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MASTER THESIS OF INTERNATIONAL BUSINESS LAW

**Comparative Research on the Doctrine  
of Disregarding the Corporate Personality**

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**Comparative Research on the Doctrine of Disregarding the Corporate  
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I undertake the sole responsibility for any inaccuracy in this declaration.

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## Introduction

Since the economic crisis, Chinese small and middle-sized companies have taken a heavy strike.<sup>1</sup> In order to maintain their existence and promote their competitiveness, the Chinese government carried out many measures, including some economic policies.<sup>2</sup> However, many shell companies emerged in the markets that seriously damaged the rights of creditors and ruined the investment environments at the same time. In order to make a balance between encouraging investment and creditors' protection, we should focus our attention on the issues of 'how to find the Golden Section in Limited Liability'. Doctrine of disregard of the corporate veil is such kind of "golden ratio".

Doctrine of disregard of the corporate veil, also called piercing the corporate veil in the Common Law legal systems, is not an unfamiliar but rather a significant topic in the corporate law world. According to this doctrine, legal personality of a specific corporation will be ignored in a specific case. Moreover, shareholders' limited liability will be no longer respected. Though the doctrine denies the shareholders' limited liability, it only works as an exception depending on each separate decision. Namely, the shareholders' limited liability is a basic rule to obey. Thus, this doctrine works as a supplementary instrument to make 'Limited Liability' functions perfectly. While this doctrine only takes effect in certain circumstances. The doctrine of denying the corporate personality serves for equality and justice within the relations between shareholders and creditors.

This doctrine can be traced back to the late 19<sup>th</sup> century in US where she has a long history of precedents. For the purpose of solving the problems of inequity caused by abusing legal personality and limited liability of shareholders, more and more countries, including China, began to develop this kind of doctrine. Nowadays it has been one of many principles widely recognized by both Civil Law countries and Common Law countries in the corporate law field.

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<sup>1</sup> According to the news published in March 10<sup>th</sup> 2009, 7.5% of the small and middle-sized enterprises in China have bankrupt since the economic crisis of 2008. <http://news.qq.com/a/20090310/001055.htm>, accessed in June 11, 2012.

<sup>2</sup> <http://www.sme.gov.cn/web/assembly/action/browsePage.do?channelID=20124&contentID=1236654183095>, accessed in June 11<sup>th</sup>, 2012.

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The doctrine was first to set up in the case of *United States v. Milwaukee Refrigerator Transit co.*, based on the idea that the legal personality shall be denied if it is used for the purpose of shielding frauds, protecting crimes, or evasion of law. The theoretical grounds referring to piercing the corporate veil are abundant. Some jurists want to solve this group of cases with agency rules which present the corporation as just an agent for its controlling shareholders. Others claim the veil of a corporation should be lifted when the corporation is used by its shareholders as an instrument. A few jurists proclaim separate personality should be ignored if the corporation plays the role of an alter ego of the shareholders. And some jurists are of the view that corporations have the same identity as their shareholders. Though it is not possible to reach a unanimous understanding on the theoretic grounds, the prerequisites for denying the corporate personality in different theories are similar components that consist of the outlook of veil piercing as a whole.

On the other side of the world, the revolutions to limited liability are secretly underway. With regard to the increasingly apparent flaws of limited liability, some Chinese jurists introduced the theory of denying the corporate personality to China. The theory was not accepted as a corporate principle until it was enacted in the Company Law promulgated in 2005. Generally speaking, the provision of the doctrine is very vague. We cannot find some precise direction from the law. Thus, we should learn some good experience from the United States in this specific field.

For the purpose of clarifying these issues; the layouts of this thesis will be as follows.

In the first Chapter, the background of this doctrine will be given in order to show why this doctrine has been recognized by many countries, what was its original purpose? A simple historical process of the corporate development seems to be needed without doubt. (Related legal terminology: corporate personality and shareholders' limited liability: the relations between them). Compared with other related terms, the definition of disregard of corporate personality will be clearly described.

In the second chapter, the legal framework of the doctrines in the United States will be discussed precisely, including the general doctrines and famous cases in the

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specific categories. I plan to do the research from the perspective of the creditors (voluntary ones or involuntary ones). Meanwhile, the issues of how this doctrine works in different situations, such as inadequacy of capital or assets stripping, will also be focused on.

In the third chapter, the framework of disregarding the corporate entity in China will be presented. The insufficiencies of the PRC legal framework are going to be highlighted. A brief introduction of Chinese theories on the problems of denying the corporate personality will be made. (What are the basic theories and what are their effects to the legislation). The progress of related legislation with the development of theories is also listed in this part. Then some practices in China will show how these relevant rules work in this field and what the effects are. Both progressions and flaws shall be presented.

The following chapter, a blueprint of disregard the corporate personality in China will be shown. The following problems shall be solved. What conditions can be regulated by disregarding the corporate personality? How to determine these conditions? Can undercapitalization, transfers of Assets, over-control and mixture of personality exhaust all kinds of conditions? If not, how do we regulate those incidents?