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Luxembourg District Court rules on company wrongdoing as ground for piercing corporate veil

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Introduction

As with most legal systems, Luxembourg law recognises a principle of separate corporate personality, according to which a company is a legal person on its own, with an existence, rights, obligations, assets and liabilities that are separate from those of its shareholders and subsidiaries.

According to this principle, a company's shareholders and subsidiaries are protected by a 'corporate veil', which prevents them from being held liable for the company's actions and does not allow the company's creditors to reach the assets of its shareholders or subsidiaries.

Piercing corporate veil

The corporate veil allows economic actors to organise their business affairs in order to properly segregate and compartmentalise their potential liabilities and is thus of fundamental importance not only for corporate law, but also for the business world at large.

Hence, piercing the corporate veil and allowing a company's creditors to hold its shareholders or subsidiaries liable for the company's actions, as if they were their own, and to reach their personal assets is traditionally possible only under limited and exceptional circumstances.

Luxembourg legislation explicitly allows for the piercing of the corporate veil only in the specific context of bankruptcy proceedings for the benefit of the bankrupt company's creditors:

- Pursuant to Article 495-1 of the Commercial Code (which provides for the so-called '*action en comblement de passif*'), shareholders can be ordered to bear (totally or partially) the company's debts if, acting as a (*ipso jure* or *de facto*) director or company manager, they have contributed, through serious misconduct, to the company's bankruptcy.
- Pursuant to Article 495 of the Commercial Code (which provides for the so-called '*action en extension de la faillite*'), the company's bankruptcy can be extended to shareholders, if acting as a (*ipso jure* or *de facto*) director or company manager, they:
  - entered into commercial transactions for their own benefit, under the cover of the company;
  - disposed of the company's assets as if these had been their own; or
  - pursued, in an abusive manner and in their own interest, a loss-making business that could lead only to the company's insolvency.

Besides the abovementioned legal bases, which apply only in the specific framework of a company's bankruptcy, Luxembourg case law also allows the corporate veil to be pierced in certain situations where the company in question would be qualified as fictitious.

Traditionally, case law would consider a company 'fictitious' in one of the following circumstances:

- in cases of pretence (simulation) – that is, if, at the time of the company's constitution, all of its shareholders lacked '*affectio societatis*' (ie, a shareholder's sincere will to collaborate in order to achieve a

common objective) – for instance, because the shareholders really acted only as nominees or figureheads for a third party; or

- in cases of intermingling (confusion) – that is, if the company's shareholders acted as though there was no separate corporate personality by:
  - taking decisions on the company's behalf as if the company was not an independent legal entity, but rather a mere business unit of a shareholder, thus showing that the company lacks any real autonomy in decision making; or
  - intermingling the company's assets with their own (eg, holding the accounting in common between the company and its shareholders and having payments made indifferently by the company or its shareholders), thus showing that the company lacks any real patrimonial autonomy.

On 15 May 2019 the Luxembourg District Court went beyond this traditional concept by allowing for the corporate veil to be pierced without examining whether the concerned companies could qualify as fictitious. Instead, the court based its decision on the grounds that the concerned companies had helped their shareholders to commit the wrongful actions that had generated the creditor's claim.(1)

Facts

In the case brought before the Luxembourg District Court, the claimant already held a judgment rendered a few years earlier by a Czech court that ordered the defendants to pay him certain amounts on the grounds of misappropriations of corporate assets and fraud.

To enforce the Czech judgment in Luxembourg, the claimant initiated third-party attachment proceedings, which allow a creditor to attach assets of their debtor in the hands of a third party, such as a bank, and then have the assets transferred to the creditor, provided that the attachment is validated by a Luxembourg court – which was precisely what the Luxembourg District Court was asked to do in this case.

The claimant had attached assets that belonged not only to the defendants themselves, but also to two companies of which the defendants were shareholders.

The claimant argued that the attachment of the two companies' assets was justified by the fact that the companies had been created and used by the defendants for the sole purpose of allowing the latter to commit the misappropriations of corporate assets and fraud that were the basis of the Czech court's judgment.

The defendants argued that the companies were third parties, as only the defendants themselves (and not the companies) had been condemned by the Czech court, and that the companies' assets could therefore not be attached based on the judgment.

Decision

The Luxembourg District Court ruled in the claimant's favour, declaring the attachment of the two companies' assets to be valid.

The court held that a third party's assets could be attached not only in case of pretence or intermingling (ie, when a company qualifies as fictitious), but also if a third party has acted in a way for which it could be held liable (in which case their actions would justify the piercing of the corporate veil).

The court noted that based on the Czech judgment, the defendants' wrongful actions (misappropriations of corporate assets and frauds) had been committed through the two concerned companies, which had played an active role in their wrongdoing.

Comment

This judgment can be seen as confirmation that the case law on piercing the corporate veil has evolved, as the Court of Appeal already rendered a similar decision on 16 October 2014. Thus, this trend follows the opinion expressed by part of the legal doctrine that a wrongful action committed by a company should allow for the piercing of the corporate veil in the context of third-party attachment proceedings.

Therefore, apart from in the specific context of a company's bankruptcy, the often-difficult task of proving that a company is fictitious is no longer the only possible way in which to thwart a debtor's fraudulent manoeuvres. This judgment proves that a company's wrongdoing can be a sufficient ground for piercing its corporate veil – a ground which will certainly be used by litigators.

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Endnotes

(1) 2019TALCH01 / 00166.

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