DISREGARD OF LEGAL ENTITY—DANISH CASE LAW

BY

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I. INTRODUCTION

In Danish company and bankruptcy law, companies incorporated in accordance with the statutory requirements remain separate legal entities even in relation to affiliated entities. Specific rules may, under certain conditions, attach importance to affiliation; but such rules show that the separateness of legal entity is in general respected, even when affiliated companies collapse.

However, in the last two decades a number of Danish cases have dealt with the issue of disregard of legal entity. Most cases have involved —what later turned out to be unsuccessful—reorganization of enterprises facing economic problems. The reorganizations have been carried out by splitting an existing business into more companies. Among commentators, disregard of legal entity has been discussed especially in relation to a new financing mechanism employed in recent years.[1] The mechanism may operate as follows.

> A total business enterprise is split into at least two companies, a parent and a wholly-owned subsidiary. The parent normally transfers its accounts receivable and other liquid non-operating assets to the subsidiary. The parent retains all its other assets, although it may also transfer the goods it has manufactured and use the subsidiary as a sales organization.
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> A bank can make floating loans to the subsidiary, which then uses the money to pay for the assets that the parent transfers to it. In most cases, the loan from the bank is 80 per cent of the gross value of the transferred assets. Through provisions in the subsidiary's by-laws or agreement between the subsidiary and the bank, the former's business activities are limited to transactions necessary for this financing device. In a typical arrangement, the parent agrees to subordinate its claims on the subsidiary to the claims of the bank. This means that if the parent becomes insolvent and bankrupt, the bank will in reality be the subsidiary's only creditor and it will obtain full payment through the assets transferred by the parent to the subsidiary.

II. DANISH STATUTES

To help the reader understand the context in which Danish court reasoning and rulings in cases on lifting the corporate veil must be seen,

[1] See Kiilerich-Hansen in *UfR* 1982 B, p. 425; Godsk Pedersen in *UfR* 1985 B, p. 352; Erik Werlauff, *Revision & Regnskab* 1986, p. 43; and Nis Jul Clausen in *UfR* 1986 B, p. 82.

a short introduction to the avoidance clauses of the Danish Bankruptcy Act[2] and the personal liability clauses of the Danish Company Acts[3] follows.

2.1. The purpose of a bankruptcy procedure under the Danish Bankruptcy Act is to distribute the assets of the estate equally among the creditors of the debtor.[4] Because of the substantial risk that a debtor facing insolvency and bankruptcy may favour some but not all of his creditors, or may try to keep assets out of the estate, equal distribution can be achieved only through provisions on the avoidance of contracts and other transactions in bankruptcy.

Until 1977 the avoidance provisions in the Danish Bankruptcy Act[5] all used a subjective standard requiring some kind of bad faith. It was a prerequisite for avoidance that the debtor should be insolvent at the time of the suspected transaction. More important, the party to the transaction should know or should have known of the insolvency, meaning deficit and not illiquidity. These two requirements made it difficult to predict whether certain transactions might be set aside under a later bankruptcy procedure, and most cases would depend on the question of burden of proof. Further, if for example the bankrupt estate could not lift the burden of proof, even untypical transactions could stand.

In 1977 a new Bankruptcy Act was enacted. Its avoidance provisions were divided into two categories, one using an objective standard and one based on a subjective standard. The objective provisions avoid certain types of transfer that occur within three months before the registration of insolvency,[6] or in the case of those between affiliated entities,[7] transfers up to two years before insolvency.[8] The kinds of transaction covered by these objective avoidance provisions are:

a. gifts,[9] normally transfers to insiders, family members or affiliated entities at less than market price where there appears to be no business purpose for the transfer,

b. certain kinds of unusual payment such as transfers of goods instead

[2] Act no. 588 of September 1, 1986.

[3] The Public Limited Company Act (Act no. 433 of July, 1988) and the Private Limited Company Act (Act no. 434 of July, 1988).

[4] The Danish Bankruptcy Act, sec. 97.

[5] Act no. 164 of April 1, 1971, secs. 20–30.

[6] For determination of the time of registration of insolvency, see the Danish Bankruptcy Act, sec. 1.

[7] For definition of affiliation, see *ibid.*, sec. 2.

[8] *Ibid.*, secs. 64(2), 67(2) and 70(2).

[9] *Ibid.*, sec. 64.

of cash payment, payment of debts before maturity or payment of huge sums,[10]

c. granting of a security interest or mortgage to a pre-existing unsecured creditor.[11]

The reason for selecting this specific type of transfer for avoidance without further requirement is its characteristic feature, namely that such transfers are all atypical and generally occur just before and just because of the coming bankruptcy, and there is generally not the normal need to protect the parties to them. Also, the objective provisions can be used even though—which is uncommon—the company is not insolvent at the time of the transaction. As long as the suspected transaction occurs within the stated period before registration of insolvency, it is avoided under the 1977 Act. And even though the third party has no knowledge of the economic problems faced by the bankrupt, the transfer will be avoided.

The subjective avoidance clause[12] comes into play when a debtor while insolvent makes a transfer which unduly favours one creditor at the expense of the others, or whereby assets are withdrawn from the creditors. By using the word "unduly", it has been stressed that the transactions may occur under exceptional circumstances or be atypical at the time of insolvency, now meaning illiquidity. Therefore, transactions covered by the subjective provisions may have the same characteristic features as the transactions covered by the objective avoidance provisions mentioned above, but are not limited thereto. Typical examples of undue preference are tax payment and payment to one creditor but not to others. However, it is required that the favoured creditor knew or should have known of his debtors' insolvency and of the fact that he was being unduly favoured by the transfer. There is no time limitation in this subjective provision, but claiming undue preference makes it more difficult to avoid transactions that took place long before the formal registration of insolvency. The courts, however, may also be reluctant to use the subjective provision because of the estate's difficulties in proving the subjective elements of insolvency and of the impropriety of preferential transfers.

2.2. Under the Danish Company Acts,[13] board members, shareholders,

[10] *Ibid.*, sec. 67.

[11] *Ibid.*, sec. 70.

[12] *Ibid.*, sec. 74.

[13] The Danish Public Limited Company Act (Act no. 433 of July, 1988, secs. 140–141) and the Danish Private Limited Company Act (Act no. 434 of July, 1988, secs. 110–11).

accountants and others who have acted on behalf of the company can under certain conditions be held personally liable. Personal liability arises only when the agent has, intentionally or negligently, caused injury to the company, its shareholders or its creditors. However, shareholders can be held liable only when acting with, at least, gross negligence.[14] Typical cases where directors and managers have been held personally liable are: obtaining company credit using misleading or directly wrong financial statements;[15] unreasonable self-dealing transactions such as transfers of assets at less than cost price to themselves or to affiliated entities; increasing their own or family members' salaries just before bankruptcy,[16] or making insider loans which are unlawful under the Danish Company Acts.[17] Finally, insiders have been held liable for unsecured company credit obtained at a time when it is obvious that the business will be wound up because of economic problems.[18] However, a recent Supreme Court decision[19] indicated that even in this situation courts may be reluctant to impose personal liability. In this case, liability of the directors was denied even though the credit was obtained before noon and bankruptcy declared the same afternoon. However, negotiations concerning reconstruction had gone on until the very last minute.

III. DANISH CASE LAW

To clarify Danish court usage in cases of disregard of legal entity two leading Supreme Court cases, 1968 UfR 766 and 1978 UfR 880, will be analysed. In both cases the corporate veil was lifted. In addition a recent decision of the Western Division of the Danish High Court, 1986 UfR 697, will be discussed in detail. Here the court upheld the legal entities. Common to the three cases is that they all involved different kinds of reorganization/financing device created by companies facing economic problems.

3.1. In 1968 UfR 766,[20] the issue was whether payments made by a subsidiary under a reconstruction plan involving some of the parent

[14] Act no. 433 of July, 1988, sec. 142, and Act no. 434 of July, 1988, sec. 112.

[15] 1982 UfR 595.

[16] 1929 UfR 183.

[17] 1979 UfR 777, and Act no. 433 of July, 1988, sec. 115–115a, and Act no. 434 of July, 1985, sec. 84–84a.

[18] 1961 UfR 515 and 1966 UfR 732.

[19] 1977 UfR 274.

[20] Annotated by Supreme Court Justice H. Schaumburg in *UfR* 1969 B, p. 116.

company's creditors in relation to an avoidance clause in the Danish Bankruptcy Act were to be considered as deriving from the parent company.

1968 UfR 766. In the Autumn of 1964 the airline Flying Enterprise Ltd. (F) was facing economic difficulties, with a capital deficit of about 10 mill. DKK. With a view to reconstruction, two new companies were formed: Conair Ltd. (C) with a share capital of 1.1 mill. DKK and Flying Enterprise Sales Ltd. (S), DKK 10,000. C purchased 51% of the shares in F, and F subscribed for DKK 9,000 shares in S, while the remaining DKK 1,000 was subscribed by two lawyers, who served as board members of F. The latter block of shares was transferred to F. S's share capital was paid up by F making out a cheque to itself and at the same time giving a discharge for a similar amount as "advance on office expenses, rent etc.". There was considerable overlapping of persons on the three boards, and S had no employees of its own.

According to the reconstruction plan, contracts with travel agencies for flying were to be made with S. From the profits, DKK 150 per flying hour were to be spent in advance payment of interest and amortization on F's debt to creditors K 1–3. (F's debt to K 1–3 consisted of old debts of about 3 mill. DKK and of new loans of 1 mill. DKK.) The remaining profits were to be used in payment of aircraft leases etc. to C, or to be transferred to F. A separate bank account was opened for the arrangement. On March 5, 1965, F declared bankruptcy and subsequently S went into liquidation.

During a subsequent legal action about avoidance of the payments to K 1–3, which S had made according to the "150 DKK arrangement", the estates of F and S asserted that in relation to the payments received K 1–3 should be regarded as if these payments had come directly from F.

The Supreme Court held that creditors K 1–3 could not base any legal claim on the existence of S and that, with regard to F's estate, they were situated as if the payments had come directly from F. In the reasoning for lifting the corporate veil between F and S, the Supreme Court stressed that S was established at a time when F had a deficit, that S had no actual paid-up capital, or any capital at all; and that F and S had common board members, too. With regard to S's business, the Supreme Court stated that although the contracts with the travel agencies were made formally with S, the sole purpose of S was really to manage all of F's receipts, including payments under the 150 DKK arrangement.

In 1978 UfR 880, the question was whether one company could be regarded as secured creditor in another company's bankrupt estate or whether the veil should be lifted between the two.

1978 UfR 880. A company A/S Inka-Print (A) doing business in the textile industry experienced severe economic problems. A reorganization plan was arranged with one of its most important creditors, the finance company Balfour, Williamson & Co. (B), who agreed to finance A continuously. This plan involved the creation of a new company, Inka-Print International A/S

(C), wholly owned by B. The financing device was set up in the following manner: C would buy raw materials with finance from B and sell finished clothes. In turn A was to do the sewing for C on contract. In consideration of this work A was to receive the sale price of the clothes less the cost price of the raw materials and VAT. Besides this, there was a further deduction of 1% from total turnover. A possible sales loss was to lie with A, who also guaranteed payment of the accounts receivable arising from sales.

A declared bankruptcy and the question arose whether the court should lift the veil between A and C. If it did so, raw materials, finished clothes, and accounts receivable in the possession of A could not be returned to C in order to secure loans that B had advanced to C. The Maritime and Commercial Court's majority stated to begin with that C's financial affairs were managed by B. Further, the court pointed out, C had not had any independent business, but everything was effected according to B's instructions; B and C had no regular business relationship; B was solely a financial enterprise, and with regard to staff and offices C and A were almost identical. In the light of this the purpose of the arrangement had been solely to create a preferential position for B compared to the other creditors. Under these circumstances C could not claim preference.

The Supreme Court also decided to lift the veil between A and C, reasoning that the purpose of the chosen device had been solely to ensure B's preference, and that C had not carried out any activity with regard to purchase of raw materials or sale of products sold on A's account and at A's risk.

Although the Supreme Court in both cases lifted the corporate veil the reasoning is different. In 1968 UfR 766, specific circumstances (deficit, part of reorganization, lack of capaital, interlocking directorates) which support lifting the veil are mentioned explicitly, and it is accordingly established that although the contracts with the travel agencies were made formally with the subsidiary, this in fact had the sole purpose of managing the parent company's receipts. In 1978 UfR 880, however, no concrete circumstances to support lifting the veil are emphasized, even though present. The Supreme Court applies a twofold reasoning —seemingly more on principle—that the purpose of the arrangement was solely to ensure the preference of finance company B, *and* that the recently-established company, C, had not in fact carried out any activities with regard to purchase or sale of goods.

Although the securing purpose, especially emphasized in the latter case, has been significant for the holding in both cases, there is no reason to believe that a financing device involving a split into more companies will be disregarded solely because its primary purpose is to secure one or a few creditors. Apart from situations covered directly by the Danish Bankruptcy Act avoidance clauses, it is generally recognized as legitimate to secure loans etc. But the crucial point is what kinds of debt are to be secured, and how the arrangement has been implemented.

Generally Danish law, statutes[21] as well as case law, accepts and encourages attempts by businesses facing economic problems to weather the storm and set up reorganization plans, provided that the purpose is to carry on the business (or to wind it up without formal bankruptcy proceedings), without favouring one or a few creditors.[22]

A closer examination of the reorganization device in 1968 UfR 766 shows that the purpose, or at least the result, of the payment of DKK 150 per flying hour was largely to secure/repay pre-existing unsecured debts (the new loan was 1 mill. DKK compared to the old unsecured debts of 3 mill. DKK). The situation was less obvious in 1978 UfR 880, but here too old unsecured advances from the finance company Balfour were repaid. Securing or payment of old unsecured debts does not have the same rescuing effect as securing new loans. In particular, when the question of lifting the corporate veil as in 1968 UfR 766 is raised in relation to avoidance, the considerations underlying sec. 70 of the Danish Bankruptcy Act (avoiding security interest on already granted unsecured debts) support the principle that arrangements whose primary purpose is to create such security without falling within the direct wording of the section, should hardly enjoy protection in case of bankruptcy. Moreover, in 1968 UfR 766 the combination of insolvency and the short interval (about 3 months) between the arrangement and the final economic collapse supports the fact that the reorganization plan was an attempt to delay the crash in order to create a better position for creditors K 1–3.

We shall now look more closely at the method used to obtain security in the two cases. The method used in 1978 UfR 880 could hardly be carried out between totally independent parties. Danish law is generally not very favourable to the need for inventory financing.[23] In particular

[21] See the Danish Bankruptcy Act, secs. 10–16e, concerning suspension of payment.

[22] See the general principle of equal distribution of debtor's assets, Danish Bankruptcy Act, sec. 97.

[23] Under Danish law, a security interest in inventory can only be perfected by possession or filing (Act no. 622 of September 15, 1986, secs. 43–47). Taking possession of inventory involves depriving the debtor of the productive use of the inventory. Filing, on the other hand, requires that the filing documents describe in detail each item covered by the security interest (Act no. 622 of September 15, 1986, secs. 43(4) and 10(1)). A security interest in inventory does not automatically continue in the proceeds. A new and independent perfection by possession, filing or notification is required in order to perfect a security interest in the proceeds.

Perfection of a security interest in chattel paper and accounts receivable requires notification to each debtor (Act no. 669 of September 23, 1986, sec. 31(1)b and (2)). Such it is difficult to establish an efficient security which, as in 1978 UfR 880, includes raw materials, semi-products and finished goods in current production. The traditional measures such as mortgage (established by filing) and pledge (by taking possession) are hardly particularly applicable, just as maintaining third-party ownership during current production will rarely be possible. Between independent parties, it is difficult under existing law to create and uphold an arrangement for establishing a security interest. No wonder, then, that the courts will be sceptical towards claims that the security interest has been established using affiliated companies. This is particularly so when, as in 1978 UfR 880, the separation of the companies had not been strictly implemented.

To consider the importance of how the arrangement is implemented, we return to 1968 UfR 766. Here, one company, the subsidiary S, through the 150 DKK arrangement, paid the debts of another company, the parent company F. This atypical element of the case, which is hard to base on rational economic and commercial considerations, must give rise to distrust of the entire arrangement. More important in the present connection is that such circumstances indicate that S has not in fact acted independently, but has been managed solely by, and in the interest of, F. Moreover, F's board treated S's assets as if they were its own, for example in connection with subscription of share capital. If when establishing a certain financial and security arrangement the board acts without separating the affairs of the companies, it cannot later, in relation to avoidance of the same transactions, assert that two independent entities exist.

Similar considerations seem to underlie the ruling in another Supreme Court case.

> *1977 UfR 526.* Here the veil in relation to an avoidance clause[24] was lifted between two affiliated companies, the one having pledged a motorboat to

notice must clearly identify the secured party and the account transferred. It is normally necessary to give notice after each new addition to the account and the notice will indicate to whom the debtor must pay.

Filing, notification or possession of each item of collateral is required. The filing or notification is not sufficient if it identifies the current and after-acquired collateral generally but not specifically. Hence, describing the collateral in a security agreement or financing statement as "all accounts receivable", "after-acquired", all items of a certain kind or all assets of a company (Act no. 622 of September 15, 1986, secs. 47a–47b) is insufficient for perfection and may not even be sufficient for attaching security interest.

[24] The question was whether the old Danish Bankruptcy Act, sec. 21 (now sec. 70), was applicable. Under the Act, security granted for already existing unsecured debts is void. But this provision only covers situations where the debtor and pledger are the same legal entity. Pledge for third-party debt cannot be voided unless a formal legal separation, as in this case, is set aside.

> secure debts of the other. The companies were owned by the same persons. The Supreme Court stated that with regard to management, economic conditions and accounts no distinction existed between the two companies which in reality were run as one. The pledging was due to the close relationship between the two companies, of which the pledgee was well aware.

The mere fact that the two companies had common directors will hardly be decisive: such a standpoint would in general have incalculable consequences for legal relations between affiliated companies. But in the case under discussion, as clearly appears from the evidence, nothing had been done to keep the companies' affairs separated: on the contrary, it was quite by chance which company's assets were used to cover the obligations of either.

Another question in connection with the two cases is the significance of insolvency at the time the device is set up.

In 1968 UfR 766 it clearly appears that the considerable capital deficit of Flying Enterprise was an important factor in the Supreme Court decision. This seems well founded, as the combination of insolvency and the short period of about three months between the arrangement and the final crash supports the view that the arrangement was primarily an attempt to postpone bankruptcy so as to create a better position for the unsecured creditors K 1–3.

It is, however, difficult to determine what influence Inka-Print's economic situation had for the outcome in 1978 UfR 880, as this factor is not mentioned in the Supreme Court's reasoning. But there is no reason to believe that insolvency is generally a crucial factor in Danish cases on lifting the corporate veil.

In other cases courts have lifted the veil, even where the parent company was solvent when the subsidiary was incorporated.

> *1980 UfR 806.* In 1975 a solvent company M incorporated a subsidiary D. M's production and employees were transferred to D, and shortly after the incorporation D lent its total share capital to M. Both companies declared bankruptcy in 1978, whereupon D's employees claimed salary from M's estate, asserting that there was no reality in the company split.
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> Emphasizing that D had no capital available, had common directors, was jointly taxed with M, and that D was not independently VAT-registered, the Western Division of the Danish High Court held that D was not in fact independent, but had functioned solely as an intermediary in connection with the payroll. Accordingly the veil was lifted between D and M and the employees could claim their salary from M.

The omission by the court of any mention of M's financial position seems quite natural since, with regard to the issue of the case, possible insolvency was unimportant for determining the real function of D. But apart from this there are considerable similarities between 1980 UfR 806 and 1968 UfR 766. In both cases, the courts concluded that there was no business reality in the subsidiaries apart from the assigned administrative functions: payment of wages and distribution of the parent company's receipts.

3.2. While all the cases discussed above, in different connections and with various reasoning, have lifted the corporate veil, the Western Division of the Danish High Court has in a recent decision upheld a parent/subsidiary construction which was set up for the sole purpose of financing the parent's business.

1986 UfR 697. On January 1, 1980, a company J.P. Chokolade- og Sukkervarer engros Løsning Aps (J.P. Chocolate) was incorporated. In connection with liquidity difficulties at the end of 1981, J.P. Chocolate applied for an increase of its overdraft facility with the defendant, its banker Sparekassen Sydjylland. As a condition for further credit facilities, the bank demanded security interest in J.P. Chocolate's accounts receivable. It turned out to be too costly to carry this out through ordinary factoring. Instead J.P. Chocolate incorporated a wholly-owned subsidiary "Handelsselskabet af 21.12.1981 Aps." (the Trading Company). The bank granted the Trading Company credit of max. 1.6 mill. DKK.

The procedure between J.P. Chocolate and the Trading Company was that the former bought the goods for resale. When orders for goods were taken, J.P. Chocolate in the name of the Trading Company made out an invoice to the customer. At the same time an invoice from J.P. Chocolate to the Trading Company was made out giving the latter a rebate of 5% on the resale price. This 5% was to cover the Trading Company's overhead charges plus any losses on accounts receivable. Customer payments were placed on the Trading Company's account with the defendant, and the Trading Company's payments for goods to J.P. Chocolate were made from this account. Sales were entered on J.P. Chocolate's computer. The Trading Company could, within the credit limit, draw 80% of the value of the accounts receivable, which the defendant was able to check on computer print-outs. The Trading Company employed no staff, and the two companies had the same board members. Further, J.P. Chocolate had made a statement of renunciation to the bankers with regard to the outstanding balance with the Trading Company.

On October 20, 1983, J.P. Chocolate declared bankruptcy. The bankrupt estate now claimed that some payments by the Trading Company to the defendant bank should, under the avoidance clause in the Bankruptcy Act, be treated as if they were made by J.P. Chocolate. The defendant claimed that the affairs of the companies had been kept clearly separate.

On the evidence, the court found that the finances of the two companies had been kept separate, and that each company had had its own accounting and separate accounts with the defendant. Further, when orders were

> received from a customer an invoice was made out for the Trading Company's purchase of the goods from J.P. Chocolate, and payment took place in connection herewith, by transfer from the Trading Company's account to that of J.P. Chocolate. Finally, there were no reasons to believe that a loss on the Trading Company's accounts receivable should have been borne by J.P. Chocolate. Thus, and considering the background for the establishment of the Trading Company, the court did not find reason to lift the veil between the two companies.

By the court's ruling, the transfer from J.P. Chocolate to the Trading Company was regarded as an actual sale of goods and not as establishing a security interest in accounts receivable. This is so because if accounts receivable had been involved, the arrangement could not stand, as perfection of a security interest in accounts receivable under Danish law requires notification of the debtor.[25] But the companies involved had indeed ensured that there were actual sales of goods: invoicing was concurrent, payment took place in connection herewith, and the Trading Company as seller bore the risk of the customers' non-payment. However, had J.P. Chocolate had to bear the losses as a result of customers' non-payment of their debts, the ruling would probably have been different. It must be regarded as quite unusual for a seller of a product (here J.P. Chocolate) to bear the risk of the product's proceeds (here the accounts receivable accruing from the buyer's—the Trading Company's—resale of the product). This could hardly be regarded as anything but an indication that the parties had actually tried to establish a security interest in accounts receivable.

3.3 The High Court's reasoning shows that the ruling is closely connected to the specific conditions under which this arrangement was established and carried out. Therefore it may be unwise to overestimate the principle importance of the ruling. Further the reasoning—particularly the detailed recital of reasons for not lifting the corporate veil—seems to suggest that the court was in some doubt as to whether the arrangement should stand. However, the decision leaves the immediate impression that it is more favourable than the two Supreme Court cases towards financing and security devices achieved by means of company splits. There are however differences between the three models employed and the circumstances at the time of establishment which may explain the different court decisions.

Common to the cases was that the companies were in clear need of finance if the business was to be carried on. While the devices employed

[25] Act no. 669 of September 23, 1986, sec. 31, and footnote 23 above.

in 1968 UfR 766 and 1978 UfR 880 both resulted in the financier obtaining payment/security not only for the additional new credit but also for past unsecured loans, the 1986 UfR 697 arrangement only secured future advances. In relation to a subsequent bankruptcy there is nothing to suggest that the latter arrangement should be contested. It is fully legitimate as part of a reorganization plan for a creditor, as a condition for further advances, to demand and obtain security interest for the new credit. The fact that this is obtained by an unusual arrangement will not in itself substantiate a disregard, but the courts will probably be considerably more critical towards such an arrangement than towards the application of traditional methods of obtaining security interest.

As a result of this critical attitude, the courts will attach importance to whether there are special grounds for choosing a specific atypical arrangement. In 1986 UfR 697 it is not surprising that the High Court found it crucial that there was a certain reason for choosing this particular atypical model in preference to a more traditional arrangement such as factoring. The evidence shows that an ordinary factoring arrangement was not suitable because of excessive costs—the accounts receivable consisting of many small debtors. Thus the choice of method was not dictated by the fact that, legally, a more traditional solution would have been difficult to achieve (as in 1978 UfR 880). Nor was the reason that such a traditional solution, even if it were feasible, would have other disadvantageous legal consequences such as avoidance under the Danish Bankruptcy Act (1968 UfR 766). The choice of method was, however, based on a legitimate business and financial rationale: it was presumably the only, and certainly the most inexpensive, way in which future financing could be obtained and secured.

That the cost was lower primarily because the device made use of sale of goods instead of establishment of security interest (the latter requires costly notification of the debtors) did not influence the court's judgment. But in 1986 UfR 697 the whole reorganization device and its implementation also demonstrated that the companies involved had taken the legal as well as the practical consequences of the device chosen.

IV. THE DANISH APPROACH—DECISIVE FACTORS

The analysis of Danish courts' use of lifting the corporate veil leaves the clear impression that one can hardly consider it to be an independent legal doctrine. First, the number of cases is too small. Secondly, lifting the veil is typically invoked as a supplement to other legal rules either laid down in statutes or by well-recognized case law. This is especially so when lifting has been applied to expand the use of the Danish Bankruptcy Acts' avoidance clauses to cover situations that do not fall directly within the wording of a section. Thirdly, when courts disregard legal entity the approach is relative in the sense that disregard in relation to one transaction/creditor does not automatically mean disregard in other contexts.

But this is not to say that some more general principles cannot be derived.

In deciding whether to disregard the legal entity, Danish courts employ an objective standard focusing on whether the actual business practice corresponds to the formal (asserted) legal model. Where more untraditional or atypical devices are used, legitimate business and economic rationales for choosing that particular model may be crucial.

When passing judgment the courts may consider a number of factors which indicate disregard of legal entity. None of these factors, however, are by themselves sufficient to lift the veil. They can only be regarded as indicia of the crucial point, namely whether the entities involved have taken the legal as well as the actual consequences of a chosen (asserted) formal legal model.

Some of the indicia emphasized by courts will be discussed briefly in what follows.

4.1. The courts have stressed overlapping of board members as well as common officers and employees.[26] But even though directors of one company of a concern may have substiantial influence on the affairs of another group company, this is not sufficient reason to lift the veil: as shareholder in the subsidiary, a parent is free to elect members to the subsidiary's board. But board members have a fiduciary duty to serve the interest of that particular company. Therefore, if the actual behaviour of a subsidiary's directors shows that their decisions do not reflect the wishes and needs of that subsidiary but that of the parent or the parent's creditors,[27] then the veil may be lifted.

Further it must be noted that the veil is not lifted merely because a company does not have its own employees or office facilities, but uses those of an affiliated company. Yet such factors may awake the court's

[26] See 1968 UfR 766, 1980 UfR 806 and 1983 UfR 267.

[27] This was the case in 1968 UfR 766 and 1977 UfR 526.

suspicion. Therefore a prerequisite for accepting the separation in this situation is that the affairs of the companies have been kept separate formally as well as actually.[28] Where there are common employees they must be clearly instructed as to what business is done for which company. Secondly, the receiving company must be charged for the output; and thirdly, when more activities are placed in a company, it may be difficult to persuade the court that there are reasons for not having independent employees in this company.[29]

4.2. Disregard of formalities may also play a part in cases on lifting the corporate veil. The rationale is that the "price" of obtaining status as an independent legal entity, and hence of limited liability, is that the company has been treated as a distinct entity by its owners, and this includes observing statutory formalities.[30] The formalities related to the economic affairs of the company, such as separate bookkeeping and accounts, are the most important, because these afford the one and only way to check whether the companies involved have actually taken the consequences of the (asserted) transactions and *de facto* kept the businesses separate. Especially when substantial self-dealing transactions are present, current and clearly separated accounts and bookkeeping are crucial.[31] On the other hand, even though accounts are current, the veil may be lifted if the formal registration of assets bears no relation to the actual location so that assets are commingled.[32,33]

[28] See 1986 UfR 697.

[29] In 1978 UfR 880 the defendent companies asserted that the subsidiary Inka-Print International was buying raw material and selling finished clothes, even though it had no employees to manage this kind of business.

[30] Sec. 156(1) and (6) of the Danish Public Limited Company Act (sec. 123(1) and (6) of the Danish Private Limited Company Act) requires a company to use *aktieselskab* (*anpartsselskab*) in its name, and the letterhead must show the registration number of the company.

[31] This was the case in 1986 UfR 697.

[32] In 1968 UfR 766 commingling was present, as one company (Flying Enterprise Sales) through the 150 DKK arrangement paid the debts of another company (Flying Enterprise).

[33] Commingling of assets, and self-dealing, are both factors which suggest that the economic affairs of the companies have not been separated, but there are major differences between the two. Commingling is related to the fact that neither formally nor actually can it be determined to which company certain assets belong, or that there is no relation between the formal registration and the actual location of the assets. On the other hand self-dealing refers to the amount and terms of transactions between affiliated companies. Normally these transactions will reflect actual (perhaps unfair) transfers of assets between the companies and they are formally posted to accounts and in financial reports.

4.3. The concept of inadequate capitalization assumes that, in the normal course of business, a company incurs obligations and presents certain risks to society for which it ought to be financially responsible. In return for the protection of limited liability, a company should have, at the time of incorporation, capital and other economic resources that are reasonably sufficient in the light of its forseeable obligations and risks.

Generally, inadequate capitalization has not played a major part in Danish cases on lifting the corporate veil, and it is doubtful whether greater paid-up capital as required by the Danish Corporate Acts[34] may be deemed necessary. The rationale seems to be that when the Danish Corporate Acts have detailed the conditions for incorporation, including the requirement of minimum capital to be paid in efficiently, this must be considered as exhaustive. In other words, it is up to the legislature and not to the courts to decide whether more paid-up capital is required. From a more practical point of view, there are other provisions in the Danish Company Acts which may prevent a company becoming at least grossly undercapitalized. One example is that a board of directors is obliged to call a general meeting within six months of a company losing half its share capital.[35] This forces the board to follow the company's economic development continuously throughout the fiscal year, and it may thus take appropriate action before total collapse.

But this is not to say that paid-up capital and other economic resources of a company are unimportant in cases on lifting the veil. Combined with other factors, lack of economic resources may indicate that a company has not been treated as an independent entity. In relation to reorganization by means of company-splitting, a large capital deficit may be important, as it indicates that there was no chance of weathering the storm; on the contrary the whole device may have been set up to favour one or a few creditors.[36]

But inadequate capitalization has been emphasized mostly in another context, namely in relation to the business behaviour of the companies involved. Even though assets may have been paid in formally as capital, the shareholders (the parent or other affiliated companies) have, by means of other transactions, still retained control over them. This can be achieved for example by making advance payments for future expen-

[34] For public limited companies, the minimum capital is DKK 300,000 (Act no. 433 of July, 1988, sec. 1(3)), and for private limited companies DKK 80,000 (Act no. 434 of July, 1988, sec. 1(3)).

[35] Act no. 433 of July, 1988, sec. 69a, and Act no. 434 of July, 1988, sec. 85a.

[36] See 1968 UfR 766.

diture,[37] or by lending the capital to affiliated companies.[38] None of these subsequent transactions are themselves illegal or unacceptable, but when they occur just after incorporation and nothing else is done to make economic resources available for the (asserted) business of a newly incorporated company, it is hard to persuade the court that the new company has any independence. On the contrary the parent company has still been able to use the money or other assets paid in as capital: it has treated the subsidiary's assets as if they were its own.

V. SUMMARY

Companies incorporated in accordance with the statutory requirements of Danish company laws remain separated legal entities even in relation to affiliated entities. However, a few Danish cases have dealt with the issue of disregard of legal entity. Lifting the corporate veil is typically raised and used to supplement other legal rules either laid down in statutes or by well-recognized case law, and the courts' use of lifting the veil can hardly be viewed as an independent legal doctrine.

In deciding whether to disregard legal entity, Danish courts employ an objective standard focusing on whether the actual business practice does correspond to the formal (asserted) legal model. Legitimate business and economic rationales for making a split into more companies may be crucial. When adjudicating, the courts may consider a number of factors (e.g. overlapping of executives, disregard of formalities, undercapitalization, commingling of assets and self-dealing), which indicate disregard of legal entity. None of these factors, however, is by itself sufficient to lift the veil.

[37] See 1968 UfR 766.
[38] See 1980 UfR 806.