**Question 1**

Judicial corporate veil piercing exists in most parts of the world. The majority of the scholarship emerging through the efforts of the commentators and courts in Australia and elsewhere considers the conditions under which the veil is ought to be pierced. Despite the famous comment of Easterbrook and Fischel that piercing happens freakishly like the lightening, and thus, remains unprincipled, severe and rare,[[1]](#footnote-1) the literature and case laws underlie the arguments in favor of veil piercing in the present times.[[2]](#footnote-2)

Registering a company is of considerable importance for the owners as it protects them under the corporate veil. It indicates to the fact that the registered corporation is an independent legal entity from its shareholders, and if it gets in to debt or if anything goes amiss, the directors (owners) are not responsible. Moreover, the court actions taken in this regard will not be against the directors but the company itself. Overall, it provides the owners with limited liability protection. The analogy of corporate veil stems from this protection.

The concession theory posited the same conception; it treats a registered corporation as an entity that a government has created, i.e., a corporation exists as a legal entity only because governments require so. For this reason, a company distinct from its directors and shareholders, and considers to receive the concession or privilege from the government. From the strong version of the theory, such privilege must be obtained on a regularly basis. For the sake of discussion, in the judgment of a 1985 case,[[3]](#footnote-3) the Court explained limited liability as a privilege, which is inevitable to the expansion of commerce and opportunities. However, almost simultaneously, it remains exposed to abuse as well. The judgment further elaborated that irresponsible structural engineering in the form of actions such as creating, transforming or dissolving incorporated companies to the creditor's prejudices is a mischief in this regard, and the courts must pay a heed to such matters.

On the other hand of the discussion, the natural entity theory makes two claims. The first supports the argument that corporations come into existence as a natural product due to the social and economic interaction of humans instead of being created through the corporate law, which gives official acknowledgment to their existence. The second claim elaborates the fact that the corporation exists independently from its shareholders and directors. Otto von Gierke describes a corporation as a large group, which enjoys an independent and real life along with a conscious will and the ability to act independently from its shareholders. This claim is further supported by the argument that a corporation continues to exist despite the fact that its management and membership change over time.[[4]](#footnote-4)

However, over the period of time, situations may arise where the shareholders would be taken as responsible. It is legally known as 'piercing' or 'lifting' the veil. Such a situation effectively opens up the assets of shareholders and directors of the corporate entity to the creditors and third parties. What makes this situation a bit tricky is the lacking in the law, where the Courts have failed to provide a specific outline of when to pierce or lift the veil. Further, the law does not expressly mentions anything in this regard. As noted in the previous literature, “conditions in which the corporate veil may be lifted are greatly circumscribed.”[[5]](#footnote-5) It provides solid grounds to the open discussion that if there is any real benefit to such language whilst the courts remain reluctant to lift or pierce the corporate veil.

Generally speaking, two common categories exist under which the veil is effectively pierced. The first category is when the company is registered with the sole purpose of taking advantage of the veil, i.e., for the objectives of fraud and improper conduct. Further, if the company is a mere sham or cloak, it is tantamount to improper and fraudulent conduct as well. Primarily, it occurs when the company has been set-up with the mission of not trading. If the Court senses such a situation, the veil is immediately lifted.

Moreover, most of the times, companies do act as the parent companies for others. In such a situation, the subsidiary or daughter company becomes an agent for the principal, i.e., the parent company. Under these conditions, the parent company is taken as responsible for the contracts being made by the daughter company on its behalf. Therefore, the Courts many lift the corporate veil to taken as the parent company responsible. However, the second category arises when the registered company utilizes its corporate veil for the purpose of avoiding fulfilling its legal obligations. A simple example is that if a company ABC owed money to its creditor but transferred its assets to another legal entity for the purpose of avoiding payment of the debt. In such a scenario, the courts will immediately lift the veil.

The Corporations Act 2001 (Cth) provides the legal support to this argument.[[6]](#footnote-6) It provides several provisions relating to the conditions under which the independent legal entity of a company can be disregarded. Thus, in these situations, the courts remain ready to lift the veil. For instance, Section 588G of the Act covers the directors' personal liability for debts incurred by the company whilst stepping into insolvency.[[7]](#footnote-7) The prime reason of providing this Section in the Act is to provide protection to the unsecured creditors of a company. Thus, when a company faces the issue of insolvency, the impact it will make on the creditors must also be taken into consideration. In a recent case of 2000, the court stated in its judgment that creditors are given a direct interest in the company, when it is near insolvency.[[8]](#footnote-8) This right is given as a duty of imperfect obligation owed to creditors coming in to effect. Therefore, under such a situation, the directors are personally found responsible to trade whilst insolvent.

Moreover, section 267 of the Act also provides the conditions under which the corporate veil can be pierced.[[9]](#footnote-9) It includes the invalidating charges granted to officers of a company in the existence of certain conditions. In a similar fashion, section 588FE explains that the invalidating non-commercial transaction being entered into by the company and its officers under particular situations also provide a smooth ground for the courts to lift the corporate veil. Additionally, section 292 elaborates that the legal entity doctrine can be disregarded in relation to the requirement of consolidated financial statements in the case of large group of organizations.[[10]](#footnote-10) In the same vein, section 295 explains that a holding company remains responsible for the debts incurred by its subsidiary company because it gives rise to the situation of an agency.[[11]](#footnote-11)

However, it must be noted that other than these provisions, directors and shareholders of the registered company may still be taken as responsible for anything going amiss such as the situations of corporate crimes, insolvent trading, and breach of the directors' duties. As a matter of fact, and as precedent over the time, the Courts in Australia remain reluctant in enforcing these provisions. As a matter of fact, over time, the courts in Australia, for instance, the House of Lords in 1897, have been affirming the fact that firms are independent legal entity. Thus, the shareholders are often not taken as responsible for the debts of the company beyond their initial capital investment. Simultaneously, they maintain no proprietary interest in the assets of the company.

Another angle to proceed in to this discussion is to establish the fact that if the court must always recognize the independent legal personality of a corporation. The two preeminent economics and law theorists, Easterbrook and Fischel explain that the individuality of a corporation is not a matter of reality but convenience. The economic theories concerning corporations support the argument otherwise. There are two principal strands of the economic theories, i.e., agency theory, and transaction-cost economies. As has already been touched in the earlier part of the discussion, companies do act as the parent companies for others, and in such a situation, the daughter or subsidiary company becomes an agent for the parent company, i.e., the principal. However, the agency theory as a part of the economic theories addresses the problems that arise due to the separation of the ownership and control within a corporation.

Primarily, the economic perspective perceives a corporation as a type of firm, i.e., an economic concept, which consists of a series of contracts, or transactions, between the shareholders. The agency theory elaborates it as a 'nexus of contracts'. Thus, the contract, in this situation, does not represent the legal idea of the terminology.[[12]](#footnote-12) Instead, it exhibits the adaptive and voluntary nature of the arrangements made between the shareholders of the company. Thus, it denies the existence of a firm as an independent legal entity.

Moreover, the agency theory of the economic perspective of a corporation insists that the sole purpose of existence of a firm is to maximize the profits on the investment. Therefore, they must be treated in the same regard as a sole trader. Also, it explains that within the large corporations, a separation exists between the investors and the management. The managers act as the agents of the investors. They are guided by self-interest. Thus, the business remains exposed to the risk that the managers will work on maximizing the profits in their interest rather than that of the company. Eventually, investors have to put in the monitoring cost to ensure that the managers operate the firm to maximize the profits rather than to support managerial self-interest. On the other hand, managers want to retain their position in the company, and therefore, incur bonding cost. Both of these costs are referred to as agency costs.[[13]](#footnote-13) Unsurprisingly, both sides try to lower their costs, which often leads to fraudulent and unfair conduct.

Eventually, courts acknowledge the fact that under certain circumstance, it becomes necessary to lift the corporate veil in order to deny the shareholders the protection they enjoy under the limited liability principle, and thus, to stop the unjust. However, In Walker v Wimborne (1976), the court expressed its concern to the fact that the directors must be responsible for safeguarding the interest of the creditors.[[14]](#footnote-14) But, this concern could never be transformed in the shape of a duty due on the ground that it was contrary to the independent personhood doctrine of a company under the limited liability principle. For this reason, the application of piercing the corporate veil remains an exception instead of a rule. Moreover, since there is no duty on the shoulders of the directors of a company to safeguard the interest of the creditors, there is no remedy available to the creditors against the company. Thus, the court must be willing to find the directors responsible so as to launching an action for recovering the debt. It is evident from the case law as well. For instance, in Ring v Sutton (1979), the court decided that the directors were responsible for not fulfilling their duties and disregarding the creditors’ interests because they caused the company to lending money at rates much lower than the market value.[[15]](#footnote-15)

It takes us back to the discussion that if there is any real benefit to such language whilst the courts remain reluctant to lift or pierce the corporate veil. The term 'piercing the veil' was first coined in a 1973 case.[[16]](#footnote-16) However, the phrase 'lifting the veil' was soon referred to as being out-dated in a 1987 case.[[17]](#footnote-17) The difference between the two phrases was later made clear in the judgment of a 1991 case,[[18]](#footnote-18) where the court stated that piercing the veil is an expression reserved to treat the prerogatives and answerabilities of a company as that of its shareholders while lifting the veil exhibits the expression of looking beyond it, i.e., with having regard to the shareholding in a company from a legal perspective. In Australia, however, the difference between the two phrases is still not much clear. Thus, the courts continue to use the terms interchangeably.

It is worth mentioning here that the courts refer to lift or to look past the veil when they proceed to look into the operating mechanism of a company. Moreover, the ultimate effect of piercing the veil is similar to looking beyond the veil therefore the phrase is used interchangeably with the other phrase, i.e., lifting the veil. The prime purpose of this distinction is to reinforce their independent meaning.

Interestingly, the case law does not make the application of the doctrine of corporate veil piercing any clearer. For this reason, it is often claimed that in Australia, there lacks the broad principle of company law indicating the situations under which the courts must or should lift the veil.[[19]](#footnote-19) It has also been noted in other commentaries that listing the cases in which the veil must be lifted remains impossibility. In a similar fashion, the phrase has also been described as an esoteric label in a 1966 case. The judgment elaborated that fact any principle in this regard could not adduced due to the fact that the authorities in which the veil had been lifted have not been of such consistency to support such principles. In the same vein, Professor Farrer described piercing the veil as unprincipled and incoherent.[[20]](#footnote-20)

Indeed, the courts in Australia have been taking a fact-based approach to the doctrine of piercing the veil, and so far, no particular trend has readily been adopted in this regard, as is clear from a brief overview of the cases. However, the commentators and researchers have been analyzing the situation from various angles. For instance, one commentator noted that the vigorously factual nature of the types of problems involved in the piercing cases do stand in the way of formulating a generally applicable test.[[21]](#footnote-21) Another commentator has also noted that the disinclination of the courts in describing a set of rules to take decisions in the piercing cases remains a hurdle. It has also been elaborated that the courts prefer to retain the discretion of judging each case on its merits to themselves.[[22]](#footnote-22)

Overall, it can be argued that the phrase 'piercing or lifting the veil' is nothing more than a figure of speech that does not alter the legal aspects of the facts. For this reason, it was decided in a 1949 case that the employees of a company owned by a government are not the employees of the government itself primarily due to the fact that the company is a distinct person from its shareholders, who are not responsible to creditors for the company's debts. Also, they do not own the company's properties.[[23]](#footnote-23) However, it is worth mentioning here that in piercing the veil, the courts do not violate the doctrine of independent legal personality of the companies. They only prevent injustice from happening.

Three instances of veil piercing occur. Firstly, when the courts pierce the veil in order to reach the directors so that the court can correctly attribute liability to the party responsible for wrongdoing. Secondly, where the company is closely taken as, where the shareholders need limited liability as an encouragement to invest in the company, and the reasons including the inability to freely transfer shares, the disinclination to diversify, and the need to monitor and its cost, are absent. Lastly, when the company commits a tort, the courts lift the veil. In all of these situations, a removal of the limited liability protection will encourage the introduction of other protection strategies such as insurance or adequate capitalization and more acceptable levels of risk-taking by the investors.

Under these conditions, it is suggestible that legislation recognizing the substantive grounds on which the veil must be lifted must be passed. The model of parent company’s liability facing piercing of corporate veil must include the duties of directors to act in good faith and with care and diligence. This approach must be codified and made a part of the present legislation in the form of an effective laundry list. However, the code must only identify the number of areas of likely breach, and what would amount to a breach must be left to the courts.

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