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PIERCING THE CORPORATE VEIL DOCTRINE IN INTERNATIONAL COMMERCIAL ARBITRATION: VIEW FROM THE UKRAINIAN PERSPECTIVE

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SUMMARY

This article will examine the tendencies for application of the piercing the corporate veil doctrine in international arbitration, particularly from the position of its relevance and timeliness for Ukrainian science and practice. Piercing the corporate veil doctrine traces its beginnings and use in the United Kingdom and USA common law legal systems, and is completely disregarded by the Ukrainian science. This doctrine clashes with a corporate law principle of separation of a company from its owners, but focuses on a coherent activity of a business entity. Considering widespread cases of corporate misconduct and abuses of separate legal personality, the author observes a fertile area for implementation of this doctrine in legislation and dispute resolution practice in Ukraine. In section I, this article addresses the topicality of the research devoted to this doctrine in current Ukrainian realities. Section II outlines the general implications of the piercing the corporate veil doctrine. Section III examines the use of the piercing the corporate veil doctrine for the extension of the arbitration agreement to the non-signatory parties in international commercial and international investment arbitration, as well some countries litigation practice and legislation to reform outlined in Section IV. This article will ultimately conclude that the piercing the corporate veil doctrine is appropriate and fair, and should be implemented into Ukrainian legislation, and regulatory enforcement.

Key words: lifting the corporate veil doctrine, limited liability principle, single-shareholders company, multiple shareholders company, public interest, group of companies, parent company, subsidiary company, fraud or wrong, loss or injury, abuse of privilege.

АНОТАЦІЯ

У статті розглядаються тенденції до застосування доктрини зняття корпоративної вуалі в міжнародному арбітражі, зокрема, з позиції її актуальності та своєчасності для української науки й практики. Доктрина зняття корпоративної вуалі виникла та почала застосовуватись у системі загального права США й Великобританії. Водночас вона повністю ігнорується українською наукою, оскільки суперечить основоположному принципу корпоративного права щодо відокремлення компанії від її власників, адже фокусується на узгодженій діяльності суб'єкта підприємницької діяльності. З огляду на поширені випадки зловживання принципом відокремленості юридичної особи наголошується на багатообіцяючих перспективах імплементації доктрини в законодавство України та відповідної практики вирішення спорів. У першій частині статті розглядається актуальність дослідження доктрини зняття корпоративної вуалі в сучасних українських реаліях. У другій частині публікації викладено загальні умови застосування доктрини зняття корпоративної вуалі. Третя частина статті адресує можливості застосування доктрини з метою розширення арбітражної угоди на сторін, які не є її підписантами, у міжнародному комерційному арбітражі та міжнародному інвестиційному арбітражі. Судову практику й законодавство деяких держав розглянуто в четвертій частині публікації. Наостанок зроблено висновок, що доктрина зняття корпоративної вуалі є доцільною для імплементації в українське законодавство з метою досягнення принципу справедливості в регулятивному правозастосуванні.

Ключові слова: доктрина зняття корпоративної вуалі, принцип обмеженої відповідальності юридичної особи, компанія з одним учасником, компанія з множинними учасниками, публічний інтерес, група компаній, материнська компанія, дочірня компанія, омана та неправомірна діяльність, шкода й збитки, зловживання правом.

Formulation of the problem. The Ukrainian revolution in 2014 opened up new opportunities for a comprehensive reform of the state's political, economic and legal systems. According to current realities of Ukraine, there is a crucial need to develop legal standards for a civil liability of real ultimate beneficiary owners of a business, despite the corporate tools and structures established by them in order to minimize the possible risks from the third parties, to reduce or even avoid the tax burden and to conceal illegal actions. Prominent example of such grafts relates to fraudster banks' shareholders, registered in foreign jurisdictions, who stripped banks of their assets and forced them to bankruptcy when thousand of depositors were unable to withdraw their savings. It is hard to find a reasonable explanation why business owners with unfair intentions, avoiding their responsibility, confusing their counterparts, shall have advantage over the other market players by using immunity principle for limited liability of a legal entity.

The purpose and objectives of article. National judicial remedies demonstrate their failure to address misuse of the liability principle of a legal entity. In this respect alternative dispute resolution is a key for achievement of fairness, justice and transparency on the national market. Such grounds lead to a conclusion that there is a definite necessity in comprehensive legal reform of Ukrainian legal framework as a whole, and in particular the field of corporate law which has an impact on different spheres of economic and social life of the country.

The presentation of the main research material. Traditional law in a growing number of areas is being supplemented by a doctrine of corporate veil doctrine that focuses on the business enterprise as a whole, not on its fragmented components. In the recent years international legal community has been widely discussing the need for, and the limits of, application of the piercing the corporate veil doctrine – the idea that shareholders might sometimes be personally liable for the debts or deeds of a corporation. This doctrine clashes with a fundamental principle of corporate law that a corporation is regarded to be a legal entity separate from its shareholders, whereby shareholders generally enjoy protection of limited liability for the acts and debts of the corporate entity. Having its origins in common law countries, that is primarily the United States (further – USA)

and the United Kingdom (further – UK), the corporate veil doctrine allows disregarding corporate shield of legal entities and is now quite familiar to many civil law jurisdictions.

King Solomon ended up not splitting the baby when he understood who the real parent of the child was. Almost three thousand years after King Solomon, the judges and arbitrators might be fully aware of the real parent of the company, but it is very difficult to predict whether they would split the rights and liabilities, or treat the group of companies as one entity. Remarkably, that namely the court decision with the King's Solomon same name outlined the existence of the corporate veil between the real shareholders and their company. House of Lords in the famous decision *Salomon v. Salomon Co. Ltd* formulated the primacy of the limited liability separate corporate personality [1]. In this case the Court, acting in a capacity of the highest instance, applied the Limited Liability Act of 1855 and ruled that the shareholder of the company was not liable for indebtedness of his company [2, p. 117–119]. However it is worth to mention that such approach was controversial already at that time. For instance, in the decision of the lower Court of Appeal in the case *Broderip v. Salomon* imposed the liability on the single shareholder and founder for the debts of his company [3, p. 340–341]. As Marcantel points out, its emergence was an "equitable response to the perceived – or actual – unfairness that could result from the application of strict limited liability statutes" [4, p. 199].

The piercing of the corporate veil doctrine is reserved for exceptional cases. Disregard of the corporate form is allowed only in cases where defendant's hiding behind the black letter of the law may result in some kind of injustice. Nevertheless, the doctrine is widely used in the United States and is popular in many other countries of the world. Different variations of the doctrine are known today in Australia, Canada, China, England, France, Germany, Switzerland, some Latin American and other countries. For instance, Professor Thompson in his 1991 article published the results of the research that involved around 1,600 cases dealing with the piercing the veil doctrine [5, p. 1036].

At the same time, despite its wide application, the doctrine remains one of the least understood. Professor R.B. Thompson stated that "Piercing the corporate veil is the most litigated issue in corporate law and yet it remains among the least understood" [5, p. 1036], S.B. Presser expressed the opinion, that "the current state of veil-piercing law is chaotic" [6, p. 411], and C.M. Douglas suggested that the doctrine represents "jurisprudence without substance" [7, p. 41].

Interpretation of this doctrine is controversial even within one jurisdiction and legal system. It becomes even less predictable in international arbitration when several national legal systems enter into the operations and start to interplay. Piercing the corporate veil may have a concrete practical meaning to the purpose of an arbitration agreement or a bilateral investment treaty [8, p. 169]. In the context of international commercial arbitration the piercing of the corporate veil doctrine, in addition to substantive liability, came to be used as a means of extension of the arbitration agreement to the non-signatory parties. One of the most well-known examples of piercing the corporate veil for the benefit of consenting non-signatories is the *Dow Chemical* International Chamber of Commerce arbitration. In that case, the tribunal allowed parent companies to be claimants despite the fact that the arbitration clauses were between the defendant and subsidiary companies of the same parent group [9].

When parties conclude a number of contracts at realization of a common economic transaction, advance planning for dispute resolution becomes an inherently complex issue [10]. One of these complexities involves piercing the corporate veil. The primary impression such piercing leaves is that of uncertainty and unpredictability. Such uncertainties are detrimental to the legitimate expectations of the parties to a contractual relationship, and involve serious risks associated with the enforcement of arbitration awards.

Domestic courts are likely not to recognize and enforce an arbitration award piercing the corporate veil in the absence of a written arbitration agreement. Jurisprudence under the International Centre for Settlement of Investment Disputes (further – ICSID) Convention allows one to avoid the enforcement problem. However, the approaches of ICSID tribunals are inconsistent. In this respect ICSID tribunals took in the past three major conceptual approaches, namely:

1) declining jurisdiction in the absence of an explicit arbitration agreement (*Zhinvali v. Georgia*) [11, p. 392–405];

2) piercing the veil by looking into the issue of foreign control;

3) piercing the veil on the basis of interpretation of the concept of "investment" in accordance with the intent of parties to the arbitration agreement or purpose of an international treaty (*CMS Gas Transmission Co. v. Argentina* [12], *Barcelona Traction case* [13], *Holliday Inns v. Morocco* [14, p. 159], *IBM v. Ecuador* [15, p. 102]). Although tribunals refer to piercing the corporate veil, they often use them without a clear explanation.

Outlining the most recent implementation of the piercing the corporate veil doctrine, it has been reported that Hungary was one of the civil law jurisdictions where a shareholder might be held liable for the debts of its company [16]. According to Hungarian law one of the grounds for piercing the corporate veil is a so-called "long-term detrimental business policy", being a series of unreasonable decisions made by the controlling shareholder concerning the controlled company that ultimately ruin the latter. Previously, however, only the majority shareholder that owned shares at the moment of commencing involuntary liquidation proceedings could be subject to a liability claim. At the end of 2012 Hungarian Supreme Court reconsidered statutory provisions of Hungarian company law extending the scope of the piercing the corporate veil provision and allowing holding former majority shareholders liable for the debts of the bankrupt company resulting from the above mentioned long-term detrimental business policy. The Supreme Court judgment has already been named landmark for Hungarian company law. Despite the fact that the Court's conclusion raises a number of practical issues connected, the dramatic change in the approach of Hungarian courts to the piercing of the corporate veil issue testifies the objective need for deviation from principle of distinct personality of legal entity from its owner, so firmly established in Ukraine, Russian Federation and other post-Soviet states.

Conclusions. In conclusion, it should be noted that the piercing the corporate veil doctrine can have different forms and requirements depending on applicable national law. The doctrine can play a role of a legal instrument protecting investors' and creditors' rights and to some extent guaranteeing protection for fair market players, ensuring zero tolerance to limited liability personality abuse in corruption purposes. At the same time in this respect it is worth to quote I.M. Wormser: "The concept is not an "open sesame", which will open all gates; when to use it, when to ignore it, is the present day dilemma" [17, p. 43].

However, there are downsides of such piercing because it negates many of the benefits that the corporate form offers. The creditors will be in a more difficult position to monitor assets, and corporations will be unwilling to take business risks that may result in their shareholders' corporate or personal assets being exposed to liability.

At the same time, it is important to remember that successful application of the doctrine at one stage of the dispute does not guarantee its success at later stages. In particular, extension

of the arbitration agreement to third parties on the basis of the discussed doctrines involves significant risk of further refusal of recognition and enforcement of the arbitral award by national courts. Therefore, at the time when a lawyer decides on application of the respective doctrine he or she must also consider approaches to that doctrine taken by national courts, first of all, in jurisdictions where the setting aside or recognition and enforcement proceedings might take place.

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