary, which in the tax return had used the parent's losses to offset against its own taxable income, had not gained anything at the subsidiary's expense. The subsidiary had failed to provide for a compensation clause in the agreement. *Id.* at 1002-04. The decision was affirmed by the Court of Appeals (206 F.2d 495) denying a rehearing for the same reasons and holding that the parent also had no claim under a theory of unjust enrichment. *Id.* at 497-99.

where its own and the subsidiary's interests conflicted with each other.²⁹⁰ This modified test favors the plaintiff by shifting the burden of proof to the defendant parent.

The business judgment rule was developed to assess the behavior of directors and officers of independent corporations. It states the rebuttable presumption that directors and officers act honestly and in good faith if they are (1) disinterested, (2) independent, and (3) informed. If these prerequisites are met, a court will not interfere with management decisions unless a plaintiff can prove some gross and palpable overreaching to the subsidiary's disadvantage.²⁹¹ Consequently, the burden of proof is on the plaintiff. As the following two examples illustrate, this burden is very difficult for a shareholder to overcome this presumption.

In *Case v. New York Central R.R.*,²⁹² a subsidiary profited while its parent incurred losses. Because the parent held more than eighty percent of the outstanding stock of the subsidiary and also occupied all of the latter's major positions, it was entitled to a consolidated tax return under the existing rules of the Internal Revenue Code. The tax return resulted in a tax savings for the subsidiary of about \$3.83 million, of which the parent appropriated \$3.56 million, leaving the subsidiary with only \$270,000.²⁹³ The court applied the business judgment rule and found the agreement to file a consolidated return fair because the parent did not gain anything at the subsidiary's expense.²⁹⁴ Therefore, the court rejected this claim of a minority shareholder of the subsidiary.

In *Meyerson v. El Paso Natural Gas Co.*,²⁹⁵ the parent corporation used the subsidiary's losses in a consolidated tax return and did not share the benefits of the losses with the subsidiary. A minority shareholder brought suit demanding a fair division of the tax benefits.²⁹⁶ The court rejected the claim reasoning that the arm's length test would be inapplicable in parent-subsidiary relations.²⁹⁷ Instead it applied the business judgment rule to the fairness of the tax savings' allocation and held that the rule's boundaries were not crossed.²⁹⁸

Finally, the intrinsic fairness test²⁹⁹ evolved in situations of "interested" directors who are represented on both sides of a transaction involving their corporation. Self-dealing requires that the majority shareholder, by virtue of its

290. *Epstein*, 174 F.2d at 766; *Seagrave Corp. v. Mount*, 212 F.2d 389, 397 (6th Cir. 1954); *Goldberg*, *supra* note 274, at 1228.

291. *Smith v. Van Gorkom*, 488 A.2d 885 (Del. 1985); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971); *Gries Sports Enter., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 963-65 (Ohio 1986).

292. 204 N.E.2d 643 (N.Y. 1965).

293. *Id.* at 645.

294. *Id.* at 646-47.

295. 246 A.2d 789 (Del. 1967).

296. *Id.* at 790.

297. *Id.* at 794.

298. *Id.*

299. This test is also referred to as the "compelling business reason" test. *Shivers v. Amerco*, 670 F.2d 826, 832 (9th Cir. 1982).

control, receives something to the exclusion and detriment of its subsidiary.³⁰⁰ The test also applies where the parent, by virtue of its majority, has the power to dictate an agreement with the subsidiary.³⁰¹ In these situations, the presumption of the business judgment rule³⁰² cannot be maintained. Consequently, the burden of proof is shifted so that directors must show the transaction is fair to both corporations.³⁰³

The intrinsic fairness test is also applicable to fact patterns where a parent seizes a business opportunity of the subsidiary. The test requires a showing that (1) the subsidiary had the financial possibility to exercise the opportunity, (2) the opportunity was within the subsidiary's normal business, and (3) the opportunity resulted in profits or was of practical advantage to the subsidiary.³⁰⁴ If the parent violates these rules and exercises a business opportunity of its subsidiary, it is held liable to the subsidiary. The subsidiary can then, by application of the rules of a constructive trust, claim the profits the parent corporation received.³⁰⁵

In *David J. Greene & Co. v. Dunhill International, Inc.*,³⁰⁶ the court confronted two issues. First, the court dealt with a contemplated merger of the plaintiff minority shareholder's subsidiary into its parent. The parent occupied most of the subsidiary's directorates, and the court held the intrinsic fairness test applicable, requiring the defendant to prove the fairness of the merger.³⁰⁷ Second, the plaintiff alleged the violation of fiduciary duties owed by the parent to the subsidiary and its minority shareholders. The claimed violation resulted because the parent had acquired another company, which was a competitor of the subsidiary. The court applied the intrinsic fairness test and found that the parent had usurped the subsidiary's opportunity.³⁰⁸

In *Jedwab v. MGM Grand Hotels, Inc.*,³⁰⁹ a plaintiff minority shareholder invoked the intrinsic fairness test. There a majority shareholder, under a contemplated merger agreement, expected to receive better consideration for his

300. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

301. *Mayflower Hotel Stockholders Protective Comm. v. Mayflower Hotel Corp.*, 173 F. Supp. 416, 420-23 (D.C. 1949).

302. *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 595 (Del. 1986).

303. *In re Reading Co.*, 711 F.2d 509, 518 (3d Cir. 1983); *Taussig v. Wellington Fund, Inc.*, 313 F.2d 472, 479 (3d Cir. 1963); *Sinclair Oil Corp.*, 280 A.2d at 720; *Gabelli & Co. v. Liggett Group, Inc.*, 444 A.2d 261 (Del. Ch. 1982); *Gries Sports Enter., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 968-69 (Ohio 1986).

304. *Sinclair Oil Co.*, 280 A.2d at 722; *Guth v. Loft, Inc.*, 5 A.2d 503 (1939); *David J. Greene & Co. v. Dunhill Int'l*, 249 A.2d 427, 434 (Del. Ch. 1968); *Maxwell v. Northwest Indus., Inc.*, 339 N.Y.S.2d 347, 351-55 (N.Y. Sup. Ct. 1972). In this case, a parent purchased a 10% share of the outstanding stock of another corporation that it wanted to acquire as a whole. The court rejected the claim of a minority shareholder of a subsidiary, asserting that the acquisition was an opportunity of the subsidiary that the parent should not have exercised. The court also held that from the very beginning, the business chance had come to the parent and thus was one belonging to the parent. *Id.* at 354.

305. *Collie v. Becknell*, 762 P.2d 727, 731 (Colo. Ct. App. 1988); *Guth*, 5 A.2d at 510, 511.

306. 249 A.2d 427 (Del. 1968).

307. *Id.* at 429-31.

308. *Id.* at 434, 435.

309. 509 A.2d 584 (Del. 1986).

stock than preferred shareholders.³¹⁰ The test was also applied in *Burton v. Exxon Corp.*,³¹¹ where, the shareholder opposed the majority's decision to distribute dividends only to a certain class of preferred stock, all of which were held by the parent majority corporation. Thus, the business judgment rule, which normally controls the distribution of dividends,³¹² could not be relied upon by the defendant. The court held that the distribution served only the purpose to shift money from the subsidiary to its parent.

In *Getty Oil Co. v. Skelly Oil Co.*,³¹³ a subsidiary corporation for reasons of newly enacted federal legislation, lost its rights to import a certain quota of crude oil because it was a controlled corporation.³¹⁴ Since the parent's quota was not affected, the subsidiary demanded supply from its parent after it had unsuccessfully opposed the relevant laws.³¹⁵ The court rejected the application of the intrinsic fairness test because the subsidiary had suffered the disadvantage for reasons beyond the parent's control.³¹⁶ Furthermore, the parent did not gain anything to the exclusion and detriment of the subsidiary.³¹⁷ The subsidiary had to show that the parent's refusal to share its own supplies was unfair in terms of the business judgment rule. It failed in this respect because it could not show gross and palpable overreaching.³¹⁸

In *Sinclair Oil Co. v. Levien*,³¹⁹ the court also preferred the business judgment rule to the intrinsic fairness test. A minority shareholder sued the parent and asserted that the subsidiary was forced to distribute excessive dividends, which made it impossible for his company to expand its business. The court rejected the argument that self-dealing by the parent, as a requirement for the application of the intrinsic fairness test, could be shown solely on the basis that the parent had held more than ninety percent of the subsidiary's shares. Self-dealing, according to the court, required damage caused to the subsidiary. The plaintiff failed because, as a shareholder, he equally benefitted from the dividends that were in compliance with the relevant statutory rules and which the court found to be within the limits of legality.³²⁰ Interestingly, the court did apply the intrinsic fairness test to another transaction entered into by the subsidiary and a third party, in which the parent benefitted.³²¹

The court's result often depends upon the test applied.³²² Moreover, the selection of a test will determine the court's discretion as to the defendant's

310. *Id.* at 596. However, the court also concluded that this "heightened standard of judicial review" would not be very difficult for the defendant to overcome. *Id.*

311. 583 F. Supp. 405, 416 (S.D.N.Y. 1984).

312. *Id.* at 415-16; *see also* David J. Greene & Co., Inc. v. Dunhill Int'l, Inc., 249 A.2d 427, 430-31 (Del. 1963).

313. 267 A.2d 883 (Del. 1970).

314. *Id.* at 885.

315. *Id.*

316. A similar argument was given by the court in *In re Reading Co.*, 711 F.2d 509, 520 (3d Cir. 1983).

317. *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 887-88 (Del. 1970).

318. *Id.* at 888.

319. 280 A.2d 717 (Del. 1971).

320. *Id.* at 721-22.

321. *Id.* at 722-23.

322. Goldberg, *supra* note 274, at 1225.

behavior (i.e., the parent's decisions) and, often more importantly, the allocation of the burden of proof. Furthermore, as the preceding cases show, especially since *Sinclair Oil Co. v. Levien*,³²³ which has been accepted by most courts,³²⁴ a plaintiff must meet a substantial burden if he wants to allocate the burden of proof to the defendant through application of the intrinsic fairness test.³²⁵ Accordingly, courts will most likely apply the business judgment rule to parent-subsidary situations³²⁶ even if the parent pursues its own interests. The business judgment rule determines a subsidiary's distribution of dividends, business opportunities of a subsidiary usurped by the parent, and the division of benefits received by consolidated tax returns.³²⁷

3. Piercing the Veil in Parent-Subsidiary Situations

a. General

Piercing the veil is also an issue where a parent company owns³²⁸ and controls³²⁹ a subsidiary. The corporate law principle of limited liability, also called entity law, is equally upheld in the context of affiliated companies.³³⁰ The issue of disregarding the legal fiction of a subsidiary is governed by the equitable rules of piercing the veil. Courts apply the same standards in situations where the principle of limited liability is challenged, and where a creditor seeks an individual shareholder's obligation for his entity's debts.³³¹

b. Control

The most significant factor in determining a parent's liability is its control over the subsidiary company.³³² Courts often question how much control and

323. 280 A.2d 717 (Del. 1971).

324. *Burton v. Exxon Corp.*, 583 F. Supp. 405, 415 (S.D.N.Y. 1984); *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 595 (Del. 1986); *Gabelli & Co. v. Liggett Group, Inc.*, 444 A.2d 261 (Del. Ch. 1982); *Chasin v. Gluck*, 282 A.2d 188, 192 (Del. Ch. 1971).

325. *See Chasin v. Gluck*, 282 A.2d 188 (Del. Ch. 1971). Here, the parent's majority shareholder entered into a lease agreement with its subsidiary. The plaintiff was a minority shareholder of the subsidiary and the parent's majority shareholder was a director of the subsidiary. Plaintiff contended that when the parent defaulted on payments owed to the subsidiary under the agreement, the defendant violated its fiduciary duties because it did not terminate the agreement and the subsidiary sustained losses. The court did not apply the intrinsic fairness test because defendant did not benefit from the debts incurred by the subsidiary and, furthermore, the court found that the agreement had been fair. *Id.* at 192-93.

326. *Goldberg, supra* note 274, at 1231-32.

327. *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 887 (Del. 1979).

328. *See Blumberg, Limited Liability, supra* note 18, at 605-11, 623-26 (providing a historical overview on the emergence of corporate groups); *Krendl, supra* note 1, at 6 (providing the reasoning for applying the principle of limited liability in the context of corporate groups).

329. The mere potential of exercising control is not sufficient. *Craig v. Lake Asbestos of Quebec, Ltd.*, 843 F.2d 145, 152 (3d Cir. 1988); *Krendl, supra* note 1, at 57.

330. *Blumberg, Limited Liability, supra* note 18, at 575; *Blumberg, Corporate Entity, supra* note 14, at 286, 321.

331. *In re Palmer Trading, Inc.*, 695 F.2d 1012, 1017 (7th Cir. 1983); *HENN, supra* note 4, § 148, at 345-46; *BALLANTINE, supra* note 4, § 137; *BLUMBERG, SUBSTANTIVE LAW, supra* note 34, at 105-06; *Blumberg, Corporate Entity, supra* note 14, at 288.

332. *American Protein Corp. v. AB Volvo*, 844 F.2d 56, 60 (2d Cir. 1988); *Japan Petroleum Co. (Nigeria) v. Ashland Oil, Inc.*, 456 F. Supp. 831, 841 (Del. 1978); *BLUMBERG, SUBSTANTIVE LAW, supra* note 34, at 187,

domination is required to lift the veil between a parent and its subsidiary. Generally, parent companies combine ownership with control of an entity.³³³ Therefore, parent companies cannot be regarded as passive investors who, in general, are not liable under a doctrine of piercing the veil.³³⁴ Moreover, a parent's liability for reasons of control and domination does not depend on the extent of its ownership. Courts do not distinguish between partly and wholly-owned affiliates.³³⁵

i. Interlocking Directorates

Generally, the fact that directors and officers of a parent occupy the same positions in the subsidiary³³⁶ does not satisfy the requirements for piercing the subsidiary's veil even if combined with the parent's 100% ownership of the subsidiary.³³⁷ Identical directorates traditionally occur in parent-subsidiary situations and cannot be deemed as a sufficient reason to disregard the subsidiary's limited liability.³³⁸ Therefore, directors and officers who are representing both a parent and its subsidiary are said to "wear the hat"³³⁹ of the company for which they are acting. Moreover, interlocking directorates do not prove that a parent company actually exercised domination and control.³⁴⁰ Therefore, they can only be a relevant factor among others.³⁴¹

ii. Exertion of Influence

In determining the relevance of the control factor, courts often hold that a parent has to exercise complete control, that the subsidiary no longer pursues its own interests, or that the subsidiary is merely a division of the parent company.³⁴² However, it is accepted that the parent may determine the subsidiary's

428; Krendl, *supra* note 1, at 25-26. "If domination cannot be proven, there is no basis for going forward to other issues." *Id.* at 25.

333. Blumberg, *Corporate Entity*, *supra* note 14, at 327; Thompson 1994, *supra* note 5, at 35.

334. *See supra* note 140.

335. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 132-33.

336. *Id.* at 189, 211, 428; Thompson 1994, *supra* note 5, at 36.

337. *American Protein Corp. v. AB Volvo*, 844 F.2d 56, 60 (2d Cir. 1988); *McKinney v. Gannett*, 817 F.2d 659, 665-66 (10th Cir. 1987); *United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 691 (5th Cir. 1985); *FDIC v. Sea Pines Co.*, 692 F.2d 973, 977-78 (4th Cir. 1982); *FMC Fin. Corp. v. Murphree*, 632 F.2d 413, 422 (5th Cir. 1980); *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098, 1104 (5th Cir. 1973); *North American Plastics v. Inland Shoe Mfg. Co.*, 592 F. Supp. 875, 879 (Miss. 1984); *Amsted Indus., Inc. v. Pollak Indus., Inc.*, 382 N.E. 2d 393, 397 (Ill. 1978).

338. *Northern Ill. Gas Co. v. Total Energy Leasing Corp.*, 502 F. Supp. 412, 417 (Ill. 1980); *American Trading & Prod. Corp. v. Fischbach & Moore, Inc.*, 311 F. Supp. 412, 415 (N.D. Ill. 1970).

339. *Jon-T Chemicals, Inc.*, 768 F.2d at 691.

340. *Krivo Indus. Supply Co.*, 483 F.2d at 1104.

341. *Craig v. Lake Asbestos of Quebec, Ltd.*, 843 F.2d 145, 150 (3d Cir. 1988); *Krivo Indus. Supply Co.*, 483 F.2d at 1109; *Japan Petroleum Co. (Nigeria) v. Ashland Oil, Inc.*, 456 F. Supp. 831, 841 (Del. 1978); *Musman v. Modern Deb, Inc.*, 377 N.Y.S.2d 17, 20 (N.Y. App. Div. 1975).

342. *Craig*, 843 F.2d at 150; *McKinney v. Gannett Co., Inc.*, 817 F.2d 659, 666 (10th Cir. 1987); *FMC Fin. Corp. v. Murphree*, 632 F.2d 413, 422 (5th Cir. 1980); *Krivo Indus. Supply Co.*, 483 F.2d at 1106; *Banco de Desarrollo Agropecuario, S.A. v. Gibbs*, 709 F. Supp. 1302, 1308 (S.D.N.Y. 1989); *Schmidt v. Roehm GmbH*, 544 F. Supp. 272 (Kan. 1982); *Japan Petroleum Co. (Nigeria)*, 456 F. Supp. at 841; *Musman*, 377 N.Y.S.2d at 20.

general policies and exercise supervision.³⁴³ Additionally, the parent may control the subsidiary's finances and expenses and grant loans.³⁴⁴

In *Japan Petroleum Co. v. Ashland Oil*,³⁴⁵ a Kentucky-based oil company founded a wholly-owned subsidiary in Nigeria. The court rejected the parent's liability even though all major positions were held by officers and directors of the parent, who also had discretion in financial matters including loans and expenses exceeding \$250,000. The court reasoned that the financial plan was elaborated by the subsidiary, which also had its own accounts within the cash management program of the parent. Furthermore, the subsidiary paid its own employees, had assets amounting to seventy million dollars, and controlled its own day-to-day management.³⁴⁶ The court held that the subsidiary was an operating company rather than a mere shell, and that it was tolerable for a parent to centralize common matters of affiliated companies.³⁴⁷

Similarly, the court in *Craig v. Lake Asbestos of Quebec*³⁴⁸ did not hold the parent liable to a subsidiary's employee creditor. The parent had publicly declared that the subsidiary's merger into the parent was for the purpose of expanding the parent's business and that it would control the subsidiary's management.³⁴⁹ Additionally, a minority of the subsidiary's directorates was held by directors of the parent, which controlled the subsidiary's finances as well as its policy toward dividend distributions.³⁵⁰

In other decisions, courts have held that certain indicators such as arm's length transactions, separate tax returns, and business activities in different branches, show that there is no complete control of a subsidiary exercised by its parent.³⁵¹ Even if these factors are not present, it does not necessarily follow that complete control is affirmed. Moreover, courts particularly focus on whether a parent interferes with the day-to-day business of a subsidiary.³⁵² In *American Bell Inc. v. Federation of Telephone Workers of Pennsylvania*,³⁵³ a union claimed that its labor agreement with a subsidiary also extended to the defendant subsidiary because both subsidiaries were wholly-owned by the same parent. The plaintiff argued that the parent's knowledge of the agreement should be imputed to the defendant. The court rejected the claim and treated the

343. *Lowell Staats Mining Co. v. Pioneer Uravan, Inc.*, 878 F.2d 1259, 1263 (10th Cir. 1989); *Johnson v. Flowers Indus., Inc.*, 814 F.2d 978, 980 (4th Cir. 1987); *Miles v. American Tel. & Tel. Co.*, 703 F.2d 193, 197 (5th Cir. 1983); *Baker v. Raymond Int'l, Inc.*, 656 F.2d 173, 180-81 (5th Cir. 1981); *American Trading & Prod. Corp. v. Fischbach & Moore, Inc.*, 311 F. Supp. 412, 415 (N.D. Ill. 1970).

344. *Krivo Indus. Supply Co.*, 483 F.2d at 1104-05, 1110; *Schmidt*, 544 F. Supp. at 274; *Japan Petroleum Co. (Nigeria)*, 456 F. Supp. at 841.

345. 456 F. Supp. 831 (Del. 1978).

346. *Id.* at 844-45.

347. *Id.* at 845-46.

348. 843 F.2d 145 (3d Cir. 1988).

349. *Id.* at 151.

350. *Id.* at 152.

351. *American Trading & Prod. Corp. v. Fischbach & Moore, Inc.*, 311 F. Supp. 412, 414 (N.D. Ill. 1970); *Musman v. Modern Deb, Inc.*, 377 N.Y.S.2d 17, 17 (N.Y. App. Div. 1975).

352. *Department of Envtl. Protection v. Ventron Corp.*, 468 A.2d 155, 165 (N.J. 1983) (rejecting this factor as being sufficient); *Craig v. Lake Asbestos of Quebec, Ltd.*, 843 F.2d 145, 152 (3d Cir. 1988); BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 493.

353. 736 F.2d 879 (3d Cir. 1984).

defendant corporation as distinct from its parent although the parent participated in the subsidiary's management.

In *Johnson v. Flowers Industries, Inc.*,³⁵⁴ an employee of a subsidiary sued the parent company and asserted that his labor contract was wrongfully terminated by the parent. The claim was unsuccessful because the court found that the parent neither controlled the subsidiary's employment decisions nor its regular management.³⁵⁵ In *Schmidt v. Roehm GmbH*,³⁵⁶ the court denied a claim against a parent company which was based on a theory of product liability of the subsidiary. The court found that the subsidiary did not acquire all of its products from the parent. Additionally, the court relied on the parent's manager's testimony which indicated that he alone directed the subsidiary's business.³⁵⁷

In *McKinney v. Gannett*,³⁵⁸ in contrast, a plaintiff-director of a subsidiary newspaper corporation which he had formerly owned successfully claimed benefits under his employment contract. The court found that the parent had negotiated the contract with the plaintiff, that it had controlled the subsidiary's finances, and had withdrawn all of the subsidiary's profits.³⁵⁹

These decisions indicate that a parent company has wide power to control its subsidiary without being subject to liability. Although a parent company may cross the line if it interferes with the day-to-day management³⁶⁰ of the subsidiary, the control factor alone generally will not result in the parent's liability.³⁶¹ A different outcome may occur where control is excessive,³⁶² which is the case if additional factors are found. Most relevant are lack of indicia of a separate corporate organization, lack of compliance with corporate formalities, inadequate capitalization,³⁶³ economic, administrative, and financial integration (group integration), or the use of a common group public persona (the use of the same name without conspicuous identification as to the various entities).³⁶⁴

It is decisive whether the subsidiary could still be regarded as a separate entity and whether the control exercised by the parent was actual, participatory, and total.³⁶⁵ Most courts, adhering to the doctrines of alter ego or instrumen-

354. 814 F.2d 978 (4th Cir. 1987).

355. *Id.* at 981, 982.

356. 544 F. Supp. 272 (Kan. 1982).

357. *Id.* at 276.

358. 817 F.2d 659 (10th Cir. 1987).

359. *Id.* at 666.

360. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 211-12.

361. *Id.* at 190, 494; BALLANTINE, *supra* note 1, at 314, 318, 319.

362. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 351, 494.

363. *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 684 (4th Cir. 1976).

364. *Miles v. American Tel. & Tel. Co.*, 703 F.2d 193, 195, 196 (5th Cir. 1983); *Schmidt v. Roehm GmbH*, 544 F. Supp. 272 (Kan. 1982); BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, §§ 10-11; *Blumberg, Limited Liability*, *supra* note 18, at 360.

365. *Johnson v. Flowers Indus., Inc.*, 814 F.2d 978, 981 (4th Cir. 1987); *Gartner v. Snyder*, 607 F.2d 582, 586 (2d Cir. 1979); *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098, 1105-06, 1110 (5th Cir. 1973).

tality,³⁶⁶ require a further showing of an inequitable result, unfairness, or injustice, even in situations involving excessive control.³⁶⁷

c. Detriments to the Creditor

A plaintiff-creditor who wants to pierce a subsidiary's veil for reasons of domination must allege the parent's excessive control and furthermore, that denial of shareholder liability would amount to an inequitable outcome.³⁶⁸ Therefore, it is necessary to find factors such as the manipulation of the subsidiary's finances, undercapitalization, or misrepresentation.³⁶⁹

For example, in *Edwards Co. v. Monogram Industries, Inc.*,³⁷⁰ the court did not impose contractual liability on a parent and stated that the creditor was unable to show that the subsidiary was used for fraudulent or abusive practices.³⁷¹ Despite the existence of interlocking directorates and complete control, the court held that the subsidiary had a separate existence apart from the parent because the two entities' books and minutes had been kept separately.³⁷²

In *Northern Illinois Gas Co. v. Total Energy Leasing Corp.*,³⁷³ the court held that a subsidiary's contract creditor could pierce the veil. The court held the parent liable where it regularly caused the subsidiary's debtors to remit money on its own accounts and withdrew money from the subsidiary's accounts. The court, affirming that the parent had stripped the subsidiary's assets,³⁷⁴ approved the elements of fraud and wrongdoing.³⁷⁵ Similarly, the courts in

366. See *supra* note 55 and accompanying text.

367. *American Protein Corp. v. AB Volvo*, 844 F.2d 56, 60 (2d Cir. 1988); *Edwards Co. v. Monogram Indus., Inc.*, 730 F.2d 977, 979 (5th Cir. 1984); *Schmidt*, 544 F. Supp. at 275, 277. In *Gartner*, the court held that the plaintiff had to show either excessive control or elements of fraud. 607 F.2d at 586. The plaintiff bought a townhouse from the defendant's corporation which subsequently breached the contract and this suit arose. *Id.* at 583, 585. Although the corporation was undercapitalized and dominated by the defendant, the court refused to pierce the veil because it could neither find fraud nor that the corporations transacting the defendant's personal business. *Id.* at 586. In disregarding corporate formalities among the indebted and two other corporations, where the defendant was also an owner, the court held in dicta that this might only justify extended liability to the other companies rather than personal liability of the shareholder. *Id.* at 587-88. This is similar to the holding in *Walkovszky v. Carlton*, 233 N.E.2d 6 (N.Y. 1966). *Id.* at 587. The court stated that the creditor could, at most, look for liability in the involved entities. Cf. *supra* note 41. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 352, 494; Blumberg, *Limited Liability*, *supra* note 18, at 360-61.

368. *Brown v. Syntex Lab., Inc.*, 755 F.2d 668, 674 (8th Cir. 1985); *In re Palmer Trading, Inc.*, 695 F.2d 1012, 1016-17 (7th Cir. 1983); *FDIC v. Sea Pines Co.*, 692 F.2d 973, 976 (4th Cir. 1982); *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098, 1106 (5th Cir. 1973); *Agristor Leasing v. Meuli*, 634 F. Supp. 1208, 1213 (Kan. 1986); *American Trading & Prod. Corp. v. Fishback & Moore, Inc.*, 311 F. Supp. 416 (Ill. 1970); *Department of Env'tl. Protection v. Ventron Corp.*, 468 A.2d 150, 164 (N.J. 1983). See *supra* note 330 and accompanying text.

369. *FMC Fin. Corp. v. Murphree*, 632 F.2d 413 (5th Cir. 1980); *Scott v. AZL Resources, Inc.*, 753 P.2d 897, 901 (N.M. 1988); Blumberg, *Limited Liability*, *supra* note 18, at 361.

370. 730 F.2d 977 (5th Cir. 1984).

371. *Id.* at 984.

372. *Id.* at 985. The same court previously held to the contrary that the subsidiary existed only on paper.

Id. *Edwards Co. v. Monogram Indus., Inc.*, 713 F.2d 139, 142 (5th Cir. 1983).

373. 502 F. Supp. 412 (Ill. 1980).

374. *Id.* at 416, 418.

375. *Id.* at 419-20.

*Service Iron Foundry, Inc. v. M. A. Bell Co.*³⁷⁶ and *McKinney v. Gannett Co.*³⁷⁷ used the argument of asset-stripping in this context to hold the parent liable.

When parent and subsidiary enter into transactions detrimental to the subsidiary, it will have the same effect as siphoning the subsidiary's assets. In *Sabine Towing & Transportation Co. v. Merit Ventures, Inc.*,³⁷⁸ a parent founded a subsidiary shipping company that leased ships from another subsidiary.³⁷⁹ The court found that the transportation company never had a chance to make profits due to the overall economic situation. The other subsidiary, however, profited from the leases. Furthermore, the parent filed for a consolidated tax return thereby reducing its taxes by the subsidiary's losses.³⁸⁰ Consequently, the parent was held liable for debts incurred by the subsidiary.

In *Washington National Corp. v. Thomas*,³⁸¹ a parent caused its subsidiary to offer services of trust agreements in the investment market at below-market prices. This was conditioned on the subsidiary investing twenty percent of the money received in other companies of the group. Obviously, the subsidiary could make no profits, which however, was beneficial to the parent.³⁸² Again, the parent which previously assumed its subsidiary's debts was held liable.³⁸³

d. Contract and Tort Creditors

A final question is whether a court in the context of affiliated companies distinguishes between contract and tort creditors. Contract creditors consent to the position that they occupy while tort creditors have involuntarily assumed their position. Thus, if a parent's liability is denied, a contract creditor receives only what it bargained for when entering into a contract with the debtor subsidiary.³⁸⁴

Although the courts do not differentiate between contract and tort creditors, the pertinent factors of these rules are valued differently.³⁸⁵ For example, the factor of undercapitalization is deemed to be less relevant in the case of tort creditors.³⁸⁶ In contrast, the lack of indicia of separate companies is more important where a creditor has dealt with its debtor. A court may find that this is a sufficient basis for piercing the veil even in the absence of the parent's excessive control.³⁸⁷

376. 588 P.2d 463, 475 (Kan. 1978).

377. 817 F.2d 659, 666 (10th Cir. 1987).

378. 575 F. Supp. 1442 (5th Cir. 1983).

379. See *supra* note 141 and accompanying text.

380. 575 F. Supp. at 1447.

381. 570 P.2d 1268 (Ariz. 1977).

382. *Id.* at 1274.

383. *Id.*

384. Blumberg, *Limited Liability*, *supra* note 18, at 618.

385. *Miles v. American Tel. & Tel. Co.*, 703 F.2d 193, 195 (5th Cir. 1983); BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 350, 351.

386. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 202, 203, 465.

387. *Id.* at 351; Thompson 1994, *supra* note 5, at 36.

Generally speaking, it is more difficult for a contract creditor to pierce the subsidiary's veil than for a tort creditor.³⁸⁸ On the other hand, where a bargain between creditor and subsidiary did not occur or where the creditor was misled as to the identity or financial condition of its debtor, performance of a contract cannot be ordered.³⁸⁹ Therefore, even a sophisticated creditor such as a bank may be able to pierce a company's veil,³⁹⁰ as happened in *FDIC v. Sea Pines Co.*,³⁹¹ where the court found supplementing factors in addition to the parent's control.³⁹²

C. German Law (*Konzernrecht*)

1. General

The German law of affiliated entities is based on statutory provisions embodied in AktG sections 15-19 and 291-327. AktG sections 291-327 provide the legal consequences of domination within the context of affiliated entities. AktG sections 15-19 define affiliated entities. In other words, the application of AktG sections 291-327 is limited to affiliated companies as defined in AktG sections 15-19.³⁹³

Although AktG sections 15-19 contain four different types of parent-subsidiary relations all require an *Aktiengesellschaft* being dominated by another "Unternehmer," an entity or person pursuing business interests referred to as "entrepreneur."³⁹⁴ Since the term *Unternehmer* has no precise legal definition, there has been dispute whether an individual can be an entrepreneur in this context. The *Bundesgerichtshof* approved the question if the owner has further business interests besides his entity.³⁹⁵

388. *United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 692, 693 (5th Cir. 1985) (holding in a tort case that excessive control combined with undercapitalization was a sufficient basis to disregard the subsidiary's veil); *Edwards Co. v. Monogram Indus., Inc.*, 730 F.2d 977, 982 (5th Cir. 1984); *Miles*, 703 F.2d at 195; BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 108, 109, 424.

389. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 427, 491; Blumberg, *Limited Liability*, *supra* note 18, at 621.

390. BLUMBERG, *SUBSTANTIVE LAW*, *supra* note 34, at 427.

391. 692 F.2d 973 (4th Cir. 1982).

392. The FDIC's predecessor loaned \$250,000 to a subsidiary which had a stated capital of only \$1,000 and was controlled by its parent. *Id.* at 973-74. The court held that the parent violated its duties to the creditors when it caused the subsidiary, then indebted by some \$2 million, to enter into several detrimental transactions. First, the parent mortgaged the subsidiary's only unencumbered property which was valued at \$350,000 and the parent credited the subsidiary only \$8,000. *Id.* at 977. Furthermore, the parent caused the subsidiary to terminate a lease arrangement with a third party resulting in the former's relief of a guarantee for the latter's lease payments. *Id.* According to the court, these events proved the element of injustice and unfairness as to the subsidiary's creditors, and it pierced the veil because the lender had no reason to know of the prospective treatment of the subsidiary when lending the money. *Id.* at 977, 978.

393. AktG §§ 15-19 applies to other entities as well. See Judgment of Feb. 2, 1981, BGH, 80 BGHZ 69, 72-74; ADOLF BAUMBACH & ALFRED HUECK, *GMBH-GESETZ* app. 1, m.no. 3 (15th ed. 1988); Heinz-Dieter Assmann, *Gläubigerschutz im faktischen GmbH-Konzern durch richterliche Rechtsfortbildung* (pts. 1 & 2), 1986 JZ 881, 885, 1986 JZ 928.

394. SCHMIDT, GESELLR, *supra* note 9, at 1007, 1011.

395. Judgment of Oct. 10, 1977, BGH, 69 BGHZ 334, 337; SCHMIDT, GESELLR, *supra* note 9, at 785, 786; Commentary, 1991 NJW 3142, 3143; See also Assmann, *supra* note 393, at 885, para. 3; Ulmer, *supra* note 261, at 1581, para. 2; Wolfgang Vonnemann, *Die Haftung im qualifizierten faktischen GmbH-Konzern*, 1990

The most relevant fact pattern involving affiliated entities is contained in AktG section 18, a *Konzern*.³⁹⁶ Affiliated entities usually are referred to by the term *Konzern*. AktG section 18 requires several companies, either a dominating and a controlled company or companies independent from each other, being uniformly directed.³⁹⁷ Other forms of affiliated entities are defined in AktG sections 16,³⁹⁸ 17,³⁹⁹ and 19.⁴⁰⁰

AktG sections 291-327 contain various fact patterns of domination and the ensuing legal consequences. These provisions distinguish between (1) domination based on agreements (a contractual *Konzern*, AktG sections 291-310),⁴⁰¹ (2) de facto domination (sections 311-318 AktG),⁴⁰² and (3) integrated entities (AktG sections 319-327).⁴⁰³ Additionally, there is the concept of qualified (centralized) de facto domination which has no statutory basis and was developed by the *Bundesgerichtshof*, in the context of a dominated GmbH.⁴⁰⁴ The concept was also approved by the German constitutional court, the *Bundesverfassungsgericht*, and held to comply with the constitution.⁴⁰⁵

From a creditor's point of view, sections 302, 303, and 317 of the AktG are most important. Sections 302 and 303 of the AktG, in the context of a contractual *Konzern*, state the dominating entity's obligations to assume the subsidiary's losses and, after terminating the agreement, to provide security for the creditors' benefits in the amount owed by the subsidiary.⁴⁰⁶ Under AktG section 317, with respect to de facto domination, the dominating entity is liable to the subsidiary for any losses incurred by the subsidiary.

BETRIEBS-BERATER 217, 220, para. 1.

396. A brief overview of German *Konzern* law embodied in the *Aktiengesetz* is provided in WIR 1993, *supra* note 53, at 198 (Box IX.2).

397. ROWEDDER, *supra* note 15, § 52 Anh., m.nos. 14, 15; SCHMIDT, GESELLR, *supra* note 9, at 791-92.

398. AktG § 16 deals with majority ownership.

399. AktG § 17 applies when there is one dominating company and one controlled company. A company is "controlled" if the other entity can exert its influence, directly or indirectly. Majority ownership carries an assumption that control can be exerted. AktG § 17, para. 2. The distinguishing element as to AktG § 18 is its lack of uniform direction. See SCHMIDT, GESELLR, *supra* note 9, at 789-91.

400. AktG § 19 describes entities which own at least a twenty-five percent share of one another. See SCHMIDT, GESELLR, *supra* note 9, at 793.

401. Bonanno, *supra* note 264, at 155-58.

402. *Id.* at 158-63. For the differences between contractual and de facto domination, see ROWEDDER, *supra* note 15, § 52 Anh., m.no. 16; SCHMIDT, GESELLR, *supra* note 9, at 405-08.

403. Integrated entities are of less practical relevance and thus not mentioned further. Under AktG § 319, an *Aktiengesellschaft* can be integrated into another company if the prospective controlling company holds ninety-five percent of the *Aktiengesellschaft's* shares. This gives the dominating company even more controlling power than a domination agreement. See *infra* part IV.B.3.d. However, there are still two separate entities, although factually the situation is close to a merger. In general, the controlling company must assume all obligations of the dominated company. See AktG §§ 321-22.

404. Five cases have become famous in this respect. Judgment of Sept. 16, 1985, BGH, 95 BGHZ 330; Case Commentary, 1980 NJW 231 [hereinafter *Gervais*, 1980 NJW 231]; Case Commentary, 1986 NJW 188 [hereinafter *Autokran*, 1986 NJW 188]; Case Commentary, 1989 NJW 1880 [hereinafter *Tiefbau*, 1989 NJW 1800]; Case Commentary, 1991 NJW 3142 [hereinafter *Video*, 1991 NJW 3142]; Friedrich Kübler, Case Comment, 1993 NJW 1200 [hereinafter *TBB*, 1993 NJW 1200]. These cases are described *infra* notes 502-39 and accompanying text.

405. Case Commentary, 1993 NJW 2600 [hereinafter 1993 NJW 2600]. This decision occurred in the context of *Video*, 1991 NJW 3142, *supra* note 404.

406. See *infra* note 514.

AktG sections 291-327, as opposed to AktG sections 15-19,⁴⁰⁷ are applicable where an *Aktiengesellschaft* (a corporation) is the dominated entity. Although no pertinent provisions in the GmbHG regarding a controlled GmbH exist, case law was developed by the *Bundesgerichtshof*,⁴⁰⁸ starting with its decision in *ITT*.⁴⁰⁹ The rules differ from those respecting an *Aktiengesellschaft*, although some provisions, especially AktG sections 302 and 303, are applied to a GmbH by analogy.⁴¹⁰

The various fact patterns involving domination, such as contractual *Konzern*, de facto *Konzern*, and qualified de facto *Konzern* occur in the context of *Aktiengesellschaft* or GmbH. However, the entity form of a GmbH is more relevant as to de facto and, especially, qualified de facto domination, whereas domination agreements are primarily discussed with respect to an *Aktiengesellschaft*.⁴¹¹ The reason is found in the different rules of the GmbHG and the AktG regarding the relation of ownership and management under the two entity forms. Whereas the management of a GmbH⁴¹² is subject to the directions of the members (GmbHG sections 37, paragraph 1, 46 numbers 5, 6) making explicit agreements less important, the board of directors of an *Aktiengesellschaft*, the *Vorstand*,⁴¹³ is only bound by its own discretion under AktG section 76, paragraph 1, regardless of whether the company is independent or part of a *Konzern*.⁴¹⁴ Accordingly, majority ownership of an *Aktiengesellschaft* does not necessarily imply power to control and its exertion.

Again the law in the context of affiliated entities bears the presumption that control, combined with entrepreneurial interests of the dominating party, is disadvantageous to the controlled entity and its creditors as to justify the former's obligations.⁴¹⁵ Therefore, the application of these provisions is not dependent on a creditor's knowledge of its debtor's financial condition or whether an obligation arose out of tort or contract.⁴¹⁶ Due to the nexus to entrepreneurial interests embodied in AktG sections 15-19, the statutory sections can only be invoked if majority ownership or domination of an entity are

407. AktG §§ 15-19 are also applicable to other entities such as a GmbH. See *supra* note 393.

408. SCHMIDT, GESELLR, *supra* note 9, at 415, 1006-07; Assmann, *supra* note 393, at 882; Ulmer, *supra* note 261, at 1579; Vonnemann, *supra* note 395, at 217; Cf. *supra* note 404.

409. Peter Ulmer, Case Comment, 1976 NJW 191 [hereinafter *ITT*, 1976 NJW 191]; see *infra* note 447 (mentioning *ITT* in the context of de facto domination).

410. BAUMBACH, *supra* note 393, at m.no. 3; DRÜKE, *supra* note 166, at 91.

411. ROWEDDER, *supra* note 15, § 52 Anh., m.no. 7.

412. The *Geschäftsfuehrer* manages and represents the GmbH. See GmbHG §§ 35-52 (notably § 35, para. 1).

413. The "*Vorstand*" of an *Aktiengesellschaft* (AktG §§ 76-94) manages and represents an *Aktiengesellschaft*. Other bodies are the "*Aufsichtsrat*," which is the supervisory board over the management (AktG §§ 95-116, notably § 111, para. 1), and the "*Gesellschafterversammlung*," which is the shareholder's assembly (AktG §§ 118-47).

414. SCHMIDT, GESELLR, *supra* note 9, at 411, 675, 892, para. 2; Horst Konzen *Geschäftsfuehrung, Weisungsrecht und Verantwortlichkeit in der GmbH und GmbH & Co.KG*, 1989 NJW 2977, 2780.

415. Cf. *supra* part III.D.

416. SCHMIDT, GESELLR, *supra* note 9, at 786, 1008.

connected to business goals outside the subsidiary, which cause the subsidiary's interests to be sacrificed by the parent.⁴¹⁷

The following describes the various fact patterns of control and domination within affiliated entities and the legal consequences. The text distinguishes between *Aktiengesellschaft* and GmbH.

2. Contractual *Konzern* - *Vertragskonzern*

a. *Aktiengesellschaft*

Under AktG section 291, paragraph 1, an *Aktiengesellschaft* may submit itself through an explicit domination agreement to another company's direction.⁴¹⁸ The statute assumes the existence of a *Konzern* as defined in AktG section 18⁴¹⁹ and the two entities are referred to as a *Vertragskonzern* or contractual *Konzern*.⁴²⁰

AktG section 308, paragraph 1, sentence 1, enables the parent corporation to instruct the board of directors of the *Aktiengesellschaft*.⁴²¹ This power includes giving instructions that are detrimental to the subsidiary (AktG section 308, paragraph 1, sentence 2).⁴²² However, in limiting the parent's discretion, the instructions must be beneficial to the overall interests of the *Konzern*.⁴²³ The parent will be held liable to the subsidiary for any damages caused by violating these rules.⁴²⁴

As a further safeguard to the subsidiary's interests, the dominating company's managers must exercise control in an orderly and diligent manner (AktG section 309, paragraph 1). If the managers violate these rules, they must reimburse the subsidiary for the damages incurred (AktG section 309, paragraph 2).⁴²⁵ A claim for damages under AktG section 309, paragraph 2, can be asserted by the dominated entity, its shareholders, or by the creditors if they cannot obtain satisfaction from the debtor corporation (AktG section 309, paragraph 4).

From a creditor's point of view, sections 302 and 303 of the AktG are more significant than a possible violation of AktG section 308, the domination agreement, or a claim under AktG section 309. AktG section 302 states that the

417. If the statutory provisions are not applicable, the rules of piercing the veil, *Durchgriffshaftung*, may apply.

418. Under AktG § 292, the entities may also make other agreements. An example may be a profit-transfer agreement under which the dominated corporation transfers any profit to the parent corporation for tax purposes. The parent will then be permitted to assign the profits to its own financial balance sheets. See KÖRPERSCHAFTSSTEUERGESETZ §§ 14, 17 (German corporate tax code); ROWEDDER, *supra* note 15, § 52 Anh., m.nos. 19-20; SCHMIDT, GESELLR, *supra* note 9, at 800, para. 3.

419. Compare AktG § 18, para. 1, sent. 1, with *supra* part IV.C.1.

420. The legal term is "*Vertragskonzern*." Compare SCHMIDT, GESELLR, *supra* note 9, at 794, para. 3, with 1009, para. 2.

421. AktG §§ 76-94.

422. SCHMIDT, GESELLR, *supra* note 9, at 797; Bonanno, *supra* note 264, at 157.

423. AktG § 308, para. 1.

424. The liability will be based on the equitable rules of "positive *Vertragsverletzung*" (pVV), violation of contractual duties. See DRÜKE, *supra* note 166, at 93. For pVV in general, see PALANDT-HEINRICHS, *supra* note 66, § 278, m.nos. 104-29.

425. Bonanno, *supra* note 264, at 158.

parent corporation is obliged to pay for all losses the dominated *Aktiengesellschaft* incurred in a taxable year.⁴²⁶ Thus, it can be said that a subsidiary's creditor is a creditor of the *Konzern*, its only concern has to be whether the *Konzern* is able to meet the subsidiary's obligations.⁴²⁷ After termination of a contractual *Konzern*, a creditor is protected by AktG section 303, which states the parent's obligation to provide guarantees amounting to the creditors' claims against the subsidiary.

AktG sections 302 and 303, generally do not entitle a creditor to a direct claim against the parent corporation. However, the domination agreement is deemed to be terminated if the subsidiary files for bankruptcy. If further proceedings are not instituted⁴²⁸ and payments are not made by the indebted entity, a creditor has a direct action under AktG section 303, paragraph 1 against the parent corporation.⁴²⁹

b. GmbH

The provisions of the AktG apply directly only to a dominated *Aktiengesellschaft* regardless of whether the parent is an *Aktiengesellschaft*, a GmbH, or a sole shareholder.⁴³⁰ However, it is more likely that a GmbH is controlled than an *Aktiengesellschaft* due to the rules regarding management and management's subordination to directions.⁴³¹ There may also be a domination agreement facilitating control over the GmbH, although for the same reasons, thus it will not often be found.⁴³²

Although no statutory provisions exist, there is no dispute that a domination agreement with a GmbH is equally legal and binding.⁴³³ Moreover, the dominating entity, by virtue of the agreement, is entitled to the same powers over the GmbH as the rules of the AktG provide. Accordingly, the GmbH is obliged to follow instructions, unless detrimental to the overall interests of the *Konzern*.⁴³⁴ The dominated GmbH most likely will no longer pursue its own interests, but will be controlled in a manner to achieve benefits for the *Konzern*.

The parent's liabilities follow the rules applicable to an *Aktiengesellschaft*.⁴³⁵ Thus, according to AktG section 302, the dominating company must

426. SCHMIDT, GESELLR, *supra* note 9, at 798-99. AktG §§ 302, 303 will be described in more detail. See *infra* note 514 and accompanying text.

427. DRÜKE, *supra* note 166, at 95.

428. This is a case where the assets are not sufficient to meet the expenses of the proceedings. See KONKURSORDNUNG [KO] § 204, para. 1.

429. *E.g.*, *Autokran*, 1986 NJW 188, *supra* note 404, at 192; DRÜKE, *supra* note 166, at 96, 97; Ulmer, *supra* note 261, at 1582.

430. Cf. *supra* part IV.B.3.b.

431. SCHMIDT, GESELLR, *supra* note 9, at 1006-07; See *supra* part IV.B.3.b.

432. ROWEDDER, *supra* note 15, § 52 Anh., m.no. 39.

433. BAUMBACH, *supra* note 393, at m.no. 27; ROWEDDER, *supra* note 15, § 52 Anh., m.nos. 19, 20; SCHMIDT, GESELLR, *supra* note 9, at 1009-10; Commentary, 1989 NJW 295, 296, para. 4 (two GmbHs had concluded domination and profit-transfer agreements); Konzen, *supra* note 414, at 2978, 2981.

434. DRÜKE, *supra* note 166, at 97; ROWEDDER, *supra* note 15, § 52 Anh., m.nos. 63-64.

435. ROWEDDER, *supra* note 15, § 52 Anh., m.no. 67; SCHMIDT, GESELLR, *supra* note 9, at 1009; Konzen, *supra* note 414, at 2981.

reimburse the subsidiary for all losses sustained.⁴³⁶ Under AktG section 303, after termination of the contractual *Konzern*, the dominant company is obliged to provide creditors with guarantees that become effective if the subsidiary defaults.⁴³⁷

3. De facto *Konzern*

The advantage of a domination agreement under German law is that there is statutory certainty as to the parties' duties and liabilities,⁴³⁸ especially with respect to the dominating company's assumption of obligations (AktG sections 302 and 303) which exist regardless of any specified damage caused to creditors by the control. However, entities are also affiliated without explicit agreements. In these situations, a court must investigate whether an exercised control was sufficiently tight and disadvantageous to the subsidiary to justify parent's liability. In the absence of domination agreements, German corporate law distinguishes between de facto *Konzern*⁴³⁹ and qualified (centralized) de facto *Konzern*,⁴⁴⁰ the latter having been defined by the courts, notably the *Bundesgerichtshof*, and commentators.

Qualified de facto domination involves a higher degree of domination than de facto domination and comes close to a contractual *Konzern*. The legal consequences are similar to the situation in a contractual *Konzern*.⁴⁴¹ Under de facto domination, the law provides only for a subsidiary's claim for damages resulting from a particular transaction. Accordingly, the parent is not directly liable to a creditor who may only assert the debtor entity's claim. Moreover, the subsidiary has the burden of proof. Because of the difficulty stating a cause of action, which requires proof of the transaction's disadvantage to the subsidiary including specific damages incurred, commentators view the legal means in a de facto *Konzern* as ineffective.⁴⁴²

a. *Aktiengesellschaft*

If the dominated company is an *Aktiengesellschaft* AktG sections 311 and 317 are applicable. These sections provide that the parent is liable to the subsidiary for all losses and damages incurred by the subsidiary in transactions where the parent is responsible.⁴⁴³ A subsidiary, a shareholder, or the subsidiary's creditors may bring a claim.⁴⁴⁴ In order to ascertain whether damages have occurred, AktG section 312 states that the subsidiary's board in a dependency report must list and describe all transactions entered into with the

436. Schmidt, *Insolvenzrisiko*, *supra* note 161, at 306.

437. BAUMBACH, *supra* note 393, at m.nos. 27(a), 28.

438. Bonanno, *supra* note 264, at 175.

439. *Id.* at 158.

440. See *infra* parts IV.C.3.a & b.

441. See *supra* part IV.C.1.

442. SCHMIDT, GESELLR, *supra* note 9, at 802; see *infra* parts IV.C.2.b & IV.C.3.

443. SCHMIDT, GESELLR, *supra* note 9, at 805; Assmann, *supra* note 393, at 886, para. 3(a); Bonanno, *supra* note 264, at 161; Ulmer, *supra* note 261, at 1580, para. 1.

444. AktG §§ 309, para. 4, 317, para. 4.

parent, affiliated companies, or with other legal subjects on behalf of the parent.⁴⁴⁵

b. GmbH

The provisions of the GmbHHG do not contain rules governing de facto domination. Nonetheless, a GmbH must be protected like a de facto *Konzern*.⁴⁴⁶ The proposal to apply the relevant provisions of the AktG, sections 311 and 317, has not prevailed because the underlying situations are too different.⁴⁴⁷ For example, the GmbHHG lacks rules as provided in AktG sections 313-315, which in a detailed manner describe requirements of accountant approval of the annual reports thereby effectuating protection for minority shareholders and creditors.⁴⁴⁸

As in American law, the parent⁴⁴⁹ owes fiduciary duties to the subsidiary, when exercising its managerial powers.⁴⁵⁰ These fiduciary duties also exist in a *Konzern* and are not suspended by virtue of such a context. The parent is not privileged because of its domination over the subsidiary.⁴⁵¹

A parent company violating its fiduciary duties is liable to the subsidiary for the resulting damages.⁴⁵² The GmbH's claim for damages may be brought by the GmbH, a minority member,⁴⁵³ or by a creditor of the subsidiary if it cannot obtain satisfaction from the debtor entity.⁴⁵⁴ Although a subsidiary's cause of action is asserted in this context, creditors of the subsidiary also derive benefits because the debtor entity's assets increase.⁴⁵⁵

A different situation exists where a parent is the sole member. According to most commentators, a company has no rights per se as to its existence. They argue that a sole member, able to dissolve its company, owes no fiduciary duties to the company.⁴⁵⁶ Here, creditors can only resort to other rules such as

445. Bonanno, *supra* note 264, at 162.

446. *Gervais*, 1980 NJW 231, *supra* note 404, at 232; SCHMIDT, GESELLR, *supra* note 9, at 1011.

447. *Autokran*, 1986 NJW 188, *supra* note 404, at 190, para. 4; *ITT*, 1976 NJW 191, *supra* note 409; BAUMBACH, *supra* note 393, at m.no. 34; Assmann, *supra* note 393, at 886, paras. (b)-(c); Ulmer, *supra* note 261, at 1582, para. (b); Herbert Wiedemann, *Die Bedeutung der ITT-Entscheidung*, 1976 JZ 392, 394-95.

448. DRÜKE, *supra* note 166, at 121; Assmann, *supra* note 393, at 928, para. 1(a).

449. Konzen, *supra* note 414, at 2981.

450. As discussed, contrary to the situation in an *Aktiengesellschaft*, the officers in a GmbH are subject to the members' directions. GmbHHG § 37, para. 1.

451. *ITT*, 1976 NJW 191, *supra* note 409, at 191; BAUMBACH, *supra* note 393, at m.no. 10; DRÜKE, *supra* note 166, at 122; Konzen, *supra* note 414, at 2985, para. (b).

452. ROWEDDER, *supra* note 15, § 52 Anh., m.no. 49; SCHMIDT, GESELLR, *supra* note 9, at 1013; Konzen, *supra* note 414, at 2981.

453. *ITT*, 1976 NJW 191, *supra* note 409, at 192, para. 2.; BAUMBACH, *supra* note 393, at m.no. 15; Wiedemann, *supra* note 447, at 395. In general, if a shareholder sues, it is called an *actio pro societate*, and the benefits are received by the company. See LUTTER, *supra* note 10, § 13, m.no. 3; PALANDT-HEINRICHS, *supra* note 66, § 705, m.no. 20; SCHMIDT, GESELLR, *supra* note 9, at 519.

454. *Autokran*, 1986 NJW 188, *supra* note 404, at 192; DRÜKE, *supra* note 166, at 123; Assmann, *supra* note 393, at 929, para. (c).

455. BAUMBACH, *supra* note 393, at m.no. 27(a); Assmann, *supra* note 393, at 929; Ulmer, *supra* note 261, at 1581, para. 3(a).

456. *Autokran*, 1986 NJW 188, *supra* note 404, at 190, para. 4., 191, para. 5(c); BAUMBACH, *supra* note 393, at m.nos. 10, 35; Stimpel, *supra* note 15, at 613-14.

GmbHG sections 30-32(b) (preservation of stated capital),⁴⁵⁷ BGB section 826,⁴⁵⁸ or piercing the subsidiary's veil as described in the preceding chapters of this paper.⁴⁵⁹ Other commentators argue for equal application of fiduciary duties owed by a sole owner to his company and may, as in the situation involving several owners, hold the parent liable to the dominated GmbH and its creditors in a situation of de facto domination.⁴⁶⁰

c. Realization of a Claim

Although a dependent company or its shareholders may have a claim against the parent, the imposition of liability in de facto domination is very difficult to realize.⁴⁶¹ The difficulty lies in singling out specific transactions detrimental to the subsidiary, despite the dependency report found in AktG section 312. A shareholder or creditor, as plaintiff, must have knowledge of the facts that caused damage to the subsidiary.

i. Retrieving relevant information

The majority shareholder, equipped with superior knowledge, will be of little support. Furthermore, unlike American law, German law of civil procedure requires a plaintiff to present all the pertinent facts necessary to prevail in a suit. There is no pretrial⁴⁶² proceeding under German law which would enable a plaintiff-creditor to gain the relevant knowledge. The plaintiff-creditor has a right only to receive and to sue for information from the debtor company if it has a material claim for damages. Therefore, it must present sufficient facts.

Under the provisions of the AktG, shareholders have no particular rights to inspect the company's books and minutes relating to situations where their company is part of a *Konzern*. These rights are vested in the accountants,⁴⁶³ who are entitled to comprehensive information,⁴⁶⁴ whereas a shareholder is restricted⁴⁶⁵ to receiving information during the shareholder meeting. Additionally, shareholders may demand for the appointment of accountants for special purposes at the competent court.⁴⁶⁶

GmbHG section 51(a) provides the members' general right to information including the inspection of the GmbH's books and records. This right, under GmbHG section 51(a), is deemed to be extensive and to extend to relations with

457. See *supra* note 164.

458. BGB § 826 requires a tortious act committed in bad faith.

459. BAUMBACH, *supra* note 393, at m.no. 34; DRÜKE, *supra* note 166, at 123.

460. SCHMIDT, GESELLR, *supra* note 9, at 1012; Assmann, *supra* note 393, at 931, para. (c); Schmidt, *Zum Haftungsdurchgriff*, *supra* note 227, at 2077. These authors argue that relations between GmbH and its sole member also impact third parties such as creditors. Therefore, no distinction should be drawn as to a GmbH having minority members.

461. SCHMIDT, GESELLR *supra* note 9, at 802; Assmann, *supra* note 393, at 931, para. (d).

462. See FED. R. CIV. P. 26-37 (providing for depositions, interrogatories, and the production of documents). See, e.g., *Gottesman v. General Motors Corp.*, 279 F. Supp 361, 363 (S.D.N.Y. 1967) (showing evidence that encompassed some 10,000 pages of testimony and 1,000 exhibits).

463. AktG §§ 313-15.

464. HANDELSGESETZBUCH [HGB] § 320.

465. AktG § 131.

466. AktG § 315.

affiliated companies.⁴⁶⁷ Creditors have no rights to inspect a company's documents. They depend upon the actions taken by the minority owners and are rather helpless if there is no request under AktG section 315 or GmbHG section 51(a).⁴⁶⁸

Although German law requires an *Aktiengesellschaft* and GmbH to release comprehensive information to the owners, the owners must overcome more obstacles in bringing a claim against their entity than American shareholders or members, especially in an *Aktiengesellschaft* where rights are granted to the accountants rather than the shareholders. A subsidiary's creditor, having less access to relevant information possessed by the parent and the debtor company, has even more difficulties. Suggestions to allocate the burden of proof to the dominating entity, according to which the exercise of domination is assumed to be detrimental to the subsidiary, might be helpful.⁴⁶⁹

ii. Damages Caused to the Subsidiary

In addition to retrieving relevant information, a creditor or shareholder must also show that his subsidiary company suffered damages.⁴⁷⁰ AktG section 317, paragraph 2, states a test comparable to the American arm's length test,⁴⁷¹ which determines that a parent will not be liable if an independent company would also have entered into the transaction. By analogy, the rule is applicable to a GmbH.⁴⁷²

A court must investigate whether the subsidiary received adequate compensation in a transaction with its parent company. The comparable market price is the applicable standard,⁴⁷³ however, there is often no comparable data.⁴⁷⁴ Following the statutory wording, a court must decide whether an independent company would have entered into the same transaction. Obviously, uncertainty is involved here as well as where a court must determine the exact amount of damages suffered by the subsidiary. Even accountants who are entitled to full information⁴⁷⁵ admit that it is difficult to determine whether a transaction within a *Konzern* was fair.⁴⁷⁶

4. Qualified De Facto Konzern

a. General

German courts and commentators agree that qualified de facto domination requires special protection for creditors.⁴⁷⁷ Qualified domination refers to

467. DRÜKE, *supra* note 166, at 128-29; Commentary, 1986 WERTPAPIER-MITTEILUNGEN 36, 39.

468. DRÜKE, *supra* note 166, at 127.

469. Assmann, *supra* note 393, at 932.

470. AktG §§ 311, 317.

471. *See infra* part IV.A.

472. *Autokran*, 1986 NJW 188, *supra* note 404, at 191, para. b; DRÜKE, *supra* note 166, at 133.

473. DRÜKE, *supra* note 166, at 132 (citing I WIRTSCHAFTSPRÜFER-HANDBUCH 708).

474. *See infra* parts IV.A-B (discussing U.S. law).

475. *See supra* note 463.

476. DRÜKE, *supra* note 166, at 135 (citing I WIRTSCHAFTSPRÜFER-HANDBUCH 709).

477. *Video*, 1991 NJW 3142, *supra* note 404; *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802; *Autokran*, 1986 NJW 188, *supra* note 404, at 191, para. b; *Gervais*, 1980 NJW 231, *supra* note 404, at 232; SCHMIDT,

situations where the parent company permanently interferes with a subsidiary's conduct in an unrestricted manner. It is no longer possible to single out particular transactions detrimental to the subsidiary as in a de facto *Konzern*.⁴⁷⁸ The situation is similar to a contractual *Konzern*,⁴⁷⁹ and the relevant statutory rules of the *Aktiengesetz* can be applied by analogy.⁴⁸⁰ Contrasted to a de facto *Konzern*, the main difference is the presumption that the parent's control is detrimental because of its total domination.⁴⁸¹ The parent's liability, accordingly, exists because of the given circumstances, regardless of its intent or the specified damages incurred by the subsidiary.⁴⁸²

b. *Aktiengesellschaft* and GmbH

A qualified de facto *Konzern* may occur with respect to both legal entity forms.⁴⁸³ The distinction between a de facto and a qualified de facto *Konzern* can be drawn regardless of whether the dominated company is an *Aktiengesellschaft* or a GmbH.

However, it will be a GmbH rather than an *Aktiengesellschaft* that is a dominated subsidiary.⁴⁸⁴ The provisions of the GmbHG, section 37, paragraph 1, and section 46 paragraphs 5 and 6, enable the GmbH's members to direct the *Geschaefstfuehrung* (the management) whereas the *Vorstand* of an *Aktiengesellschaft* (the board of directors) is independent from shareholder instructions (AktG section 76, paragraph 1).⁴⁸⁵

Because of the statutory discretion vested in the *Vorstand*, it is disputed whether comprehensive domination of an *Aktiengesellschaft*, amounting to a qualified de facto *Konzern*, is legal in the absence of an agreement.⁴⁸⁶ It is, however, recognized that this context may also occur with respect to an *Aktiengesellschaft*, although of much less practical relevance, and it is proposed that the rules follow those applicable to a GmbH.⁴⁸⁷

The entity form of a GmbH is regarded as an ideal subsidiary company.⁴⁸⁸ Consequently, regardless of the question of legality, an *Aktiengesellschaft* will not yet be often dominated in a qualified de facto *Konzern*.⁴⁸⁹ The cases decided by the *Bundesgerichtshof* involving the question of how to define a

GESELLR, *supra* note 9, at 805, 1015; Wolfram Timm, *Grundfragen des "qualifizierten" faktischen Konzerns im Aktienrecht*, 1987 NJW 977, at 980.

478. Konzen, *supra* note 414, at 2986, para. b.

479. AktG §§ 291; *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802-03; BAUMBACH, *supra* note 393, at m.no. 29; Assmann, *supra* note 393, at 932, para. a.

480. This analogy must be applied "in a careful manner." See *Autokran*, 1986 NJW 188, *supra* note 404, at 191; Assmann, *supra* note 393, at 932.

481. *Autokran*, 1986 NJW 188, *supra* note 404, at 189, para. 1.

482. SCHMIDT, GESELLR, *supra* note 9, at 1015, 1018; Konzen, *supra* note 414, at 2986; Ulmer, *supra* note 261, at 1581.

483. Timm, *supra* note 477, at 978-80, para. II.

484. ROWEDDER, *supra* note 15, § 52 Anh., m.no. 7.

485. SCHMIDT, GESELLR, *supra* note 9, at 675, 892, para. 2.

486. *Id.* at 806.

487. *Id.* at 806-07.

488. *Id.* at 1006.

489. *Id.* at 806.

qualified de facto *Konzern* were all in the context of a GmbH. Accordingly, the following discussion focuses on situations where a GmbH is dominated.

c. Definition

As in American law,⁴⁹⁰ courts and commentators believe that single factors, such as interlocking directorates do not justify the assumption of a qualified de facto *Konzern*.⁴⁹¹ Additionally, these interlocking directorates are permissible under German corporate law, regardless of whether the company is an *Aktiengesellschaft* or a GmbH.⁴⁹² AktG section 76, paragraph 3 states that any individual can be a member of the *Vorstand*.⁴⁹³ AktG section 88, paragraph 1, referring to members of the *Vorstand* who occupy similar positions at other entities, indicates that the legislator recognized the issue of interlocking directorates. A similar rule exists regarding a GmbH. GmbHG section 6, paragraphs 2 and 3, state that any member or other individual can be *Geschaeftsfuehrer*⁴⁹⁴ of the company. Although the factor of interlocking directorates does not justify the assumption that a qualified de facto *Konzern* exists, they are regarded as significant evidence.

Courts and most commentators, rather than focusing on formalities such as the amount of shares or interlocking directorates, look to the owners' material influence on the activities of the dominated entity. Material influence is defined as a permanent influence that is extensive and evaporates assets of the dominated entity, and will be affirmed if the subsidiary is merely a subdivision of the parent.⁴⁹⁵ Contrary to the analysis regarding a de facto *Konzern*, it is not necessary to focus on particular detrimental measures to the subsidiary.⁴⁹⁶

Some commentators,⁴⁹⁷ with respect to an *Aktiengesellschaft*, require permanent disadvantages suffered by the subsidiary in addition to control. However, most commentators believe that extensive control gives rise to the presumption of a situation detrimental to the subsidiary.⁴⁹⁸ The *Bundesgerichtshof*, in its decisions in *Tiefbau*⁴⁹⁹ and *Video*,⁵⁰⁰ concurred in this analysis but held that the parent has the possibility to escape liability.⁵⁰¹

A qualified de facto *Konzern* can be presumed if one of the three main departments of a company, such as production, acquisition, and sales, is

490. Cf. *supra* part IV.B.2.

491. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1803; BAUMBACH, *supra* note 393, at m.no. 30; DRÜKE, *supra* note 166, at 159.

492. DRÜKE, *supra* note 166, at 153-54; Timm, *supra* note 477, at 984-86.

493. See *supra* note 413.

494. See *supra* note 412.

495. *Video*, 1991 NJW 3142, *supra* note 404, at 3144; *Autokran*, 1986 NJW 188, *supra* note 404; *Gervais*, 1980 NJW 231, *supra* note 404; BAUMBACH, *supra* note 393, at m.no. 30; SCHMIDT, GESELLR, *supra* note 9, at 1015, para. a.

496. Ulmer, *supra* note 261, at 1584.

497. Timm, *supra* note 477, at 980, para. III, 987, para. VII.

498. SCHMIDT, GESELLR, *supra* note 9, at 1017-18; ROWEDDER, *supra* note 15, § 52 Anh., m.nos. 16, 61(a); Ulmer, *supra* note 261, at 1584, para. 2.

499. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802, para. 3.

500. *Video*, 1991 NJW 3142, *supra* note 404, at 3144, para. b.

501. See *infra* notes 525-27.

comprehensively controlled by the parent company. Furthermore, centralized management of the finances directed by the parent will most likely be deemed sufficient in this regard.⁵⁰² However, most recently the *Bundesgerichtshof*⁵⁰³ changed its position, holding that circumstances indicating comprehensive control are not sufficient to justify the imposition of shareholder liability. The court now requires an abusive exertion of control.

The following cases decided by the *Bundesgerichtshof* provide illustrations. They also show that the court has taken different approaches over the years.

In *Gervais/Danone*⁵⁰⁴ a partnership for business purposes, an *offene Handelsgesellschaft* (oHG),⁵⁰⁵ when suffering financial hardship, submitted⁵⁰⁶ itself to an *Aktiengesellschaft* that operated in the same market. The partnership, managed and controlled by the *Aktiengesellschaft*, was subsequently transformed into a GmbH & Co.KG, a limited partnership⁵⁰⁷ having a limited liability company as general partner. The shares were held by the owners of the former partnership and the *Aktiengesellschaft*. The *Bundesgerichtshof*, pointing to the specific threats to the dominated entity, the interests might be sacrificed for the parent's benefit,⁵⁰⁸ concluded that the *Aktiengesellschaft* had to assume the dependent company's debts.⁵⁰⁹

In another famous case, referred to as *Autokran*,⁵¹⁰ the plaintiff entered into leasing contracts with seven GmbHs, all of which were dominated and managed by the defendant owner. All the financial management, including books and minutes, was handled by a separate GmbH that was also controlled by the defendant. Furthermore, the latter holding company held contracts with all the other GmbHs, according to which the holding GmbH was entitled to all of the other entities' claims against their clients including all the profit. As compensation, the holding GmbH assumed all debts and obligations, such as wages, of the other companies. When the companies defaulted on the lease payments, the plaintiff terminated the contracts and obtained judgments against the debtor companies amounting to DM 700,000. However, the plaintiff collected only DM 44,000 from the debtors and brought suit against the defendant.⁵¹¹

The *Bundesgerichtshof*, confirming that an individual can be regarded as an entrepreneur under AktG section 18,⁵¹² argued for a qualified *de facto Konzern*

502. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1803, para. b; DRÜKE, *supra* note 166, at 164.

503. *TBB*, 1993 NJW 1200, *supra* note 404, at 1203.

504. *Gervais*, 1980 NJW 231, *supra* note 404.

505. An oHG is a business partnership of having unlimited liability. HGB § 105.

506. This submission was done through a contractual agreement; however, this agreement did not qualify as a domination agreement under AktG § 291. Therefore, the case is generally cited in the context of a qualified *de facto Konzern*. See SCHMIDT, GESELLR, *supra* note 9, at 406, para. a.

507. A limited partnership is called a *Kommanditgesellschaft* (KG). See HGB § 161.

508. *Gervais*, 1980 NJW 231, *supra* note 404, at 231, para. a, 232.

509. *Id.* Furthermore, the court mentioned the possibility of applying AktG § 302 by analogy to reach this result. *Id.*

510. *Autokran*, 1986 NJW 188, *supra* note 404.

511. *Id.* at 188.

512. *Id.* at 190, para. 2. AktG § 18 defines a *Konzern*. Cf. *supra* note 396.

because of the defendant's tight domination of his companies.⁵¹³ The court applied AktG section 303 by analogy and held the defendant liable.⁵¹⁴ Moreover, the plaintiff had a direct claim against the defendant because the debtor entities had been unable to make payments. Furthermore, there was only one member, the defendant, owning the companies which were disregarded.⁵¹⁵

Additionally, the court also allowed the defendant to prove, under AktG section 317, paragraph 2,⁵¹⁶ that the holding company's actions were similar to those an independent company would have undertaken.⁵¹⁷ Although the defendant could not win on merit under AktG section 317, paragraph 2, this holding was greatly criticized.⁵¹⁸ This criticism was due to the different situations of a de facto and a qualified de facto *Konzern*, the latter's circumstances being factually similar to a contractual *Konzern*. The reasoning was subsequently abandoned in *Tiefbau*.⁵¹⁹

In *Tiefbau*,⁵²⁰ the *Bundesgerichtshof* again decided a case involving a qualified de facto *Konzern*. The defendant-bank caused a sole proprietor debtor, owning and managing a construction business to convert into a GmbH when the business defaulted on bank loans. The bank subsequently controlled and dominated the GmbH.⁵²¹ The court held the defendant-bank liable as one of several owners of the newly created GmbH because it controlled all financial matters.⁵²² The defendant under AktG section 302, applied by analogy, assumed all losses and debts of the GmbH. Since the plaintiff was the bankruptcy liquidator of the GmbH, and thus asserted the debtor company's rights against the parent, he had a direct claim against the defendant bank. Therefore, an application of AktG section 303, providing guarantees to the dominated debtor entity, and in exceptional cases, providing a creditor's direct claim,⁵²³ was irrelevant because the plaintiff would not have attained further benefits.⁵²⁴

513. *Id.* at 190, paras. 2, 3, 5.

514. AktG § 303 requires the dominating entity after termination of a *Konzern* to provide guarantees for the creditors of the *Aktiengesellschaft*. The guarantees become effective if the debtor defaults on its obligations. Applicable during the period of the existence of a *Konzern*, AktG § 302 provides the dominating entity's duty to assume all losses incurred by the *Aktiengesellschaft* during a financial year. Both sections state a claim of the subsidiary against the dominating entity as opposed to claims of the creditors. See Schmidt, *Insolvenzrisiko*, *supra* note 161, at 306. However, this principle is not always applied. As has been said, the sections are directly applicable to a dominated *Aktiengesellschaft* in a contractual *Konzern* and, by analogy, also to a GmbH and in the context of a qualified de facto *Konzern*. See *supra* parts IV.C.2.a & IV.C.3.

515. *Autokran*, 1986 NJW 188, *supra* note 404, at 190, paras. 4-5(a), 192, para. 2. The court posed, but did not answer, the question whether § 302 AktG would also be applicable in a case like the one at bar, where the subsidiary is wholly owned. *Id.* However, this was approved. *Video*, 1991 NJW 3142, *supra* note 404.

516. Applied by analogy, the code section relates to a de facto *Konzern*. Cf. *supra* part IV.C.3.

517. *Autokran*, 1986 NJW 188, *supra* note 404, at 191, para. b.

518. SCHMIDT, GESELLR, *supra* note 9, at 806, 1015; Assmann, *supra* note 393, at 934-35; Schmidt, *Zum Haftungsdurchgriff*, *supra* note 227, at 2077; Ulmer, *supra* note 261, at 1583-84, para. 3.

519. Cf. *infra* note 520.

520. *Tiefbau*, 1989 NJW 1800, *supra* note 404.

521. *Id.* at 1800.

522. *Id.* at 1803, para. b.

523. See, e.g., *Autokran*, 1986 NJW 188, *supra* note 404.

524. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1801, para. 3.

As in *Autokran*,⁵²⁵ the court rejected an analogous application of AktG section 317, paragraph 2,⁵²⁶ and reasoned for the dominating shareholder's general liability in a qualified de facto *Konzern*. However, the court allowed a parent company to prove that the subsidiary's losses were not caused by its control and management.⁵²⁷

In *Video*,⁵²⁸ the *Bundesgerichtshof* held for a qualified de facto *Konzern* and imposed liability on the defendant parent. The plaintiff was in the business of copying videos and had a claim for DM 1.4 million against a GmbH owned and managed by the defendant. The defendant was also engaged in other businesses. The court again ruled that the defendant, as an individual entrepreneur, met the requirements of a *Konzern* as defined in AktG section 18.⁵²⁹ Furthermore, the court found a qualified de facto *Konzern* to be present since the defendant was manager and sole owner of the debtor GmbH.⁵³⁰ The court held the defendant liable under AktG section 303.⁵³¹ Moreover, the plaintiff was entitled to a direct claim because the section's rule to provide guarantees for the creditor's benefit was no longer meaningful when it became clear that the GmbH would be unable to pay off its debts.⁵³²

Finally, the court decided *TBB*⁵³³ where the defendant was sole manager of the debtor construction company, a GmbH owned by his wife. The court first held that it was possible to impute the wife's position to the defendant if he had completely controlled the debtor entity and to view him as the factual member of GmbH.⁵³⁴ The court then, in contrast to the decisions in *Video* and *Autokran*, took a different approach and clarified its previous holdings. Following the court, the defendant, despite extensive domination, could only be personally liable if control of the GmbH was abusive. Abuse, according to the court, would require an exertion of control that disregarded the dominated entity's interests in such a way that it was impossible to compensate single disadvantages suffered by the GmbH.⁵³⁵ Furthermore, with respect to rules of burden of proof and presentation of facts, the court required the plaintiff only to establish a prima facie case. Consequently, the defendant, having all the inside knowledge, had to show sufficient facts under which he would not be liable.⁵³⁶

525. See *supra* part IV.C.3.b.ii.

526. This code section, in the context of de facto domination, excludes liability of the dominating entity if it can show and prove that a diligent and independent manager would have entered into the transaction with the subsidiary.

527. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802, para. 3(a).

528. *Video*, 1991 NJW 3142, *supra* note 404.

529. *Id.* at 3143, para. 1(a).

530. *Id.* at 3144, para. c(aa).

531. *Id.* at 3145, para. 3(a).

532. *Id.* at 3145, para. b.

533. *TBB*, 1993 NJW 1200, *supra* note 404.

534. *Id.* at 1201-02.

535. *Id.* at 1203.

536. *Id.*

Since the facts were insufficiently investigated and the court had adopted new rules, the case was remanded for further proceedings.⁵³⁷

d. Legal Consequences

As the legal consequences of a qualified de facto *Konzern*, reflect the application of AktG sections 302 and 303 are applied. Thus, the imposition of liabilities on the dominating owner is similar to the situation in a contractual *Konzern*.⁵³⁸

If the *Konzern*-affiliated subsidiary has several owners, the subsidiary has a claim under AktG section 302, against the dominating owner to assume its debts and losses.⁵³⁹ This claim belongs to the subsidiary⁵⁴⁰ and can be asserted by the subsidiary, its minority owners, or a creditor if it cannot obtain satisfaction.⁵⁴¹ If the subsidiary files for bankruptcy and proceedings are instituted, the claim will be brought by the liquidator. However, if bankruptcy proceedings are not continued,⁵⁴² payments by the subsidiary cannot be expected. In such a context, the underlying purpose of AktG section 302 which is to enable the subsidiary to pay off its obligations through the parent's assumption of losses is no longer meaningful. Therefore, AktG section 303, exceptionally provides a direct claim against the parent.⁵⁴³

Where the subsidiary is wholly-owned, it has been held that a creditor may bring a direct claim under AktG section 303 even before termination through bankruptcy proceedings.⁵⁴⁴ Arguably, in such a situation there is no need to protect minority owners, and therefore, a creditor should not be required to proceed first against the debtor company. In *Video*, however, the court held that AktG section 302 was applicable to a wholly-owned company.⁵⁴⁵ Accordingly, reference is made to what has been said in the proceeding paragraph.

After termination of a qualified de facto *Konzern*, AktG section 303, in addition to AktG section 302, is applicable and the parent must provide guarantees for the creditors' benefit if they cannot get satisfaction from the subsidiary.⁵⁴⁶ Termination occurs, for example, if the subsidiary goes bankrupt.⁵⁴⁷ If proceedings are continued the liquidator may claim the amounts

537. The *TBB*-holding has been affirmed by later decisions of the same court. See Case Commentary, 1994 NJW 2980 (a holding by *Oberlandesgericht* Munich); Case Commentary, 1994 NJW 3244 (a holding by *Bundesarbeitsgericht*, the highest federal court in labor law); Karsten Schmidt, Comment, 1994 NJW 446.

538. Ulmer, *supra* note 261, at 1582, para. b, 1583, para. 1; Vonnemann, *supra* note 395, at 220.

539. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802, para. 2; *Video*, 1991 NJW 3142, *supra* note 404, at 3145.

540. Schmidt, *Insolvenzrisiko*, *supra* note 161, at 306.

541. A creditor may also seize the subsidiary's claim under AktG § 302. See BAUMBACH, *supra* note 393, at m.nos. 27(a), 30(b); DRÜKE, *supra* note 166, at 185.

542. This will be the case if the assets are not sufficient to meet the expenses of the proceedings. See KO § 204, para. 1.

543. *Video*, 1991 NJW 3142, *supra* note 404, at 3145, para. b; SCHMIDT, GESELLR, *supra* note 9, at 1017.

544. DRÜKE, *supra* note 166, at 185.

545. *Video*, 1991 NJW 3142, *supra* note 404, at 3145, para. 3(a). In contrast, the court in *Tiefbau* did not answer this question. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802, para. 2. Previously in *Autokran*, the court had stated doubts. *Autokran*, 1986 NJW 188, *supra* note 404, at 191, para. c.

546. Ulmer, *supra* note 261, at 1584.

547. SCHMIDT, GESELLR, *supra* note 9, at 800, para. 4; Vonnemann, *supra* note 395, at 221, para. 2.

owed to the subsidiary under AktG section 302. The liquidator's competence, however, does not include the creditors' claims against the subsidiary if fulfillment by the subsidiary cannot occur. Accordingly, creditors have a direct claim against the parent, independent of the actions the liquidator takes and deems to be adequate, regardless of whether the debtor company has several owners or is wholly-owned.⁵⁴⁸ Normally upon the subsidiary's default the parent would provide security and the creditors could then claim their share. However, in such a situation, the parent's security is no longer helpful because default has already occurred. Therefore, the subsidiary will not make payments to its creditors and the parent's obligation to assume the debts is clear.⁵⁴⁹

The parent's obligations under AktG sections 302 and 303 exist regardless of whether its control has caused the obligations and losses of the subsidiary.⁵⁵⁰ Furthermore, a parent's liability for reasons of qualified de facto domination cannot distinguish between voluntary and involuntary creditors. Therefore, contract and tort creditors both have a claim.⁵⁵¹ However, as stated in *Tiefbau* and confirmed in *Video*, the parent may prove that its control did not cause the subsidiary's losses.⁵⁵²

D. Summary

American and German approaches to situations involving affiliated entities are very different. American courts do not draw a clear and separating line with respect to parent subsidiary relations. Instead, they extend the application of the rules referred to by the terms piercing the veil and disregard of the entity, as summarized above.⁵⁵³

Most courts in the various jurisdictions and commentators as well agree on the circumstances and factors that should be generally be considered in deciding on a parent entity's liability for its subsidiary's debts. It is difficult, however, to provide a conclusive analysis regarding a particular case at bar. It is difficult to predict those factors which a court will deem to be decisive, and it seems impossible to predict whether they will be sufficient for piercing the veil. From a creditor's standpoint, this uncertainty is obviously not desirable since a successful claim based on piercing the veil is difficult to state. Not only must the creditor show factors such as complete domination, undercapitalization, or commingling of affairs among parent and subsidiary, but the claim will also depend on whether it is a voluntary or involuntary creditor and whether fraud was perpetrated.

In contrast, *Konzernrecht*, the German law of affiliated entities, in cases of a contractual or a qualified de facto *Konzern*, is based on the statutory provisions

548. *Video*, 1991 NJW 3142, *supra* note 404, at 3145, para. b; Stimpel, *supra* note 15, at 618; Ulmer, *supra* note 261, at 1583.

549. BAUMBACH, *supra* note 393, at m.no. 30(b).

550. Konzen, *supra* note 414, at 2986, para. b; Ulmer, *supra* note 261, at 1583.

551. DRÜKE, *supra* note 166, at 185.

552. *Tiefbau*, 1989 NJW 1800, *supra* note 404, at 1802, para. 3.; *Video*, 1991 NJW 3142, *supra* note 404, at 3144, para. b. This was previously suggested by several commentators. Ulmer, *supra* note 261, at 1585, para. 3; Vonnemann, *supra* note 395, at 221.

553. Cf. *supra* part III.C.2.a.iii.

of the AktG. By analogy, these code provisions are also applicable to a GmbH. Here, the parent entity's obligations are found in AktG sections 302 and 303. Thus, the legal consequences are clear; however, there may be some confusion whether a creditor has a direct claim or may only assert the subsidiary's rights against the parent. Furthermore, it can be reasonably anticipated if the facts indicate the presence of a contractual or qualified de facto *Konzern*.

Less certainty is involved in a de facto *Konzern*, where the parent occasionally causes the subsidiary to suffer a detriment in favor of the parent. This is not because of the relevant provisions in AktG sections 311 and 317, which provide clear rules but rather because of the practical difficulties connected with proving such a claim. As has been said in this context,⁵⁵⁴ a minority equity owner or a creditor is unlikely to prevail.⁵⁵⁵ Again, a creditor does not face these problems in a contractual or qualified de facto *Konzern* where the parent's liability is assumed, regardless of the plaintiff's status as contract or tort creditor or its knowledge of the relevant circumstances.

In short, German law in this area provides more certainty than the American law as to the prerequisites a creditor will have to meet and the ensuing legal consequences. A creditor finds this process desirable when compared to the equitable rules of piercing the veil and *Durchgriffshaftung* which disregard an entity's legal fiction only exceptionally.

V. CONCLUSION

American and German corporate law with respect to shareholder liability for obligations of the entity have both a quite similar and, on the other hand, a very different approach with respect to individuals as shareholders or members of an entity. Courts in both jurisdictions follow equitable rules that have no statutory basis referred to as piercing the veil and *Durchgriffshaftung*. Under these rules, in exceptional cases the corporate principle of limited liability is disregarded. Thus, both legal systems follow the traditional view of so-called entity law under which each incorporated entity has its distinct legal existence.⁵⁵⁶ The factors deemed crucial for an application of piercing the veil are quite similar in the two systems. Imposition of shareholder liability occurs most often where complete control is found coupled with other factors such as undercapitalization, commingling of personal and corporate assets, and disregard of corporate formalities.

In contrast to situations involving liability of individual shareholders, the systems have different means in disregarding the corporate veil in parent-subsidiary relations and in situations of corporate shareholders.⁵⁵⁷ American courts continue to apply common law rules of piercing the veil, whereas German

554. See *supra* parts IV.C.2.b & IV.C.3.

555. Indeed, to date, there is no case in this context. The *Bundesgerichtshof* in *ITT* did not investigate the adequacy of a compensation where a GmbH, as a part of a de facto *Konzern*, had to pay the parent for services received. *ITT*, 1976 NJW 191, *supra* note 404, at 191, para. 1(a)-(b). Since all the pertinent facts were not clear, the court remanded for further proceedings. Later, the parties settled. See DRÜKE, *supra* note 166, at 134.

556. Blumberg, *Corporate Entity*, *supra* note 14, at 285-86.

557. Bonanno, *supra* note 264, at 152.

law, *Konzernrecht*, has a statutory basis that imposes liability on a dominating entity regardless of a creditor's status or the legal basis of its claim. The United States continues to adhere to entity law, while German law gives way to the principle of enterprise law.⁵⁵⁸ This term describes situations where liability is imposed on the enterprise as a group of affiliated entities, as opposed to an exceptional allocation of liability to a dominating shareholder under the equitable rules of piercing the veil.

Both rules of piercing the veil and *Durchgriffshaftung* encounter criticism in their jurisdictions⁵⁵⁹ because they produce unpredictable and random decisions. Therefore, it is even more questionable whether these rules will achieve equitable results of justice and fairness in the context of corporate shareholders. Here, parent-subsidiary relations are not the only issue. Other circumstances include situations involving huge, internationally incorporated and operating conglomerates acting in one common enterprise.⁵⁶⁰ Apparently a creditor cannot distinguish between the various entities and the multiple layers of limited corporate liability. Additionally, the incorporated shareholder is not a passive investor but exercises control over the debtor entity. Therefore, enterprise law in these contexts can be argued,⁵⁶¹ albeit limited to its application, has been enacted by the German *Konzernrecht*.⁵⁶²

Although entity law is still the main principle of limited liability in the United States,⁵⁶³ legislators have already implemented laws imposing duties and liabilities within corporate groups by virtue of factors such as "control," "integrated enterprise," or "enterprise."⁵⁶⁴ Courts have also extended the obligations of dominating entities.⁵⁶⁵ Accordingly, entity law is frequently abandoned in the context of corporate shareholders. This shift toward enterprise liability has already been demanded by legal scholars Professor Blumberg,⁵⁶⁶ Professor Thompson,⁵⁶⁷ and as early as 1947, by Professor Berle.⁵⁶⁸ To date however, within corporate groups, there is no general shareholder liability in the United States. Although imperfect,⁵⁶⁹ the German *Konzernrecht*, which was

558. *Id.* at 288; Thompson 1994, *supra* note 5, at 15.

559. HACHENBURG, *supra* note 9, at Anh. § 13, m.nos. 36-38; PRESSER, *supra* note 4, § 1.02, at 1-4; SCHMIDT, GESELLR, *supra* note 9, at 200; Blumberg, *Corporate Entity*, *supra* note 14, at 361 ("the chaotic theoretical content of the doctrine"); Nirk, *supra* note 64, at 444, 446, para. 2, 448, para. 3.

560. Berle, *supra* note 35, at 342; Blumberg, *Corporate Entity*, *supra* note 14, at 298, 321, 326-27.

561. WIR 1993, *supra* note 53, at 197.

562. Blumberg, *Corporate Entity*, *supra* note 14, at 366 n.325.

563. *Id.* at 324-25.

564. *Id.* at 288-89, 298, 329-45, 355-59 (citing statutes such as the Federal Communications Act of 1934, Interstate Commerce Act (1982), Federal Power Act (1982), Fair Labor Standards Act (1982)); WIR 1993, *supra* note 53, at 197-98.

565. Blumberg, *Corporate Entity*, *supra* note 14, at 348-55 (citing courts using a standard of "unitary business"). Piercing the veil is applied more often under federal statutes such as CERCLA (Comprehensive Environmental Response, Compensation and Liability Act of 1980) or ERISA (Employee Retirement Income Security Act of 1974). See PRESSER, *supra* note 4, § 3.16.

566. Blumberg, *Corporate Entity*, *supra* note 14, at 364-75.

567. Thompson 1994, *supra* note 5, at 35-36, 39.

568. Berle, *supra* note 35, at 352, para. b.

569. SCHMIDT, GESELLR, *supra* note 9, at 793, para. 4, 802 (criticizing de facto domination).

the first of its kind when promulgated in 1965,⁵⁷⁰ may be looked upon by other jurisdictions, such as the United States, as an example.⁵⁷¹

570. SCHMIDT, GESELLR, *supra* note 9, at 784; Bonanno, *supra* note 264, at 152.

571. SCHMIDT, GESELLR, *supra* note 9, at 819.

