Reassessing Corporate Veil-Piercing in China: Judicial Trends under the New Company Law

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Corporate Veil-Piercing in China

- **Previous Research**
  - Common law jurisdictions vs China
  - Explanations for the high piercing rate in China
- **New PRC Company Law**
  - Empirical analysis of horizontal veil-piercing rates
  - Comparative analysis of common law jurisdictions and China
  - New explanations: high veil-piercing rate due to systemic differences
    - Judicial discretion
    - Legal reasoning
    - Policy orientation

Previous Research

Evolving corporate veil-piercing principles

- **English law:** ***Prest v Petrodel Resources* [2013] UKSC 34**
  - Lord Sumption: "There is a limited principle of English law which applies 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. The court may then pierce the corporate veil for the purpose, and **only 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."

- **Corporate veil-piercing rate in common law jurisdictions**: modest and gradually decreasing

Period	The US	The UK	Australia
Prior 1990 (Thompson's study)	40%	47%	38%
Recent studies	35% (2016)	N.A.	36% (2015)

Evolving corporate veil-piercing principles

- **China codified the common law veil-piercing doctrine in the PRC Company Law in 2005 and further incorporated horizontal veil-piercing in the 2023 revision**
  - **Article 23** Where a shareholder of a company evades debts by abusing the status of the company as an independent legal person or a shareholder's limited liability, seriously damaging the interests of the creditors to the company, the shareholder is jointly and severally liable for the debts of the company. (*general rule*)

    Where a shareholder uses two or more companies under its control to commit the conduct in the preceding paragraph, each company is jointly and severally liable for the debts of any of the other companies. (*horizontal veil-piercing*)

    Where the shareholder of a company that has a single shareholder is unable to prove that the property of the company is independent from the shareholder's own property, the shareholder is jointly and severally liable for the debts of the company. (*reversed burden of proof in one person companies*)

Explanations for the high piercing rate

- **Corporate veil-piercing rate in China**: significantly high and gradually increasing

Study	Number of cases	Pierced rate
2006-2010 (Huang)	99	63.64%
2006-2012 (Hawes et al)	259	72.7%

- **Why are Chinese courts so eager to hold shareholders liable despite the principle of limited liability?**
  - Huang (2012) argued that:
  - (1) The abuse of the corporate form is more prevalent in economically less developed regions due to a lower level corporate law knowledge;
  - (2) Lower-level courts lack sophistication, as their judges may not fully understand concepts of limited liability and corporate separateness. In contrast, higher-level courts are generally more experienced and cautious about piercing the corporate veil.

Explanations for the high piercing rate

- **Why are Chinese courts so eager to hold shareholders liable despite the principle of limited liability?**
- Hawes et al (2015) argued that:
  - (1) There is no significant distinction between economically developed and less-developed regions;
  - (2) The issue lies not so much with judges’ understanding of corporate law principles but rather with corporate shareholders’ lack of awareness of the need to treat the corporation as a separate legal entity. This is further compounded by an excessively vague statutory provision, which gives judges broad discretion to pierce the corporate veil in a wide range of situations.
- **Other explanations?**

New PRC Company Law

New PRC Company Law

Before the 2023 PRC Company Law revision:

- **Supreme People's Court guiding case:** *Xugong Group Construction Machinery Co., Ltd. v. Chengdu Chuanjiao Industry and Trade Co., Ltd. et al* (徐工集团工程机械股份有限公司诉成都川交工贸有限责任公司等买卖合同纠纷案[苏商终字第0107号民事判决])(2011)
  - **Personnel Overlap**: The three sibling companies shared the same key personnels, with cross-appointments among management.
  - **Business Overlap**: They were engaged in engineering machinery-related businesses and shared sales manuals and dealership agreements in their distribution activities.
  - **Financial Overlap**: They used a common bank account and failed to demonstrate a proper separation of funds.
  - The court held that their commingled personnel, business operations, and finances justified veil-piercing, making all related entities jointly liable for the debts of one sibling company.

Two explanations

Two previous explanations for the high veil-piercing rate

1. If the high piercing rate is due to corporate shareholders' lack of awareness of corporate separateness,
   - Then the 2023 revision may not significantly change the piercing rate
   - **Reason:** the issue is behavioral rather than statutory, stemming from shareholders' corporate governance practices rather than legal provisions
2. If the high piercing rate is due to vague statutory provisions that allow judges broad discretion,
   - Then the 2023 codification may also not lead to significant change in piercing rates
   - **Reason:** The codified horizontal piercing rule merely formalizes the circumstances that the SPC has already clarified, and a clearer statutory provision would not necessarily result in a significant change in the piercing rate.

Empirical findings

Horizontal Veil-Piercing in China

Period	Total cases	Veil-Pierced	Not Veil-Pierced	Piercing Rate
Pre-2023 Revision	32	13	19	40.63%
Post-2023 Revision	15	8	7	53.33% ↑

Trends in Veil-Piercing Rulings

Period	First-Instance Cases	Pierced Veil Cases in First Instance	First Instance: Piercing Rate	Appeal/Retrial Cases	Pierced Veil Cases in Appeal/Retrial	Appeal/Retrial: Piercing Rate
Pre-2023 Revision	11	2	18.18%	20	10	50%
Post-2023 Revision	13	7	53.85% ↑	2	1	50%

Empirical findings

A closer examination of judicial reasoning:

- **Before the 2023 revision**
  - Plaintiffs were often required to demonstrated personnel, business, and financial commingling collectively
  - Some courts imposed a heightened “seriousness” threshold
- **After the 2023 Revision**
  - Courts have become more flexible in accepting veil-piercing claims, even when only one form of commingling (e.g. financial transaction) is demonstrated
  - The “seriousness” threshold is no longer a decisive factor

Comparative analysis

Factor	China	Common law jurisdictions	Impact
Judicial discretion	Veil-piercing is explicitly codified in Company Law, providing courts with clear statutory authority	Governed by judicial precedent, leading to a more restrictive application	Courts are more willing to apply veil-piercing when the law explicitly authorizes them through codification
Legal reasoning	Courts apply as a means of corporate accountability and creditor protection, especially in a market with frequent corporate misconduct	Courts treat veil-piercing as an exceptional remedy (*Prest v Petrodel*)	Chinese courts treat veil-piercing as a widely used remedy
Policy orientation	Judges operate under a system that aligns with economic policy objectives (e.g. creditor protection, financial stability)	Judicial independence	Judges apply veil-piercing mechanically whenever statutory conditions are met

The way forward

1. **Issuing detailed judicial guidelines**
   - E.g. Clarifying whether "serious damage to creditors' interests" is a decisive factor in judicial reasoning
   - Providing concrete examples of both piercing and non-piercing scenarios to enhance consistency
2. **Clarifying evidentiary thresholds**
   - Applying veil-piercing only when clear and compelling evidence is present
3. **Enhancing judicial transparency**
   - Explicitly documenting factual findings and reasoning in judgements to improve consistency and legal certainty

Thank you!

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