Piercing the Corporate Veil ‹Comparative Perspectives to the Bahraini, English and American Legislative and Judicial Practice›

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Introduction:

For the sake of purifying the smooth flow and continuation of companies' business without disturbing the interests of its members, the services, and the interests of society in large, and for the purpose of maintaining prevailing commercial and corporate quality in the country without tampering with fraud and deceptive methods, comes this comparative research, which highlights, from legal point of view, the issue of piercing the corporate veil of a company -in whatever form it choose to be established- whenever it has proven to be used as a shield or veil to pass personal or illegitimate purposes contrary to the purposes of the law and regulations. This paper reflects the latest amendments to the Bahraini Commercial Companies Law, with some practical applications, and comparing it with the prominent issues raised in the English and American courts and jurist opinions.

The major effect of piercing is that a company's partners will no longer be able to rely on the corporate shield –especially in the limited liability company- when they are planning to use this corporate shield to hide the real rooted reason of their doubtful actions or omissions and therefore they might be liable in their own funds.

We will discuss various cases of corporate veil piercing as wll as the surrounding issues that revolve around how to get closer to the shareholder, director, owner's personal monies, such as the extent of the auditor's responsibility, and whether the insurance on director's liability will stand or not, we will aslo mention new concept, which is the "reverse piercing" where the American lawyers might tend to apply for reasons of achieving the justice and fairness. The areas of international arbitration, especially the international investments arbitrations pose a tremendous importance because of its complexity and the diffulty of Enforcing the arbitration award.

The purpose of this research is not to integrate a plan of action with regard to the multiple aspects in this tremendous area of law, but to highlight the relevant important legal provisions that clarify the importance of the members of boards of directors or managers' conduct based on the utmost

expected duties that fully affect their individual and collective interests in the community.

The scope of the research:

The research is limited to the Bahraini, English and American legislative and judicial practice. There is limited reference to arbitration –particularly international arbitration.

Brief content:

As a brief description of the content, we will start with defining the "Corporate Veil" as the basic rule and the "corporate veil piercing" as an exception and in which types of companies it will apply. We will discuss also the latest principles of the Case law in English and American Law, in addition to discussing briefly the surrounding issues as aforesaid mentioned in the introduction.

1. Shortcut definition of "Corporate Veil"

The most important outcome of establishing a company is the legal existence as it has independent personality from its partners, this was not recognized from the outset, as evidenced by the old legal regulations, there were no separation of company's accounts and its partners receivables. The emergence of companies and different trade relations in the Middle Ages intensify the need to separate the company's accounts from the partners' personal funds and to consider the company as an independent personality autonomous from its partners and its monies shall be the guarantee to creditors, a matter that improves monitoring of the companies' overall business.

In English Law, there is a correlation between two ideas; the first one is the (Incorporation by registration which was introduced in 1844) and the second idea is the (limited liability of a company) which was followed in 1855. Subsequently in 1897 in Salomon v. Salomon & Co. Ltd. the House of Lords effected the principles of corporate entity and limited liability into the English law where it has been decided that a company is a distinct legal person entirely different from the members of that company (shareholders, officers, directors...etc.) with separate rights and liabilities. Some argue that it is a vital fiction in the sense that individuals might balk at launching new ventures if it meant their personal assets were readily at risk .

Of course, the doctrine was recognized much earlier than in Salomon, see, for instance, Edmunds v Brown and Tillard (1668), where members were held not liable on the bond of a corporation after its dissolution, and Foss v Harbottle 1843. The true significance of Salomon's case in its more immediate context is that it confirmed the legitimacy of the "private" company and paved the way for its recognition by statute in 1907 .

(1) See: Piercing the Corporate Veil, when is too much fiction a bad thing? By will Hill Tankersley and Kelly Brenan, the Alabama Lawyer, January 2010. Vol. 71, No.1.
Cases and materials in Company Law, LS Sealy, Seventh edition, Oxford University Press.

Therefore, it is deeply rooted that a corporation or a company is treated as a separate legal person, which is solely responsible for the debts it incurs and the sole beneficiary of the credit it is owed, therefore, many business owners or partners establish their ventures under a corporate structure in an effort to protect their personal assets from claims made by internal and/or external intervening factors, and therefore any liability incurred by the company does not extend to its shareholders (beyond any money paid for the purchase of their shares), and its directors (beyond any personal liability, which they might have, for violation of their duties as directors of the company). This, in a nutshell, creates the sense of "corporate (fictional) veil" as a fundamental legal term to intensify that assets and liabilities of a corporation are separate from the assets and liabilities of its shareholders and that this rule protects shareholders from being liable personally for the company's debts and other obligations.

This article firstly explains what is understood by the terms corporate veil's piercing. Secondly, it discusses several English Law cases that are dealing with this issue and how it has developed over time. Thirdly, it compares this doctrine with the approach accepted in the American Law and discusses the doctrine under the Bahraini Law especially under the new amendments of the current Commercial Companies Law. It also deals with some economic implications of lifting the corporate veil.

"Piecing the Corporate Veil" (The exception of the rule):

In the English Law, although the Salomon principle has never been doubted, however, under certain circumstances the courts may be poised to disregard this principle and "lift the corporate veil." Nevertheless, the cases in which the courts have allowed the veil to be lifted are difficult to predict and no clear set of principles has emerged yet.

From the creditors' point of view, the consequence of the limited liability principle is that creditors' claims are restricted to the company's assets and cannot be asserted against the shareholders' assets. On the other hand, shareholders benefit from the limited liability principle because (i) once the business is successful, it is them who gain the profit, and (ii) in the event that the company is wound up their liability would be limited only to the value of their unpaid shares or their guarantee; i.e. the satisfaction of unsecured creditors' claims is endangered without shareholders being responsible.

All in all, if a company has been legally "pierced," then the corporation shield will be disregarded and its constituent members will be held personally liable in their own funds. (2)

(2)http://nationalparalegal.edu/public_documents/courseware_asp_files/businessLaw/Directors&Officers/PiercingCorporateVeil.asp

This triggered if sufficient reason for piercing occurred, such as when "the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime. Some has expressed that the law will regard the corporation as an association of persons." (3) Others said that this is the most litigated issue in corporate law ." (4)

The phrase "piercing the corporate veil" was described in a case in 1973 as "now fashionable". (5) In 1987, the phrase "lifting the corporate veil" was referred to as being "out-of-date". (6) The English courts expressly separate the meaning of the two phrases. Staughton LJ, in Atlas Maritime Co SA v Avalon Maritime Ltd,(7) stated that: "To pierce the corporate veil is an expression that I would reserve for treating the rights and liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose." In Australia, the distinction between the meaning of the two phrases is perhaps not as widely recognised, with courts sometimes referring to lifting when the effect is piercing.(8)

Young J, in Pioneer Concrete Services Ltd v Yelnah Pty Ltd,(9) defined the expression "lifting the corporate veil" as meaning "[t]hat although whenever each individual company is formed a separate legal personality is created, courts will on occasions, look behind the legal personality to the real controllers." It is important to note that courts may refer to "lifting" or "looking beyond" the corporate veil at any time they want to examine the operating mechanism behind a company. Although the ultimate effect of piercing is to "look beyond the corporate veil", (10) we use the phrase "piercing the corporate veil" in preference to the phrase "lifting the corporate veil", in order to reinforce their separate meaning.

However, in the course of reading cases in this area you will find the process variously described as "peeping", "penetrating", "parting", "lifting" or piercing the veil of incorporation . (11)

(3) United States v. Milwaukee Refrigerator Transportation Co., 142 F. 247. 255 (7th Cir. 1905)
(4) Thompson, Piercing The Veil Within Corporate Groups: Corporate Shareholders As Mere Investors, 13 Conn.J.Int'l L. 379, 383 (Spring 1999).
(5) Brewarrana v Commissioner of Highways (1973) 4 SASR 476, 480 (Bray CJ).
(6) Walker v Hungerfords (1987) 44 SASR 532, 559 (Bollen J).
(7) Atlas Maritime Co SA v Avalon Maritime Ltd (No 1) [1991] 4 All ER 769.
(8) See, for example, Commissioner of Land Tax v Theosophical Foundation Pty Ltd (1966) 67 SR (NSW) 70 (NSWCA, Herron CJ, Sugerman and McLelland JJA).
(9) Pioneer Concrete Services Ltd v Yelnah Pty Ltd (1986) 5 NSWLR 254 (SCNSW, Young J).
(10) Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549, 558 (Rogers AJA).
(11) Alan Dignam and John Lowry, Company Law, Oxford University Pressm 4th edition, page 30.

1.1 Types of entities conferring their members a limited liability:

Usually, the concept of piercing the corporate veil accompanies the "limited liability companies" or the companies that has the abbreviation of "LLC" in some countries, where this abbreviation stands as a warning to the third parties who may be dealing with that company that the liability of its members is limited to their contribution in the company's capital, and other certain types of companies. But, it is vital to say that although joint stock companies, either public or private, do not have the abbreviation of "LLC" attached to them, the liability of their shareholders is also limited to their shareholding subscription in the issued share capital of the company in question. The concept of limitation of liability of shareholders in public joint stock companies has had a positive impact on encouraging public stock market investment and has boosted the concept of the initial public offering as an indispensable source of corporate finance .(12)

In some jurisdictions, there are reasons (13) , based upon principles of economic efficiency, can be provided for why companies are granted limited liability .(14) Firstly, limited liability decreases the need for shareholders (we call them partners in Bahrain) to monitor the managers of companies in which they invest because the financial consequences of company failure are limited. Shareholders may have neither the incentive (particularly if they have only a small shareholding) nor the expertise to monitor the actions of managers. The potential costs of operating companies are reduced because limited liability makes shareholder diversification and passivity a more rational strategy. Secondly, limited liability provides incentives for managers to act efficiently and in the interests of shareholders by promoting the free transfer of shares. This argument has two parts to it. The first part is the free transfer of shares is promoted by limited liability, because, under this principle the wealth of other shareholders is irrelevant. If a principle of unlimited liability applied, the value of shares would be determined partly by the wealth of shareholders. In other words, the price at which an individual shareholder might purchase a share would be determined in part by the wealth of that shareholder which was now at risk because of unlimited liability. The second part of the argument is derived from the fact that if a company is being managed inefficiently, shareholders can be expected to be selling their shares at a discount to the price which would exist if the company were being managed efficiently.

(12) http://www.tamimi.com/en/magazine/law-update/section6-/october2-/piercing-the-corporate-veil-under-the-uae-companies-law-when-can-shareholders-be-responsible.html
(13) Ian M Ramsay and David B Noakes, Piercing the Corporate Veil in Australia, 19 Company and Securities Law Journal (2001).
(14) These reasons are drawn from F Easterbrook and D Fischel, The Economic Structure of Corporate Law, 44-41 ,1991.

In the area of piercing the corporate veil in Bahrain as will be discussed later, the law has only mentioned the Joint Stock Company, the Limited Liability Company and the Single Person Company, the other types of companies will be mentioned because, as seen above, they are treated in most of their provisions with one of those three types.

Actually, the issue of single person company is getting an intense attention. The ability to specify whether the corporate veil should be pierced could be difficult sometimes but of course not impossible. If we take an example –as mentioned by some authors in other jurisdicions- of a defendant convicted of a drug trafficking offence who earns his living by a legitimate manufacturing business which he owns and which is incorporated as a limited company. In the absence of anything untoward relating to the company the income of the company is not income of the defendant and so, for example, the "criminal lifestyle assumptions" – as in some jurisdictions- cannot be applied to the deposits into the company bank account. The Bahraini Companies Law mentioned –expreselly- in (Article 296) in the Single Person Company the situation that, "If the capital owner liquidates the company or suspends its activities, in a mala fide manner, before the expiry of its term or before the realization of its objectives he shall be liable for its obligations to the extent of his personal property. He shall also be liable to the extent of his personal property if he does not separate his personal interests from the interests of the company".

If we discussed the other types of companies, it is worth mentioning that the Bahraini Companies' Law has specified that in the General Partnership Company in Article (35), "The Company's creditors shall have a claim on the company's assets, and shall have also a claim on the private assets of any partner who used to be a member of the company at the time of contracting. All partners shall jointly be liabl towards the company's creditors, and any agreement to the contrary shall not be valid towards third parties".

The law, to the same effect, classified the Limited Partnership Company in the same category of the General Partnership Company, and that the Limited Partnership By Shares Companies are treated - as per Article 249- the same as the Joint Stock Company.

There is only one part left- excluding the "Association in participation" company- which is the "holding company", and in accordance with Article (304) of the Bahrain Law, it "shall be subject to the provisions regulating the company which it has taken its form as well as its provisions set out in this law to the extent that they do not conflict with the provisions of this Part". Article (299) of the Law stated that: "A holding company must own

more than half the capital of the affiliated company. It may take one of the following forms:

i. A joint-stock company
ii. A limited liability company
iii. A single person company.

2. Introducing the doctrine of Piercing the Corporate Veil in Bahrain:

The doctrine of piercing the corporate veil has been endorsed in the new amendments to the current Bahraini Commercial Companies' Law of 2001, the new amendments is effective under the Law no. (50) of 2014. This should be interpreted with other commercial and civil common principles such as the principal and agent theory, direct liability for affiliate's own torts, interference with contracts, and fraud, taking into account that the current law has also mentioned this doctrine to a reasonable exten, as will be highlighted later.

Article 18bis of the new amendments outlined the circumstances for veil piercing as follows:

Article (18bis)

a) The promoter (founder), partner, capital owner, the company's manager or the member of the board of directors in the shareholding company (Joint Stock Company), closed shareholding company, limited liability company or single person company, as the case be, shall be liable to the extent of all his funds for any damages that may be sustained by the company, partners, shareholders or third parties, in any of the following cases:

1. If he has provided false or untrue particulars about the company's capital in its Memorandum or Articles of Association or in its dealing with third parties, or in any of its documents, which would prejudice financial confidence in the company.
2. If he uses the company for fraudulent or illegitimate purposes.
3. If he treats the company's funds as his own personal funds.
4. If he does not separate his personal interest from the company's interest.
5. If he causes incurring obligations by the company despite the fact that he certainly or purportedly knows that the company is not able to perform such obligations on their maturity, or if such obligations have been incurred due to his gross negligence or wrongdoing.
6. If he causes the company's inability to pay the taxes and fees due to government or to public entities or organizations, and he knows certainly or purportedly this, or if the company's inability to pay such taxes and fees is due to his gross negligence or wrongdoing.
7. If he violates the provisions of the Law or the company's Memorandum or Articles of Association.

The Law goes on to put some other guidelines on the liability, in order to scrutinize the situations that might surround the doubts of veil piercing as follows:

b) Liability shall not be precluded if the violation has been committed as a result of a resolution adopted during the meeting of the board of directors, the constituent assembly or general assembly, unless he opposed the resolution that gave rise to the liability and recorded his objection in the minutes of the meeting. The absence of a member from the meeting in which the resolution was passed shall not be a reason for exemption from liability, unless he proves his lack of knowledge of the resolution or that he had knowledge of it but was unable to object to it.

c) The liability referred to in Paragraph (a) of this article shall either be personal relating to the promoter, partner, capital owner, manager or member of the board of directors, or joint in case of severalty of those who committed the violation.

The above texts are self-explanatory to the meaning and guidelines mentioned.

The prongs that the Veil Piercing doctrine consists:

2.1 In the Bahraini Law:

The above mentioned seven events are the prongs of the doctrine in the Bahraini Law, it is suggested to refer to no. 2 as per the above-mentioned article as (fraud or facade), no. 3 as (alter ego) and no. 4 as (instrumentality), these terminologies are being used in other jurisdictions as will be explained later on. The other events of veil piercing could be briefed as follows:

1- Providing false or untrue information that are prejudicing the financial confidence in the company.

2- Incurring obligations on the company while the inability to meet them existed.

3- Mismanagement (willfully or negligently): (1) Inability to pay tax or formal fees to a reason belongs to him/her. (2) Violating the law and/or the Articles or Memorandum of Association.

Moreover, the Bahraini Law put additional guidelines in order to promote the good management conduct such as the need for an explicit opposition to the meeting's resolution where the violation was decided in. Another hurdle is that the absence from a meeting where the violation was decided should not stand as an excuse, because the due diligence gestures should be taken. It is very important to mention that the above guidelines were already –to some extents- mentioned in the current Bahrain Commercial Companies Law of 2001 in Article 185-186 concerning the Joint Stock Company, in which it stated that:

Article 185: "The chairman and the members of the board shall be jointly liable before the company, the shareholders and third parties for all acts of

fraud and misuse of powers and any violation of the law or the company's articles of association and for mismanagement. Any condition to the contrary shall be null and void. A decision by the general assembly absolving the board of directors of liability shall not preclude instituting action of liability against it".

Article 186:" The liability referred to in the foregoing paragraph shall be either personal relating to a specific member or joint for all board members. In the last case the members shall be jointly liable for paying compensation unless some of them has objected to the decision causing the liability and put their objection on the minutes of the meeting. The absence of a member from the meeting, in which the resolution was passed, shall not be a reason for exemption from liability unless he proves that he was unaware of the resolution or that he was aware of it but was unable to object to it. If more than one member commit the wrongdoing, they shall be jointly liable towards the company. The liability actions shall be time-barred after the elapse of five years from the date of the general assembly meeting at which the board of directors reported on its management".

The abovementioned prongs, especially the one relating to fraud and other deceptive manner, mismanagement and non-compliance with the provisions of law and the required regulations as will be discussed later on does not exclude the criminal liability. It is with due importance to mention the enriched-examples mentioned in the Bahrain Penal Code that already punished similar events, we can take Articles 403,404, 405 and 406. Article 403 mentioned the penalties of every bankrupt trader who caused losses to his creditors "if his personal or domestic expenses are of an extravagant nature. Second: if he spends substantial sums of money in gambling or in fraudulent or speculative activities. Third: If he purchases goods for sale below the prices thereof, borrows funds, issues financial instruments or uses such other methods as may involve severe losses but seeking to obtain funds with a view to delaying the adjudication of his bankruptcy. Fourth: if he attempts, after ceasing to make payment, to satisfy debts owed to one creditor to the detriment of all the creditors".

Article 404 mentioned the penalties of every bankrupt trader who is deemed to be bankrupt by default in any of the following events "First: if he enters into a contract in favor of a third party and without consideration offering substantial undertakings compared with his financial position at the time of giving such undertakings. Second: if he does not maintain commercial books or if his books are incomplete or not properly maintained so as to reflect the truth of his liabilities or entitlements or if he does not make the required stock-taking according to the Commercial Law. Third: if he does not comply with the regulations governing the Commercial Registry.

Fourth: if he fails to present a statement for ceasing to make payment on the date specified for this purpose in the Commercial Law, if he fails to submit the balance sheet or if there is proof as to the incorrectness of the details furnished by him after ceasing to make payment in accordance with the said Law. Fifth: if he fails to personally appear before the Bankruptcy Judge or to provide the details and information requested by the said judge or if such details are found to be incorrect. Sixth: if he allows, after ceasing making payment, a special privilege to one of his creditors with the intent of gaining his agreement to a settlement. Seventh: if he was declared bankrupt yet again before fulfilling the undertakings arising from a previous settlement".

Article 405 mentioned the penalties for the commercial companies that should be declared bankrupt and its members should be liable if "If they assist in the Company's cessation to make payment by making a false announcement concerning the subscribed or paid-up capital, by publishing an incorrect balance sheet, by distributing false dividends or by taking by way of deceit for their account what is in excess of what they are entitled to under the Company's Memorandum of Association".

Article 406 discusses the responsibility of the concerned persons "if they willfully neglect the publication of the Company's Memorandum of Association in the manner laid down by the law. Third: If they commit acts in contravention of the Company's Articles of Association or if they ratify and confirm such acts".

The above text-based examples could be used as a presumptions that turns the burden of proof to the potential responsible individuals, taking into account the definition of fraud provided in the Bahrain Civil Code of 2001, in which it mentioned in Article (90) that: "Lies or intentional silence on the part of one of the parties as to a fact or as to the accompanying circumstances shall constitute fraudulent misrepresentation if it can be proved that the contract would not have been concluded by the other party had he had knowledge thereof".

The areas of "alter ego" and "instrumentality" that promote the possibility of veil piercing is mentioned in the Bahrain Bankruptcy Law particularly in Article no. 15 which stated that:"Where a petition of bankruptcy of a company is submitted, the Court may adjudicate the bankruptcy of any person who conduct business operations for his own account by using the company name and disposing of the company's properties as his own".

Holding the managers of the Limited Liability Compay's liable in their private property is mentioned in current company law of 2001in Article (263) which stated that "The name of the company shall be followed by the phrase (with Limited liability). Such particulars shall be mentioned in all

the company's contracts, invoices, advertisements, papers and publications, or else the company's managers shall be jointly liable to the extent of their private property towards third parties". Another examples of joint-liability is already mentioned with regard to the Joint-Stock Companies and the Holding Comapnies such as those mentioned in the margin (footnote). (15)

(15) Article (108) of the Company Law Law which stated that: "If a joint-stock company is incorporated in a way incompatible with the law, any concerned party may request the company to undertake the necessary correction within one month from the date of his request. If the company does not affect the required correction within this period, the concerned person can claim at the High Civil Court the nullity of the company within one year from the date of incorporation. However, the shareholders shall not use the nullity of the company as an excuse against third parties. The company shall be liquidated as a going concern without prejudice to the right of any concerned party to institute legal proceedings for joint liability against the founders, the members of the first board of directors and the first auditors". Also, Article (130)"In the case of offering new shares for public subscription, a prospectus shall be issued containing, in particular, the following details:
1. The reasons of the capital increase.
2. The resolution of the extraordinary or the ordinary general assembly, as the case may be, authorizing the capital increase.
3. The capital of the company at the time of issuing the new shares, the amount of the proposed increase, the number of the new shares and the issue premium, if any.
4. A statement on the in-kind shares, if any.
5. A statement on the average profits distributed by the company during the three years preceding the capital increase.
6. A declaration from the auditor certifying the details mentioned in the prospectus.
ii. The chairman of the board of directors and the auditor shall sign the prospectus and shall be jointly liable for the accuracy of the details contained therein". The same applies in Article 143 in the case of the call for public subscription for the loan bonds.
Another example is Article (115) which stated that:
"i. The shareholder shall pay the value of the shares on the due dates. Interests shall be charged for the delay in payment once the date falls due without the need for serving a notice.
ii. If a shareholder fails to pay a due installment, the board of directors shall be entitled to sell the share after serving a notice to the defaulting shareholder by registered mail with a delivery note. If the shareholder does not pay the amount within ten days from the date of receiving the notice, the company may sell the share in the Bahrain Stock Exchange or in a public auction. However, the defaulting shareholder may pay the due installment until the date of the auction in addition to the expenses incurred by the company.
iii. The company shall recover from the proceeds of the sale the delayed installments and expenses and refund to the shareholder any excess amounts. If the proceeds fall short of the company's entitlements the company shall claim the difference by using the ordinary methods". And I assume the "ordinary methods" as mentioned earlier is to refer to the personal monies of the shareholder.
It is important also to highlight that the "holding company", in order to implement the provisions of piercing the corporate veil, a holding company must own more than half the capital of the affiliated company and it should be established mainly to:
i. To manage its affiliated companies or to participate in the management of other companies in which it has shares, and to provide the necessary support for such companies.
ii. To invest its funds in shares, bonds and other securities.
iii. To own real estates and other assets necessary for undertaking its activities within the limits permitted by law.
iv. To offer loans, guarantees and financing to its affiliated companies.
v. To own industrial property rights including patents, trade and industrial marks, concession and other intellectual rights, and to use and lease them to its affiliated companies or to other companies.

• Liability arising from the control of the holding company over its subsidiaries:

The holding company must own more than half the capital of the affiliated company. It may take one of the following forms: (A joint-stock company) – (A limited liability company) – (A single person company), and because of that the holding company should be treated as per the form it takes among the three mentioned above, then it is the need to insert the same provisions of veil piercing, but the minor difficulty came if the losses, errors, defaults, mistakes, mismangemnets or violations came through the subsisdary company affiliaterd to it. This isuuse is governed by these condiotins :(16)

1. The existence of the parent company.
2. The existence of a subsidiary company or companies where the parent company contributes to a large proportion of the company's shares.
3. That the parent company controls the subsidiaries through owning a large percentage of its shares.
4. That the subsidiary company shall enjoy independent legal personality from the parent company.

As mentioned above, the subsidiary company enjoys an independent legal personality from the holding company, but this independence is only legal and not realistic; the holding company actually manages an integrated economic projects, and this project which it sits at the helm of it, allows it to impose administrative and financial control over its subsidiaries, and that is what the legal basis for the responsibility of the holding company for the debts of the subsidiary company comes from, i.e. because it is the major contributor to the company's capital, enabling it to appoint members of the Board of Directors, or dismiss them, and then to control the decisions of the board.

However, we are of the opinion that there is no need to resort to such a justification to establish the responsibility of the holding company for the subsidiary company's debt; because, a holding company with subsidiaries form an integrated economic unit combine to have all financial accounts, especially when the company is a wholly-owned Holding Company where its budget clearly shows that - this budget- is only a combine pool of accounts

(16) - مدى مسؤولية الشركة الأم الأجنبية عن ديون شركتها الوليدة المصرية " دراسة في بعض جوانب الإفلاس الدولي لمجموعة الشركات متعددة الجنسيات (القسم الأول والثاني) . د. شريف محمد غنام – مجلة الحقوق- مجلس النشر العلمي – جامعة الكويت – العدد الأول والثاني – السنة السابعة والعشرون – ربيع الأخر 1424 – مارس و يونيو 2003

of the holding company and its subsidiaries. This means that there is a financial and economic integration between the holding company and its subsidiaries. This is why some tend to say that the court may, in the case of subsidiaries' debt, take collective action against all the companies (holding and subsidiary companies), as one economic unit, although both of them are an independent company, because the independent legal personality for each of these companies is only a symbolic figure that does not exist in reality.

Finally, it must be pointed out that the Bahraini Companies Law has shown, clearly, the financial unity of the holding company and its subsidiaries when it ruled in Article (303) that, "A holding company shall prepare at the end of each financial year an aggregated balance sheet and profit and loss accounts for it and all its affiliated companies together with the notes and statements thereon in accordance with the international accounting principles".

2.2 The application of such doctrine in the courts:

Most of the cases in the Kingdom of Bahrain's Cassation Court are mostly relating to the limited liability company in which the directors (partners or managers) will be held liable in their personal monies for their willful or negligent actions or omission to comply with laws and regulations, and most of them were relating to the old Commercial Company Law of 1975 (i.e. before the current Commercial Companies Law of 2001), we can take some examples without disclosing the names of the parties as follows:

Appeal no. 32 of 1997, case no. 2/ 1988/ 2394/ 8 (17) ,the Cassation Court established that: "Managers in the limited liability company are liable to third parties for violation of provisions of the law and the mismanagement according to the text of articles 156, 157 and 235 of the Commercial Companies Law 1975 on the basis of the provisions of the tort, and they should be held personally liable for their own mistake and if they multiply, they should be jointly held responsible in solidarity to compensate third parties for damage caused as a result of this default , if it was manifested from the company's Memorandum of Association that the management was given to the appellant (the manager) and another partner without specifying the authority of each of them, and that the First Instance Court's judgment assessed the evidence based on the expert's report that the mangers of the company did not renew its registration in the commercial register since

(17) تاريخ الجلسة 1997-9-28 - مكتب فني 8 - رقم الجزء 1 - رقم الصفحة 397

1982 and never have appointed an auditor to their accounts as requested by the texts of the Memorandum of Association and did not submit to the Ministry of Commerce any of the company's annual budget or an account of profits and losses or an annual report on its activities and its financial position as Article 243 of the Commercial Companies Law required. The company's presence was not in the same as the registered address with the Ministry of Commerce's records or in any other place in Bahrain, a matter that indicates that they ceased to operate without taking action of resolve and liquidation in accordance with the law. Therefore, their responsibility is jointly recognized to compensate the respondent from their own personal monies".

In another appeal no. 73 of 1991(18) , the Cassation Court concluded that: "it was originally scheduled in the law that the responsibility of the partners in the limited liability company is limited to the extent of their shares and that the company's creditors are not entitled to demand or execute on their own money, but that if managers to one of the partners alone or with others has been put in charge, it is subject to the provisions of Article 235 of the Commercial Companies Law of 1975 which requires the responsibility of managers in solidarity towards the company, partners and third parties for violating the provisions of law or the Articles of Association or mismanagement according to the rules set forth in the joint stock company. This responsibility remains even after the dissolution as long as those were in charge of managing directors and they should be considered as liquidators until appointing a liquidator in accordance with the provisions of Article 258 of the law, regardless of whether the actions that triggered the managers to compensate constitute a crime according to the provisions of the Penal Code and the Commercial Companies' Law".

Other example is in Appeal no. 441 of 2002 (19) in which the court stated that........The text in Article 217 of the Commercial Companies Law of 1975 that limited liability company shall have a special name ... and this name must be followed with the phrase "limited liability company" with a capital statement, all of this should be mentioned in all the company's contracts, invoices, papers, communications and publications, and if all of this were not mentioned, the managers of the company should be jointly liable in their own money to third parties, and then the target of the capital statement is to protect dealers with the company , therefore, the dealers (third parties) who benefit from the recourse to the manager's own money are only those with good faith in order to benefit from this recourse.

(18) تاريخ الجلسة 1992-3-8 – مكتب فني 3 – رقم الجزء 1 – رقم الصفحة 66

(19) تاريخ الجلسة 2003-12-1 – مكتب فني 14 – رقم الصفحة 653

2.3 In the English law:

After the case of Salomon, the House of Lords' opinion dominated, until 1916, where veil lifting did occur in exceptional circumstances. The cour for example in Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd (1916) lifted the veil to determine whether the company was an "enemy" during the First World War. As the shareholders were German, the court determined that the company was indeed an enemy. (20)

In Gilford Motor Co Ltd v Horne (1933) a former employee who was bound by a covenant not to solicit customers from his former employers set up a company to do so. The court found that the company was but a front for Mr. Horne and issued an injunction.

In Jones v Lipman (1962) Mr. Lipman had entered into a contract with Mr. Jones for the sale of land. He formed a company in order to avoid the transaction and conveyed the land to instead. He then claimed he no longer owned the land and could not comply with the contract. The judge again found the company was but a façade and granted an order for specific performance. In Re Bugle Press (1961) majority shareholders in a company set up a second company in order to force a compulsory purchase of a minority shareholder's shares. The second company then made an offer for the shares in the first company and the majority shareholders accepted. As this meant that over 90 per cent of the shareolders had accepted it therfore triggered a compulsory purchase of the minority sharholder's shares under the Companies Act, . The Minority shareholder objected and the court prevented the transaction again as the second company was but a mere façade for the majority shareholders.

Other examples were followed in which we can conclude that there are certain prongs in the English Law which most scholars listed them as follows:

1- Fraud, sham or façade.

2- Unity ownership (Alter Ego, the individual treated the and regarded the corporation as his or her alter ego)

3- Unity of interest (instrumentality, using the corporation as a conduit through which he or she conducted his or her personal business).

4- Abuse of power, wrongful conduct and mismanagement (Whether the corporation was grossly undercapitalized; Failure to observe corporate formalities; Non-payment of dividends; Insolvency of the debtor corporation at the time; Siphoning of funds of the corporation by the dominant stockholder; non-functioning of other officers or other directors; Absence of

(20) Dignam and Lowry.

corporate records; not holding shareholder/director meetings to not making sure the officers follow any bylaws; two shareholders owned all stock and shareholders behavior in lease negotiations suggested they were acting for their behalf rather than for the corporation.

5- The Agency.(21) It was already decided in the Salomon case that if a company acts as an agent for another party the corporate veil might be lifted. However, the courts seem to be unwilling to determine that a principal/agent relationship exists, especially when concerning an individual controlling shareholder. Yet, the courts are less reluctant to imply that a principal/agent relationship exists when the alleged agency is between a holding company and its subsidiary, probably because in these circumstances the management of the holding company may have a better opportunity to take advantage of the limited liability principle.

In Adams v Cape the Court of Appeal held that the veil of incorporation could in essence be pierced when there was an express agency agreement, for example, between the parent and the subsidiary company. In the absence of such an agreement, no agency relationship can be presumed. According to the facts of the case, the U.S. Company rendered certain services to Cape Industries plc and even acted as its agent in relation to some specific transactions, but this was not sufficient to constitute a general agency agreement. Consequently, though there is no presumption of an agency it can be implied, i.e. agency is not automatic but also not precluded. The English Court of Appeal in Ebb Vale Urban District Council v South Wales Traffic Area Licensing Authority considered the relationship between the parent and 100 per cent owned subsidiary company. It was stated that under "the ordinary rules of law a parent company and subsidiary company, even a hundred per cent subsidiary company, are distinct legal entities, and in the absence of a contract of agency between the two companies one cannot be said to be the agent of the other." According to Cohen LJ this was clearly established by Salomon v Salomon and Co Ltd. In another English case DHN Food Distributors Ltd v Tower Hamlets London Borough Council, the Court of Appeal, or more precisely Lord

Denning MR, always keen on lifting the corporate veil, treated a group of companies as a single economic entity and enabled compensation for compulsory purchase of land to be paid.

From this decision it had been said that there is "a short step" to "the proposition that the courts may disregard Salomon's principle whenever

(21) Anna Farat & Denis Michon, Lifting the Corporate Veil, Limited Liability of the Company Decision-Makers Undermined? Analysis of English, U.S., German, Czech and Polish Approach. Common Law Review. Czech.

it is just and equitable to do so." Such situations are nowadays considered as exceptional and the verdict in the DHN case has been subject to doubt several times since, e.g. in Woolfson v Strathclyde Regional Council and Industrial Equity Limited and Others v Tower Hamlets. In Woolfson the House of Lords not only distinguished the earlier decision of the Court of Appeal in DHN but also doubted whether the Court of Appeal "properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating ... a mere façade concealing true facts."

The different judicial approaches to the question of whether a company has acted as an agent make it difficult to rationalise the judgments. In The Electric Light and Power Supply Corporation Limited v Cormack(22), Rich AJ refused to pierce the veil of a one-man company. The defendant had contracted with the plaintiffs to use their power supply for his works for two years, and not to install any other form of motive power during that period. During the two-year period, the defendant sold his works to a company of which he was the manager and shareholder. The new company then installed motive power other than that supplied by the plaintiffs. Rich AJ refused to find that the defendant had breached the contract, viewing it as a personal undertaking. Rich AJ held that "[t]hese acts are in fact being done, not by the defendant personally, but by him as agent for A.W. Cormack Ltd., which even if a "one-man company" is a different entity." Rich AJ found no evidence that the sale of the business by the defendant was done with the object of evading his personal obligations.

According to some jurists, the current position of English Courts is that, it is important to mention that the creditors are, inter alia, protected by numerous statutory provisions concerning the lifting of the corporate veil. The Parliament is always authorized to enact exceptions to the Salomon principle and has done so several times. The courts, therefore, have to accept that even though the principle of separate legal entity may cause injustice, unless the Parliament in its Act provides so, the court should not interfere. A crucial exception enacted by the UK Parliament is Section 213 of the 1986 Insolvency Act. Accordingly, the creditors are protected where the business of the company has been carried out to defraud them, and the courts on a winding-up are entitled to look behind the corporate veil in such a case.

To summarise the English common law exceptions to the Salomon principle according to Michelle G. Hicks, it is fair to say that the courts probably will not lift the corporate veil in order to impose liability on a

(22) The Electric Light and Power Supply Corporation Limited v Cormack (1911) 11 NSWSR 350 (SCNSW, Rich AJ).

shareholder for the company's debts. He also states that "in rare instances the courts will look to the substance rather than the form to deny benefits of corporate status which they think should not be enjoyed." He goes on contemplating that it is difficult to predict when the courts will do so, however, the judges' subjective perception of fairness or policy might be a useful guide.

It has also been presented that the notion that "the judges are increasingly prepared to disregard the autonomous personality of companies to facilitate the legitimate interests and expectations of those who come in contact with them, is clearly ' overstatement' of the position."

2.3.1 Principles governing veil piercing in English case law:

The below principles might work as guidance to the courts in deciding, whether the circumstances of a particular case, justifies the piercing of the corporate veil.

In VTB Capital plc v. Nutritek International Corp & Others, the High Court held that it was not appropriate to pierce the corporate veil and allow contractual claims to proceed against the defendants, who were not contracting parties to the loan agreement, i.e., the puppeteer could not be placed into the puppet's contract. . The facts are set out below.

VTB entered into a loan agreement with a third party (RAP) in order to fund the acquisition of various dairy companies from Nutritek. RAP subsequently defaulted on the loan. VTB alleged that it had been induced to enter into the loan agreement by fraudulent misrepresentations made by Nutritek as to Nutritek's control of RAP and the value of the dairy companies. After entering into the loan agreement, VTB discovered that RAP and Nutritek were under common control and, therefore, the transaction was not 'at arm's length'. VTB initially pleaded causes of action against the defendants in deceit and unlawful means conspiracy, but later applied to amend its particulars of claim in order to bring a contractual claim against the second, third and fourth defendants. VTB's application was refused.

On appeal, the Court of Appeal upheld the decision of the High Court; it was not open to the English courts to hold, once the corporate veil has been pierced, that a puppeteer was a party to a puppet company's contract. The Court of Appeal also used the opportunity to re-state and clarify the

general principles a court should apply when deciding whether to pierce the corporate veil (23):

1. Ownership and control of a company are not of themselves sufficient to justify piercing the veil

2. The court cannot pierce the corporate veil, even when no unconnected third party is involved, merely because it is perceived that to do so is necessary in the interests of justice

3. The corporate veil can only be pierced when there is some impropriety

4. The company's involvement in an impropriety will not by itself justify a piercing of its veil: the impropriety "must be linked to use of the company structure to avoid or conceal liability"

5. It follows that if the court is to pierce the veil, it is necessary to show both control of the company by the wrongdoer and impropriety in the sense of a misuse of the company as a device or façade to conceal wrongdoing.

6. A company can be a façade for such purposes even though not incorporated with deceptive intent; "the question is whether it is being used as a façade at the time of the relevant transaction(s)"

7. A piercing of the corporate veil will not be available only if there is no other remedy available against the wrongdoers for the wrong they have committed.

In the case of Prest -v- Petrodel Resources Limited Lord Sumption, in delivering the leading judgment, concluded that the corporate veil could, absent any statutory provision, only be pierced when "a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control" and only then for the purpose of "depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality". Lord Sumption described the principle of piercing the corporate veil as a limited one because "in almost every case where the test is satisfied the facts will ...... disclose a legal relationship between the company and its controller which will make it unnecessary to pierce the corporate veil."

In conducting a lengthy review of the authorities Lord Sumption distinguished between cases that applied what he termed the "concealment principle" and the "evasion principle". The concealment principle does not involve piercing the corporate veil. The interposition of a company to conceal the identity of the real actors will not deter the courts from identifying them, assuming that their identity is legally relevant. The court in that situation is not disregarding the "facade", but only looking behind it

(23) Latham and Watkins, In Practice, Janine Perkins, The London Dispute Newsletter, October 2012.

to discover the facts which the corporate structure is concealing. This could be done for instance by applying the laws of trust or agency. The evasion principle is different in that it entitles a court to disregard the corporate veil "if there is a legal right against the person in control of it which exists independently of the company's involvement and a company is interposed so that the separate legal personality of the company would defeat the right or frustrate its enforcement".

However, there were differences of opinion in Petrodel amongst the seven Justices. Lord Walker expressed doubts over the doctrine's existence. Lady Hale (with whom Lord Wilson agrees) was uncertain whether all previous cases come within Lord Sumption's formulation. At the other end of the spectrum Lords Mance and Clarke leaved open the possibility of piercing the corporate veil in circumstances beyond those envisaged by Lord Sumption. Lord Neuberger agrees with Lord Sumption but added his own analysis to his judgment.

What seemd clear, however, was that the majority of the Supreme Court acknowledge, albeit obiter, the existence of the doctrine of piercing the corporate veil and that it extends at least as far as the test formulated by Lord Sumption.

- Criminal side of piercing in English Law:

In English criminal law there have been cases in which the courts have been prepared to pierce the veil of incorporation. For example in confiscation proceedings under the Proceeds of Crime Act 2002 monies received by a company can, depending upon the particular facts of the case as found by the court, be regarded as having been 'obtained' by an individual (who is usually, but not always, a director of the company). In consequence those monies may become an element in the individual's 'benefit' obtained from criminal conduct (and hence subject to confiscation from him)(24) . The position regarding 'piercing the veil' in English criminal law was given in the Court of Appeal judgment in the case of R v Seager(25) in which the court said: There was no major disagreement between counsel on the legal principles by reference to which a court is entitled to "pierce" or "rend" or "remove" the "corporate veil". It is "hornbook" law that a duly formed and registered company is a separate legal entity from those who are its shareholders and it has rights and liabilities that are separate from its shareholders. A court can "pierce" the carapace of the corporate entity and look at what lies behind it

(24) David Winch, "Confiscation: lifting the veil of incorporation" (2013)
(25) http://www.bailii.org/ew/cases/EWCA/Crim/2009/1303.html

only in certain circumstances. It cannot do so simply because it considers it might be just to do so. Each of these circumstances involves impropriety and dishonesty. The court will then be entitled to look for the legal substance, not the just the form. In the context of criminal cases the courts have identified at least three situations when the corporate veil can be pierced. First if an offender attempts to shelter behind a corporate façade, or veil to hide his crime and his benefits from it. Second, where an offender does acts in the name of a company which (with the necessary mens rea) constitute a criminal offence which leads to the offender's conviction, then "the veil of incorporation is not so much pierced as rudely torn away": per Lord Bingham in Jennings v CPS, paragraph. Thirdly, where the transaction or business structures constitute a "device", "cloak" or "sham", i.e. an attempt to disguise the true nature of the transaction or structure so as to deceive third parties or the courts.

2.4 In the US Laws:

The doctrine of lifting the corporate veil (in the US mostly under the name of "piercing the corporate veil" or "disregard of legal entity") has its true origins in the American law and – in contrast to Europe – it is considered there to be a normal part of the legal system. Whereas European judges, not excluding the English ones, rather carefully reach a conclusion to dislodge the separate legal entity of the company, their American colleagues hand down rulings in favour of creditors, apparently without much doubt. If one realizes that apart from Texas there are no statutory examples of restrictions regarding the institution of piercing the corporate veil, it remains apparent what a great deal of responsibility they shoulder.

The maxim that a company is a separate legal entity distinct from its members was established in the USA even earlier than in the UK in the case of Bank of Augusta v. Earle (1839). Attempts to disregard the separate entity preserve a close link to equity. This may be the reason for which in the United States the piercing of the corporate veil has been equated to a lightning: "it's rare, severe and unprincipled." One can say that every factual state develops its own set of elements that should be taken into account. Traditional tests aim to prevent fraud and achieve equity. For the reason of clarity some authors have tried to provide a viable alternative to the rather changeable combination of facts and proposed using the term "the totality of circumstances rule". Notwithstanding how practical it seems in the debates, it remains still a blanket term and is just a better name of saying that the doctrine of piercing the veil is based on different elements adjudicated ad casu. In fact, much is dependent on the judge and what he/she considers an equitable result. Consequently, the outcomes of similar cases may diverge.

The U.S. courts lift the company's immunity in a variety of situations. The piercing concept does not come from the laws of the states or federal government but it is a judicial creation which varies from state to state. The scope of abuses relating to groups of companies is the most popular reason for which the courts disregard the separate entity principle. If a controlled company is organized as a mere tool in the hands of a parent enterprise and the separateness of the two corporations has ceased (instrumentality rule), one can assume that holding only the subsidiary corporation liable for any damages resulting from fraud or dishonesty of the parent company would result in injustice. Similar conclusion can be drawn under the alter ego doctrine which is also demonstrated by showing a blending of identities between two corporations and thus, in practice, it is difficult to distinguish them.

Courts primarily rely on two tests to determine the circumstances under which to pierce the corporate veil. Under these tests, both the elements and standards of proof are fairly consistent(26). The "alter ego" test is equitable in nature and pierces the corporate veil in situations where fraud, illegality, or injustice must be avoided or public policy goals would be defeated.(27) The "instrumentality" test, on the other hand, requires a showing that the controlling shareholder exercised "extensive controls over the acts of the entity giving rise to the claim of wrongdoing." Regardless of the test used, the determination of piercing the corporate veil is a fact-intensive issue and is typically decided by a jury.(28)

The fact-intensive nature of these two tests leads to an extensive overlap of factors, which explains in part why some courts use the tests interchangeably.(29) At the most general level, "these two tests essentially

(26) 114 AM. JUR. PROOF OF FACTS 3d 403, §6; see White v. Winchester Land Dev. Corp., 584 S.W.2d 56, 61–63 (Ky. Ct. App. 1979) (examining the instrumentality theory and the alter ego theory); see also House of Koscot Dev. Corp. v. Am. Line Cosmetics, Inc., 468 F.2d 64, 67 (5th Cir. 1972) (appearing to use the two theories interchangeably); see also FMC Fin. Corp. v. Murphree, 632 F.2d 413, 422 (5th Cir. 1980) (explaining that it is "inappropriate to attempt to apply any verbalization of the test in a mechanical manner").

(27) John H. Matheson, The Limits of Business Limited Liability: Entity Veil Piercing and Successor Liability Doctrines, 31 WM. MITCHELL L. REV. 411, 420 n.28 (2005) (citing Richard v. Bell Atl. Corp., 946 F. Supp. 54, 61 (D.D.C. 1996)).

(28) Johnson & Johnson Consumer Cos., Inc. v. Aini, No. 02-CV-6624 (DLI), 2009 WL 6055841, at *7 (E.D.N.Y. Dec. 1, 2009) (citing Carte Blanche PTE., Ltd. v. Diner Club Int'l, Inc., 758 F. Supp. 908, 914 (S.D.N.Y. 1991)); see also Fulgini Orilio & F.LLI S.p.A v. Letttieri, No. 05 Civ. 3718(SMG), 2007 WL 1834750, at *3 (E.D.N.Y. June 26,

(29) See 114 AM. JUR. PROOF OF FACTS 3d 403, § 1 ("In piercing the corporate veil, the courts frequently employ terms such as 'alter ego,' 'instrumentality,' and 'sham,' but the use of such words in judicial opinions is of little help to the practitioner; such labels serve as shorthand for a conclusion but provide no guidance as to what factors were considered in reaching that conclusion."); Frank H. Easterbrook & Daniel R. Fischel, Limited Liability and the Corporation, 52 U. CHI. L. REV. 89, 89 (1985) ("There is a consensus that the whole area of limited liability, and conversely of piercing the corporate veil, is among the most confusing in corporate law."); see also AE Rests. Assocs., LLC v. Giampietro (In re Giampietro), 317 B.R. 841, 846 (Bankr. D. Nev. 2004).

require proof of a unity of interest between the individual and entity and an inequitable result would follow as a consequence."(30) Some jurisdictions add a third element, "proximate cause", which requires that the underlying control and breach of duty "proximately cause the injury or unjust loss complained of . . . ." (31)

In the coming paragraphs we will give brief reviewing of the need for such a doctrine and a glanced view of its prerequisite application.

- Reverse Piercing under US Laws:

Under the US Laws, in some instances, parties may seek to "reverse pierce". "Reverse Pierce' treats the assets of the LLC as owned by the member in order to avoid fraud on creditors.

The term "reverse piercing" the corporate veil refers to a doctrine whereby courts disregard the corporation as an entity separate from one of its shareholders. In this sense, reverse piercing is similar to the more familiar doctrine of piercing the corporate veil. The difference is that in regular, "forward" veil piercing, a creditor of the corporation is typically attempting to hold a shareholder personally liable for debts of the corporation, whereas in reverse piercing a creditor of the shareholder is typically trying to hold the corporation liable for debts of the shareholder.

One might wonder why reverse piercing is necessary. The creditor of a shareholder can already indirectly reach the corporation's assets because the creditor can reach the shareholder's stock, which could be sold to pay the claim. The answer is complex because reverse piercing arises in more varied contexts than traditional veil piercing. Under some statutes it might be advantageous to treat the assets of a corporation as assets of the shareholder. In other contexts, it might simply be easier to bypass the two-step process of proceeding against the stock and then dissolving the corporation or selling the stock.

Examples:

C. F Trust, Inc. v. First Flight LTD Partnership, (Va. 2001) – The Virginia court permitted reverse piercing of the corporate veil where a judgment debtor used his limited partnership interest to evade creditors. The court was persuaded by the fact that the debtor maintained control over the

(30) 114 AM. JUR. PROOF OF FACTS 3d 403, § 6; Trustees of the Graphic Commc'ns Intern. Union Upper Midwest Local 1M Health & Welfare Plan v. Bjorkedal, 516 F.3d 719, 728–29 (8th Cir. 2008); Troyk v. Farmers Grp., Inc., 90 Cal.Rptr.3d 589, 619 (Ct. App. 2009).

(31) Davenport v. Quinn, 730 A.2d 1184, 1196 (Conn. App. Ct. 1990); see also E. Market St. Square, Inc. v. Tycorp Pizza IV, Inc., 625 S.E.2d 191, 196 (N.C. Ct. App. 2006).

partnership and its distributions despite official transfer of control and ownership to another person, and the debtor siphoned business assets for his own personal use and without a business purpose.

In re Phillips, (Colo.2006) – The court stated that Colorado law allows reverse piercing of the corporate veil when justice requires. Mallard Automotive Group, Ltd. V. Le Clair Management Corp., (D. Nev. 2001)- The Nevada court held that a party seeking to hold a corporation responsible for an individual's debt under reverse piercing does not have to prove that the corporate form was disregarded. Litchfield Asset Management Corp. v. Howell, (Conn. App.2002) – The Connecticut court found the evidence was sufficient to disregard the corporate form and hold limited liability company responsible for the debtor's personal debt where the debtor used company funds to pay for the debtor's personal expenses and used corporate funds as her own; the corporation did not pay her a salary but paid her expenses directly; the debtor owned 97 percent of the stock and all of the stock of the second corporation; and both companies operated outside of the same office space over the debtor's garage.

State Bank of Eden Valley v. Euerle Farms, Inc., it was held that the family farm was the alter ego of its occupants and the corporate veil was properly reverse pierced to reach property. LFC Marketing Group. Inc. v. Loomis, (Nev. 2000)- The Nevada court listed reverse piercing cases and found use of the doctrine was appropriate where a corporation is being used to hide assets or secretly conduct business to avoid pre-existing liability of controlling debtor.

In any case, reverse piercing is controversial. The doctrine is problematic when the relevant corporation has multiple shareholders, and even when there is only one shareholder it can give creditors of a shareholder an advantage they would not normally have relative to creditors of the corporation. As a result, reverse piercing is less universally recognized than traditional veil piercing, not having been accepted in all state courts .(32)

3. The need for corporate veil piercing:

We reached the idea that this corporate rule represents, in some judicial cases, a principle of fairness and justice and acts as an alarm to the owners, shareholders, directors and others that certain cases of liability may be initiated by creditors and tort claimants against them. This means creditors can go after the owners' home, bank account, investments, and other assets to satisfy the corporate debt.

(32) http://witnesseth.typepad.com/blog/reverse-piercing.html

The doctrine of corporate veil piercing matters because of the need to achieve these goals of:

- Corporate structure presumptively respected
- Establish the suitable jurisdiction
- Establish liability
- Expand pool of recoverable assets
- Facilitate discovery of truth and the real operations behind the company

In the UK, the taxation authorities have been actually aware of the potential for group structure to avoid taxation by moving assets and liabilities around the group Thus there are numerous examples of taxation legislation directed at ignoring the separate entities in the group.

The need for this famous section of law goes beyond the pure corporate diputes to the disputes between individuals or corporate persons and the state as a sovereign body, for example if a company sat up a corporation or a structure of group of companies in order to evade the enforcement of one or more of its then existing liabilities, it remains forever so pierced to the advantage of every other third party creditor thereafter. We can take example of the Republic of Congo in the case of (Kensington International Limited V. Republic of Congo).

In Kensington International Limited -v- Republic of the Congo (November 2005), the Congo attempted to avoid its debts by trading oil through a network of companies. These companies and the relevant transactions were found to be shams. In such circumstances, the court could pierce the corporate veil.

- Background

Cotrade SA (a wholly-owned subsidiary of SNPC (see above)) entered into a contract with Africa Oil & Gas Corporation (AOGC) for the sale of oil. AOGC sold the oil to Sphynx (BDA) Limited (Sphynx). Sphynx then sold the oil to Glencore Energy UK Limited (Glencore).

Kensington sought an order that Glencore pay to Kensington the monies Glencore owed to Sphynx on the basis that receipt of money by Sphynx would, in reality, be receipt by the Congo. The court should therefore pierce the corporate veil and treat Glencore's debt to Sphynx as a debt which was, in reality, due to the Congo. The court agreed.

- The law

In his judgment Mr Justice Cooke summarised the principles of law relating to sham contracts. The following propositions are worth noting:

o to justify the court "piercing the corporate veil", an element of impropriety or dishonesty will be required;

o a "sham" agreement is one where the parties do not honour the rights and obligations which are set out in the agreement. It serves as a smokescreen as to the true nature of their contractual relations. In reality, the agreement is not effective;

o the transfer of assets (even if not at an undervalue) so as to divest a company of those assets for the purpose of ensuring they would not be available to meet existing liabilities may justify piercing the corporate veil;

o a court will look for the substance of a matter and, in doing so, will look for the legal substance rather than its economic substance, if different; and

o the corporate veil will not be lifted where the corporate structure was created in order to evade rights of relief which third parties might, in the future, acquire. The corporate structure could legitimately be used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and, correspondingly, the risk of enforcement of that liability) would fall on a particular member of the group, rather than upon its parent or associated companies.

· The court's decision

SNPC and Cotrade were part of the state and had no independent existence. Debts owed to either of them were debts owed to the Congo. The transactions in question were all held to be shams, and therefore third party debt orders for the purchase price of the relevant cargo of oil were made.

AOGC, run by a Mr Gokana, who was also the President and Director General of SNPC and a special adviser to the President of the Congo, used AOGC's name and bank account for the sales by SNPC and Cotrade, disregarding the corporate personality, organisation or interests of AOGC and without the knowledge of anyone else at AOGC. The same position applied to Sphynx. Very little money passed through its bank account and, with regard to the cargo at issue, the monies were remitted direct from Sphynx's purchaser into the AOGC account from which Cotrade was paid.

Mr Gokana had made all the arrangements between AOGC and Sphynx; they were not at arm's length. He also indirectly controlled the contractual documents between AOGC and Cotrade. The documents were of a "shambolic nature", which rather gave the game away and illustrated the sham nature of the transaction.

3.1 A question to be raised: What is the Auditors' responsibility?

Some may raise the question that the company law shall not have provisions of piercing the veil because it might be better to blame the

auditors in any matter of fraud or commingling of assets or other potential situations.

However, small corporations are less likely than their larger counterparts to observe corporate formalities, which makes them more vulnerable to

a piercing of their corporate veil, we mean by formalities: holding annual meetings of directors and shareholders or members, keeping accurate, detailed records (called "minutes") of important decisions that are made at the meetings, adopting company bylaws, and making sure that officers and agents abide by those bylaws.

The case of the Stone & Rolls Ltd v Moore Stephens [2009] UKHL is a leading case relevant for the English company law and the law on fraud and ex turpi causa non oritur action (Latin expression that stands for: "from a dishonorable cause an action does not arise") a legal doctrine which states that a plaintiff will be unable to pursue legal remedy if it arises in connection with his own illegal act. The House of Lords decided by a majority of three to two that where the director and sole shareholder of a closely held private company deceived the auditors with fraud carried out on all creditors, subsequently the creditors of the insolvent company would be barred from suing the auditors for negligence from the shoes of the company. The Lords reasoned that where the company was only identifiable with one person, the fraud of that person would be attributable to the company, and the "company" (or the creditors standing in its insolvent shoes) could not rely on its own illegal fraud when bringing a claim for negligence against any auditors. The facts were: Stone Rolls Limited ("Company") wholly owned and directed by Stojevic ("S"). Moore Stephens were auditors who performed Audits for Company between 1996-1998. S deceitfully siphoned company assets away and falsified accounts to show more profitable transactions than the actual case. In previous litigation, a Czech bank successfully sued Company and S. Company went into liquidation. Company's creditors acting in company's name sued Auditors for failing to detect fraud, they claimed USD 174million. Moore Stephens argued that if they were negligent, it would be contrary to public policy to let Company sue them. Based on principle that claimant cannot come to court to make a plea while replying on his own illegal behavior, (Doctrine of " Ex Turpi Causa Non Oritur Actio" , the High Court decided S's action and state of mind were attributed to the Company. Auditors had a duty to detect fraud, it was the very thing they were engaged to do. Court of Appeal held that Auditors could rely on defence of Ex Turpi Cause. The House of Lords held that Auditors could rely on defense to prevent the Company's claim for negligence. S was the exclusive owner and controller and S's fraudulent intentions were attributed to the Company, as fraudulent acts done for Company's benefit and the company deemed to be aware of S's fraud. Auditors owed a duty to perform their audit diligently to

the Company (not to individual shareholder/creditors), if the company tried to bring a claim for breach of Auditor's duty, Company would be relying on its illegality.

In Bahrain, the auditors have their own unique role, which is already mentioned in the Decree Law no. 26 of 1996 concerning the Auditors in which Article (25) has stated clearly that: "The owner of the auditing office shall be responsible for compensation of damage to the customer or third parties caused by gross negligence and professional errors occurred during the performance of the office's work, and in the case of multiple auditing offices, the owners should collectively be responsible in solidarity of compensation. The owner of the auditing office must arrange insurance cover to cope with this responsibility".

Also the Bahraini Company Law of 2001 has many articles that deals with this issue such as Article 220 which concerns the joint-stock company's auditor, it stated that:" "The auditor shall be responsible for the accuracy of the details included in his report in his capacity as the representative of all the shareholders, and each shareholder shall have the right to discuss, at the meeting of the general assembly, the report of the auditor and seek clarifications on its contents. The auditor shall be liable towards the company for any damages sustained by the company as a result of his mistakes. If the company has more than one auditor and they were involved in the mistake they shall become jointly liable towards the company. The civil liability action referred to in the foregoing paragraph shall be barred after the lapse of one year from the date of the general assembly meeting at which the auditor's report was read. If the act attributed to the auditor constitutes a crime, the civil liability action shall not lapse except with the lapse of the general action. The auditor shall also be liable to pay compensation for any damage that may be sustained by any bona fide shareholder or third parties as a result of his professional error or of not complying with the accounting principles and standards".

It is important to mention that in October 2015, the amendment to the law - (Decree Law no. 28 of 2015) has replaced Article 286-c and Article 361-d to reflect the following:

"The managers, from one side, and the auditors form the other side, shall forward to the ministry of commerce - within six months from the end of the fiscal year- a copy of the balance sheet, the profit and loss account, the annual report and the signed and stamped auditor's report regarding the financial position of the company in according with the model created by the ministry. And in case the loss of the company exceeded half of its capital, the managers and the auditor should submit to the ministry a copy of the signed and stamped auditor's report. In all cases, the ministry may request

any financial data, documents, reports or additional information that it sees necessary".

Article 361-d: Without prejudice to any severer penalty provided for in the Penal Code or in any other law, imprisonment and a fine not less than five thousands Bahraini Dinars and not exceeding ten thousands Bahraini Dinars or either of these two penalties shall be imposed on:

"Each board member, director or auditor participated in the preparation or adoption of the budget or sent to the ministry letter in accordance with the provisions of paragraph (c) of Article (286) of this law in a way that does not reflect properly the truth about the financial position of the company or an account of profits and losses that does not reflect properly all the company's profits or losses for the fiscal year, or does not send to the ministry any of the financial statements, documents, reports, or letters required in accordance with the provisions of paragraph (c) of Article (286) of this law".

3.2 Directors and Officers Liability Insurance, does it stand?

In Bahrain, we mentioned a closer link to insurance of professional liability in the aforementioned Article (25) of the Auditors Law, in which it stated that: "The owner of the auditing office shall be responsible for compensation of damage to the customer or third parties caused by gross negligence and professional errors occurred during the performance of the office's work, and in the case of multiple auditing offices, the owners should collectively be responsible in solidarity of compensation. The owner of the auditing office must arrange insurance cover to cope with this responsibility".

In the United States, Canada, England and Wales, and Australia, directors and officers insurance is provided so that competent professionals can serve as supervisors of organizations without fear of personal financial loss. Directors are typically not managing the day-to-day operations of the organization and therefore cannot ensure that the organization will be successful; further, business is inherently risky. Thus the "business judgment rule" has developed to shield directors in most instances, i.e. the "directors of a corporation . . . are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge". (33)

(33) Gimbel v. Signal Cos., 316 A.2d 599, 608 (Del. Ch. 1974).

However, insuring negligence in supervising organizations, or wrongful acts and misrepresentation in financial statements is controversial due to its effect on accountability. In the United States, corporate boards have a "duty of care", but if personal financial consequences for violating that duty of care are lacking, the boards may not perform proper due diligence. In the famous case of Smith v. Van Gorkom (1985), the Delaware Supreme Court found a board grossly negligent and therefore liable. The decision created a backlash and a statute change in Delaware which allowed a corporation to amend its charter to eliminate directors' personal liability for violation of the duty of care; a version of this statute has been passed in all states, and most large corporations have such an "exculpatory clause".(34)

In some cases scholars propose that the risk of personal liability for corporate officers be increased . (35)

The types of claims are dependent upon the nature of the company. Directors and officers of a corporation may be liable if they damage the corporation in breach of their legal duty, mix personal and business assets, or fail to disclose conflicts of interest. State law may protect the directors and officers from liability (particularly exculpatory provisions under state law relating to directors). Even innocent errors in judgment by executives may precipitate claims.

The types of claims are dependent upon the nature of the corporation. For public companies, claims are primarily due to lawsuits by shareholders after financial difficulties, with a 2011 Towers Watson survey finding that 69% of publicly traded companies had claimed for a shareholder lawsuit in the past 10 years as opposed to 21% of private companies .(36) Other claims arise from shareholder-derivative actions, creditors (particularly after entering the zone of insolvency), customers, regulators (including those that would bring civil and criminal charges), and competitors (for anti-trust or unfair trade practice allegations). For nonprofits, claims are typically related to employment practice and less commonly regulatory or other fiduciary claims .(37) For private companies, claims are often from competitors or

(34) Drury LL. (2007). What's the Cost of a Free Pass? A Call for the Re-Assessment of Statutes that Allow for the Elimination of Personal Liability for Directors. Tennessee Journal Business Law.

(35) Sharfman B. (2008). The Enduring Legacy of Smith v. Van Gorkom. 33 Del. J. Corp. L.

(36) Directors and Officers Liability: 2011 Survey of Insurance Purchasing Trends. Towers Watson. https://www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2012/03/Directors-and-Officers-Liability-2011-Survey-of-Insurance-Purchasing-Trends

(37) D&O Insurance Overview. Boundas, Skarzynski, Walsh & Black LLC.
http://www.bswb.com/wp-content/uploads/2012/08/DO_Public_vs_Private2.pdf

customers for antitrust or deceptive business practices (38) and one survey of 451 executives found that lawsuits cost an average of USD 308,475 .(39)

One relatively neglected area is the personal liability to non-shareholders that directors may face due to torts committed as a result of negligent supervision .(40)

However, intentional illegal acts or illegal profits are typically not covered under Directors and Officers insurance policies; coverage would only extend to "wrongful acts" as defined under the policy, which may include certain acts, omissions, misstatements while acting for the organization.

Due to exclusions and as a matter of public policy, coverage is not provided for criminal fraud. Therefore, a company may not indemnify a director against liability arising from :

- willful misconduct or breach of trust by the director.
- the director acting without the necessary authority
- reckless trading or fraudulent acts of the director
- a fine related to an offence committed by the director unless the fine was based on strict liability. (There are limited exceptions to the prohibition on payment of fines.)

4. The Corporate Veil Piercing in International Arbitration:

We mentioned before the difficulty of bringing in the parties that have not signed an arbitration agreement. These could be parent companies, subsidiaries, private individuals, governmental and quasigovernmental entities, and states.

Generally, arbitrators distinguish between "consenting non-signatories" to arbitration agreements that seek to arbitrate, and "non-consenting non-signatories" that resist arbitration . (41) The tribunals that join

(38) Why Do Privately-Held Firms Purchase Directors & Officers Liability Insurance. Andreini & Company. Generally citing: William E. Knepper and Ann Bailey, Liability of Corporate Officers and Directors (4th Edition).
(39) Petrin M. (2010). The Curious Case of Directors' And Officers' Liability For Supervision and Management: Exploring the Intersection Of Corporate and Tort Law. American University Law Review.
(40) Stadermann F, Banis C. (2008). From 'Severability Clause' to 'Innocent Directors Clause' in Dutch D&O Policies. British Insurance Law Association.
(41) See William W. Park, Non-Signatories and the New York Convention, 2 J. DISP. RESOL. INT'L 84, 105 (2008).

non-signatories rely either on implied consent or disregard of corporate personality (42). There is no clear line between these two justifications, however, as tribunals often pierce the corporate veil as a means to enforce the parties' original intent.

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 .(43) 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.

The tribunal relied on "the common intent of the parties . . . such as it appears from the circumstances that surround the conclusion and characterize the performance and later the termination of contracts." The tribunal also followed "usages conforming to the needs of international commerce, in particular in the presence of group of companies."33 According to the single entity theory applied by the tribunal, "[a] group of companies, despite the legal status of each of the companies, represents a single economic reality which the arbitral tribunal must take into account when ruling on its jurisdiction."

However, application of the "group of companies" doctrine remains uncommon. Some authorities suggest only one out of every four cases that purport to apply the "group of companies" doctrine did actually extend jurisdiction over nonsignatories.

When it comes to arbitration under bilateral investment treaties, the legal regime is somewhat different. It has been suggested that the rules relevant to shareholder claims under investment protection treaties need to be regarded as lex specialis as established by specific treaties. This is so despite the fact that, under the national law of most jurisdictions, shareholders are not allowed to bring claims on behalf of the company in which they own shares. The inclusion of shareholdings into the definition of investment in a bilateral investment treaty would normally result in piercing the corporate veil for the benefit of the shareholder.

(42) Piercing the corporate veil in International Arbitration, Yaraslau Kryvoi Ph.D., Cleveland State university Engages Scholarship @CSU , The Global Business Law Review , Law Journals, 2011.
(43) Id. at 103 (citing Dow Chemical v. Isover St. Gobain, ICC Case No. 4131, 1983 J. Dr. Int'l 899 (1932)).

It is not enough to persuade the tribunal to pierce the corporate veil under applicable law. The enforcement of awards piercing the corporate veil creates additional problems, which is out of our scope in this stage.

Concluding remarks:

It is very important to promote Bahrain as an attractive investment environment, and these investments should be cautious and serious where risks could be inherent in such company structure in some unforeseen or deliberate consequences. As long as Bahrain represents a recipient country for foreign direct investment, a well-defined doctrine of veil piercing is essential to focus on – for example- that the shareholder in any form of companies especially the Limited Liability ones is no longer immune from responsibility at the expense of creditors or tort victims.

A courts' reluctant (or we can call it the conservative/adamant) approach has been proved – by juristic or cases in the English and American Jurisdictions -where the challenge is whether the corporate veil has to be pierced or not and on what circumstances. Some noticed that, the degree of this reluctance varied, as it becomes with very slow motive in public companies rather than the small and medium sized companies or companies with single individual. The same less frequency occurred in the case of parent companies rather than one or more individual shareholders and in tort cases rather than contract cases. It is not to say that "to pierce" is a simple process; especially in proving it in order to reveal all the scenes behind the walls of facts, but it is also not an impossible mission.

We came to note, through various cases earlier, that, despite the well-established theory that justify piercing the corporate veil, the general rule of corporate law is to maintain the legal separateness of the corporate form. Piercing the veil remains an exception. Approaches towards piercing the veil differ not only from one jurisdiction to another, but also within one national system of law.

It is suggested that as long as the purpose of veil piercing is to maintain smooth corporate behavior, I think we need to reconsider it again, I am not saying that we might consider it as the basic method and not as an exception, because this opinion – despite being coherently expressed by minority of foreign authors- may drastically ruin the well-respected corporate structured vision, but we need to dig deep attention to it, particularly with the new effect to accelerated globalization and rising productivity, high tech rapid improvements, opening of international foreign investments and giving them the access to markets, the outsourced industrial production with higher than ever speed. Some corporations may not be able to perform

normally by supporting employment and their fiscal reserves and policies. National debt has been accumulating in an accelerated way. The inability of states and international bodies to prevent from corporate direct and indirect violations to human rights issues, violations to environment, violations to workers' rights or violations to the consumers –being the end users- rights... etc. These issues require the judges to look into one given case as a single consistent and indivisible unit when it comes to decide that the corporate veil would be pierced.

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