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**Australasian Law Teachers Association - ALTA  
2006 Refereed Conference Papers**



**Australasian Law Teachers Association – ALTA  
Annual Conference**

**61<sup>st</sup> Annual ALTA Conference**

Victoria University, Melbourne, Victoria, Australia  
4 – 7 July 2006

*Legal Knowledge: Learning, Communicating and Doing*

**Published Conference Papers**

This paper was presented at the 2006 ALTA Conference in the  
'Company Law' Interest Group

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*Conference Papers published by the ALTA Secretariat  
2006*

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**THE UNDERCAPITALISATION OF A COMPANY:  
CAN THIS BE THE BASIS FOR PIERCING THE CORPORATE  
VEIL?**

**DAVID PARKER\***

The deliberate undercapitalisation of a company by its controllers has been suggested by some critics as a misuse of the corporate form, see eg, the recent James Hardie case. Insufficient capital within a company passes the risk of the enterprise to creditors, and could therefore be the basis for piercing the corporate veil. Undercapitalisation of a company has been occasionally discussed in Australian law, but has failed to materialise into any basis for regulating the company - let alone piercing the veil. In the US there is the possibility for piercing the veil on the grounds of undercapitalisation, though its application is rather uncertain. This paper discusses the concept and complexities of undercapitalisation, its lack of application in Australian and UK law, while comparing its limited use within U.S. law. This paper considers the difficulties of defining the concept of undercapitalisation, and further the arguments for and against the use of that principle as a basis for piercing. The paper concludes with some suggestions on how the doctrine of undercapitalisation might potentially apply in Australia.

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## I INTRODUCTION

Undercapitalisation of a company refers to a situation where an operating corporation has insufficient capital, or any other 'means', such as assets or credit, to properly meet potential liabilities to an outsider with a claim against the company. An unsatisfied creditor may then attempt to hold those who deliberately established company affairs with insufficient capital as personally liable. This is effectively piercing the veil by holding shareholders personally liable. The concept is a subtle one in that the focus is on underlying available capital, rather than issues of day to day solvency. In this study undercapitalisation issues relate primarily to the promoter shareholders (or parent companies) who are controllers of the company.

The concept of undercapitalisation has a number of meanings to different observers, for instance the dissenting judge in the famous American taxicab case of *Walkovsky v Carlton*<sup>1</sup> suggests a simple definition:

Undercapitalisation means a participating shareholder of a corporation vested with a public interest, organized with capital insufficient to meet liabilities which are certain to arise in the ordinary course of the corporation's business, may be held personally responsible for such liabilities.

A company may be deliberately undercapitalised at its very establishment, or, if adequately capitalised, may lose that adequacy by a dissipation of the company's capital due to a variety of reasons, either by unfortunate occurrences or from a deliberate shifting of capital. The term 'undercapitalisation' may also be expressed in different ways, for instance: 'inadequate capital', 'grossly inadequate capital',<sup>2</sup> or

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<sup>1</sup> 223 N.E.2d 6, 14 (Judge Keating).

<sup>2</sup> Harvey Gelb, 'Piercing the Corporate Veil - The Undercapitalization Factor' (1982) 59 *Chicago-Kent Law Review* 1, 21. Gelb suggests that the term may be too narrow a definition and should be framed in wider terms of an 'inadequate level of assets'. This expands the notion of what is backing up the company and allows for a more realistic consideration of whether assets have been adjusted to reflect the activities of the company as it grows or takes on riskier activities.

‘thin capitalisation’, eg, where debts incurred are of a disproportionate level to that of company capital.<sup>3</sup>

The issue of undercapitalisation of a company has been occasionally mentioned in Australian jurisprudence,<sup>4</sup> and similarly sporadically raised in British law, often indirectly, eg, in *Salomon v Salomon*<sup>5</sup> Lord Watson, reflecting on the situation of unpaid creditors in this case, said that: ‘A creditor who will not take the trouble to use the means which the statute provides for enabling him to protect himself must bear the consequences of his own negligence’.<sup>6</sup> However, there is a much richer discussion of undercapitalisation in the United States, where the issue has been considered in case law,<sup>7</sup> along with some interesting discussion in law journals.

Undercapitalisation, either deliberate or reckless, which results in reasonably foreseeable obligations to voluntary and involuntary creditors not being met, might result in the forfeiture of limited liability. As one notable American author Henry Winthrop Ballantine has put it:

If a corporation is organised and carries on business without substantial capital in such a way that the corporation is likely to have no sufficient assets available to meet its debts, it is inequitable that shareholders should set up such a flimsy organization to escape personal liability. The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffectual to exempt the shareholders from corporate debts....If the capital

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<sup>3</sup> Paul Erickson, ‘Capitalization of Close Corporations after 1980’ (1980) 17 *Idaho Law Review* 143, 143.

<sup>4</sup> With some public discussion, eg, regarding the James Hardie saga: Edwina Dunn, ‘James Hardie: No Soul to be Damned and No Body to Be Kicked’ (2005) 27 *Sydney Law Review* 339; Justice Andrew Rogers, ‘Reforming the Law Relating to Limited Liability’ (1993) *Australian Journal of Corporate Law* 136, 140; *Briggs v James Hardie Ltd* (1989) 16 NSWLR 549. Rogers J suggested that they look at issues of undercapitalisation.

<sup>5</sup> [1897] A.C. 22.

<sup>6</sup> *Ibid* 40: A reference to the fact that creditors should check the viability of who they are lending to.

<sup>7</sup> Noting that there are not very many cases, see Robert Thompson, ‘Piercing The Corporate Veil: An Empirical Study’ (1991) 76 *Cornell Law Review* 1036; Robert Thompson, ‘Piercing the Veil within Corporate Groups: Corporate Shareholders as Mere Investors’ (1999) 13 *Connecticut Journal of International Law* 379.

is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.<sup>8</sup>

However, piercing on the grounds of undercapitalisation is problematic because of definitional problems and the practicalities of determining an intention to undercapitalise. This has led to a general prohibition in the common law world to pierce on the grounds of undercapitalisation, except in the U.S., though even there it has been described as ‘...an inconsistent and indefinite legal standard being promulgated by the courts in deciding whether to pierce the corporate veil’.<sup>9</sup>

The concept of undercapitalisation is further complicated because it is closely related to the issue of underinsurance.<sup>10</sup> A company may not be able to meet its liabilities, irrespective of its capital, because it has insufficient insurance to meet its liabilities, particularly in the case of injured involuntary tort creditors.

Apart from the U.S., where undercapitalisation - along with a number of other factors, can be the basis for piercing, the issue has not been seriously considered because of the theoretical and practical problems which will now be outlined.

### ***A Definitional Problems***

A simplistic definition of undercapitalisation might be for example where a promoter establishes a company to operate a business, such that: ‘...capitalization is very small in relation to the nature of the business of the corporation and the risks that the

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<sup>8</sup> *Ballantine on Corporations* (revised ed, 1946) 302, cited in Paul Redmond, *Companies and Securities Law: Commentary and Materials* (4<sup>th</sup> ed, 2005) 163. A quotation used by many writers on undercapitalisation, including some US courts; See also Roger Meiners, James Mofsky and Robert Tollinson, ‘Piercing the Veil of Limited Liability’ (1978) 4 *Delaware Journal of Corporate Law* 351.

<sup>9</sup> Philippe Salomon, ‘Limited Liability: A Definitive Judicial Standard for the Inadequate Capitalization Problem’ (1973) 47 *Temple Law Quarterly* 351, 351.

<sup>10</sup> See, eg, a look at mandatory insurance: Frank H. Easterbrook and Daniel R Fischel, ‘Mandatory-insurance requirements are similar in some respects to minimum-capitalization requirements: Limited Liability and the Corporation’ (1985) 52 *University of Chicago Law Review* 89, 115.

business necessarily entails'.<sup>11</sup> But this can only be established in hindsight,<sup>12</sup> a plaintiff must show that the company deliberately operated with inadequate capital to pass the risk of trading activities to company outsiders. This is a distinct concept to insolvent trading which concentrates only on the day to day liquidity of the company.<sup>13</sup> Finding a workable definition of undercapitalisation is difficult since different enterprises require differing amounts of capital according to the riskiness of their enterprise. Further, the responsibility of controllers/shareholders to the ultimate creditors is hazy, particularly if the shareholders have no business relationship with company outsiders. A company may initially be properly capitalised, but then 'lose' capital. A further issue is determining what is actually capital. Definitions may be taken either from an accounting or economic stance, and even include intangible assets such as a skill base or customer relationship. As one Australian text book states 'the term capital is used in various ways which are calculated to confuse'.<sup>14</sup>

However, would such descriptions of capital, as above, take into account subtleties such as the fact that the company may have asset backing in the form of guarantees by the promoters or shareholders of the company? In fact even Aron Salomon personally borrowed in order to boost the fading hopes of his company, which led of course to the battle between secured and unsecured creditors.<sup>15</sup>

Most company law textbooks distinguish between equity capital and share capital, which further complicates the idea of capital since companies may borrow to finance its operations and pay its creditors, rather than just relying on the contributions of members.<sup>16</sup> Capitalisation of a company can be substantially from borrowing;<sup>17</sup> and indeed many Australian companies have begun to 'gear up' to increase returns to

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<sup>11</sup> Erika Clarke Birg, 'Redefining "Owner or Operator" Under CERCLA to Preserve Traditional Notions of Corporate Law' (1994) 43 *Emory Law Journal* 772.

<sup>12</sup> One problem is determining what should be adequate capital and recoverable in a similar type of enterprise: Salomon above n 9.

<sup>13</sup> Section 588G, *Corporations Act 2001* (Cth).

<sup>14</sup> Redmond, above n 8, 234.

<sup>15</sup> Above n 5.

<sup>16</sup> Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (12<sup>th</sup> ed, 2005) ch: 17 Equity Finance and ch: 19 Debt Finance.

<sup>17</sup> For suggestion of different types of capitalisation see: Anonymous, 'Capitalization' (1957) 52 *Northwestern University Law Review* 368.

fewer members and to reduce the administrative costs of managing large groups of shareholders.<sup>18</sup>

In place of a simple definition of undercapitalisation an objective standard might be set, similarly to that found in s 180(1) of the *Corporations Act 2001* (Cth) which stipulates care and diligence by directors with a ‘...degree of care and diligence that a reasonable person would exercise...’ For deliberate undercapitalisation some equivalent considerations might be to require capital according to the circumstances of the company, and to gauge it against whether a reasonable and experienced person believed there:

- was initial capital sufficient to meet obligations of the type which would be expected in a similar company;
- was any indication by controllers of an intention to deliberately undercapitalise the company;
- was a sufficient level of capital to conduct business and meet obligations of the type of business conducted; and
- were practices engaged in by the company to deliberately siphon off capital so that it would not be available to creditors.

However, to enshrine undercapitalisation in legislation would leave much to be decided by the court as to when and under what conditions this occurs. Ultimately the question of undercapitalisation has a lot to do with the theoretical purpose of a company and its consequent obligations as a result of society’s stance, eg, if the grant of the corporate form is a privilege then consequent duties are attached. It follows that if capitalisation is a duty, then failure to do so may be a reason for a court to look behind the veil and hold the controllers liable if this has led to unsatisfied creditors with the demise of the company.

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<sup>18</sup> See the list of reasons for share buy backs: Austin and Ramsay, above n 16, [24.420].

## II UNDERCAPITALISATION IN AUSTRALIA

Australian law does not have any firm principled jurisprudence or common law on piercing for undercapitalisation, underinsurance, nor specific standards on the minimum capital requirements for a company. There are references to undercapitalisation in dicta, some references in the literature, but little other than that.<sup>19</sup> The issue however has recently been raised in the cases of *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia*<sup>20</sup> and *Briggs v James Hardie Ltd* ('Briggs'),<sup>21</sup> which were groups of companies. Justice Rogers in the *Briggs*<sup>22</sup> case quoted a Professor Robert Downs<sup>23</sup> who suggested that the real determinant in tort cases dealing with a corporation is whether they '...should be permitted to shift the risk and responsibility for such occurrences to the victims or the general public by operating the business as a corporation without sufficient capital or insurance to cover foreseeable risks'.<sup>24</sup>

The behaviour of the James Hardie and Patrick group of companies is not new in Australia, the Guest Committee,<sup>25</sup> which investigated Phoenix behaviour,<sup>26</sup> also found that corporate structures were routinely used shield parent companies from liability through the creation of poorly funded companies, purely for the purpose of obtaining limited liability.

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<sup>19</sup> Undercapitalisation does not seem to figure in any study of Australian piercing. See, eg, Ian Ramsay and David Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19 *Company & Securities Law Journal* 250, 253. In this study the authors list 5 categories of piercing, none of which refer directly to piercing.

<sup>20</sup> (1998) 27 ACSR 535 (High Court).

<sup>21</sup> (1989) 16 NSWLR 549. Rogers J suggested that the issue of undercapitalisation, obvious in the case, had not really been developed in Australian law.

<sup>22</sup> (1989) 16 NSWLR 549.

<sup>23</sup> Robert Downs, 'Piercing the Corporate Veil-Do Corporations Provide Limited Liability?' (1985) 53 *University of Missouri at Kansas City Law Review* 174, 175.

<sup>24</sup> Rogers, above n 4. Rogers J later reflected on his judgment (in an article and presentation) and the situation of companies using the shield of limited liability: 'At the end of the day, it seems to me that any person giving attention to corporate law reform has to go back to the concept that limited liability is a privilege'.

<sup>25</sup> Law Reform Committee of the Parliament of Victoria, *Curbing the Phoenix Company*, No 1 (1994); No 2 (1995).

<sup>26</sup> Using the analogy of the Phoenix rising from the ashes, whereby companies who go out of business and are unable to pay their creditors arise in another form with the same management.

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**Australasian Law Teachers Association - ALTA  
2006 Refereed Conference Papers**

Potentially in the future there may be some changes to how Australia deals with groups of companies. John Kluver<sup>27</sup> for instance suggests that companies might operate as one [enterprise] and register as such so that group assets might be available to creditors.<sup>28</sup> Kluver's observations suggest that undercapitalisation is unlikely to be a fundamental issue in Australia, but rather there should be minor changes to how groups operate by recognising the totality of the enterprise.

Australian legislation while not stipulating minimum amounts of capital for the purposes of incorporation does have rules of capital maintenance and use of capital by companies. Australian law has some indirect capitalisation standards that protect the interests of creditors.<sup>29</sup> The rules that do exist in Australia have in a sense replaced the need for specific undercapitalisation rules by proscribing behaviour that could lead to insolvency, eg, one leading Australian text, Austin and Ramsay lists eight different means by which legislation gives protection to creditors, but does not give any direction on undercapitalisation.<sup>30</sup>

Australian law does not prescribe any capitalisation requirements for a company, indeed many companies are scaling down their shareholder capital by gearing up with borrowed funds, leasing equipment and buildings rather than buying them and outsourcing many activities which would have represented capital assets. Australian law refers indirectly to the use of capital by regulating the ability of controllers to specifically reduce capital. Rather, there are a number of provisions which impose penalties from a misuse of the controllers' positions. Undercapitalisation is not a basis for piercing in Australia per se.

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<sup>27</sup> John Kluver, 'Entity vs. Enterprise Liability: Issues for Australia' (2005) 37 *Connecticut Law Review* 765. In 2005 he was the Executive Director, Corporations and Markets Advisory Committee.

<sup>28</sup> Ibid 781.

<sup>29</sup> See, eg, ss 588G, 588V, and similarly regarding dealings in capital: Part 2 J.1: *Corporations Act 2001* (Cth).

<sup>30</sup> Austin and Ramsay, above n 16, [20.30].

### **III UNDERCAPITALISATION ISSUES IN THE UK**

In the UK Lord Davey observed in that famous undercapitalised company of *Salomon & Co*,<sup>31</sup> that the legislature had not seen fit to impose minimum capitalisation requirements: 'I think that this result follows from the absence of any provision fixing a minimum nominal amount of a share - the provision in s 8 that no subscriber shall take less than one share'.

Different company law inquiries have considered the issue of undercapitalisation, for instance The Jenkins Committee in 1962<sup>32</sup> gave its support to the idea that companies should be properly capitalised, but concluded that legislative changes should not be proceeded with because '...its purpose would be too easy to evade and we cannot, therefore, recommend it'.

There have been indirect references to undercapitalisation though, eg, Phoenix activity – the resurrection of insolvent companies - was referred to in The Cork Committee<sup>33</sup> as an abuse of the corporate form. The solution of The Cork Committee however was not to particularly address issues of undercapitalisation, but to suggest that the legislature raise the standards of insolvency practitioners.

The issue of undercapitalisation has been more recently considered, for instance in a CLRSR Report.<sup>34</sup> In this inquiry the committee did investigate whether there should be a mandated minimum capital threshold for companies. The committee's conclusion was that while it might deter some from incorporating, they doubted that it would '...provide any meaningful protection for creditors...'

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<sup>31</sup> [1897] A.C. 55. Where admittedly the undercapitalisation was not deliberate, though initial company capital was geared in favour of borrowed capital, eg, debentures issued to Salomon.

<sup>32</sup> United Kingdom, *Report of the Company Law Committee* (Cmnd 1749 1962) [27].

<sup>33</sup> United Kingdom, *Report of the Insolvency Law Review Committee, Insolvency Law and Practice* (Cmnd 8558, 1982).

<sup>34</sup> Company Law Review Steering Group, United Kingdom, *Modern Company Law for a Competitive Economy: Developing the Framework*, No 34 (2000) [9.66].

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2006 Refereed Conference Papers**

The inquiry decided that rather than imposing capitalisation standards generally on companies, that the accounts of companies above the 'micro company' level, but below the audit threshold, should be subject to an Independent Professional Review.<sup>35</sup> This would entail certification of the company as a 'going concern', which should provide a more effective assurance of solvency than would be offered by a minimum capital requirement. The report also made the interesting observation in Chapter 10 of the CLRSG Report that the veil should not be lifted for involuntary creditors and no reforms were needed. This was the same conclusion of the Australian CASAC report on Corporate Groups.<sup>36</sup>

Nevertheless there are some minimum capital standards in the UK, for instance public companies must have a minimum capital of £50 000,<sup>37</sup> though a company may issue partly paid shares and can call up the full amount later. Otherwise private companies can have as little capital as they wish. The CLRSG report<sup>38</sup> had analysis that showed the vast majority of 'live' companies have a very small shareholder base.<sup>39</sup> This would indicate that thinly capitalised companies, which most British companies appear to be, seems to be irrelevant as an issue of concern for at least smaller companies, and consequently piercing on the grounds of undercapitalisation seems to be irrelevant.

Undercapitalisation is occasionally mentioned in case law in the UK,<sup>40</sup> but has not established any jurisprudential standard as a grounds for piercing. The UK seems to have focused on insolvent trading and has similar legislation to Australia in the form

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<sup>35</sup> Above n 32, [8.41-5].

<sup>36</sup> Australia, *Corporate Groups Final Report (CASAC)* (2000) ch 6, [176].

<sup>37</sup> Section 118, *Companies Act 1989* (UK); See Paul Davies, *Gower's Principles of Modern Company Law* (6<sup>th</sup> ed, 1997) 229.

<sup>38</sup> Above n 33, [11.6], 352.

<sup>39</sup> Ninety per cent of companies had four shareholders or fewer.

<sup>40</sup> *Lubbe v Cape Industries Plc* (2000) 4 All ER 268. The case was brought by 3 000 employees and residents of Cape Industry's wholly owned asbestos mining subsidiary in South Africa claiming damages from the parent company in London for death and personal injury caused by exposure to asbestos near the mining operation in South Africa. The court found that the matter could be heard in London because of the nature of the case or it would be a denial of justice. The case however was settled in 2001 for £21m.

of the *Insolvency Act 1986* (UK) ss 213-15,<sup>41</sup> rather than developing any regulation over undercapitalisation. Provisions for director's duties, the placing of penalties on managers whose companies conduct fraudulent trading, and higher auditing standards has been in place of any perceived need to implement any procedures dealing with the undercapitalisation of a company.

The principle of undercapitalisation does not play any major part in piercing the veil in the UK.

#### **IV LESSONS FROM THE U.S.**

The United States has developed within its extensive veil piercing jurisprudence a principle whereby the courts may pierce the veil where a company is found to be grossly undercapitalised. Stephen Presser<sup>42</sup> in his famous study points out that federal courts and each of the states have different approaches to piercing,<sup>43</sup> some are quite reluctant to pierce, while others will do so by emphasising different factors.<sup>44</sup> The State of Delaware is particularly reluctant to pierce, as is New York to lesser degree,<sup>45</sup> while California and Texas have quite developed criteria for piercing, including undercapitalisation. Other states similarly demonstrate different degrees of willingness to embrace piercing, but each using their own versions of piercing tests and applying their own developed precedent.

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<sup>41</sup> Section 588G *Corporations Act 2001* (Cth).

<sup>42</sup> Stephen Presser, *Piercing the Veil* (1991) vii.

<sup>43</sup> See, eg, *Zaist v Olson* 227 A.2d 552 (Conn 1967) the court applied an instrumentality test, eg, a bankrupt company was undercapitalised, no formalities recognised between itself and its fellow company both owned by a shareholder. The shareholder acting on behalf of his company contracted for work to be done and to be paid for the by company. The company was bankrupted before payment was made and the creditor sought a piercing of the veil on the grounds that the company was a mere instrumentality of the shareholder, which was in fact upheld by the court.

<sup>44</sup> See, eg, Stephen Bainbridge, 'Abolishing Veil Piercing' (2001) 26 *Journal of Corporation Law* 479, 508.

<sup>45</sup> Thompson, 'Piercing the Corporate Veil: An Empirical Study', above n 7, 1051-2. The percentage of cases in which courts pierce the veil varies depending on which state's law is being applied. Among the eight states with the most piercing decisions, the percentage of cases in which courts pierced ranged from 31 per cent in Pennsylvania and 35 per cent in New York to 45 per cent in California. Given the small number of cases in each jurisdiction, the differences between the states are not statistically significant. Therefore, it is not possible to say with certainty that these results are due to different views of the law.

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**Australasian Law Teachers Association - ALTA  
2006 Refereed Conference Papers**

Nevertheless there have been some significant piercing case law on the grounds of undercapitalisation, though normally when a combination of factors (besides undercapitalisation), have been present. Some authors claim undercapitalisation is extremely important in US piercing,<sup>46</sup> whereas others claim that it is fairly insignificant as a factor.<sup>47</sup> Each author seems to have their own views, eg, Chris and James Krendl suggests undercapitalisation is an issue more prevalent for groups of companies.<sup>48</sup>

In New York on the other hand it is suggested that piercing is extremely difficult,<sup>49</sup> the veil will only be lifted if there is very clear abuse of the corporate form. Benjamin Cardozo in *Berkey v Third Avenue Railway Co*<sup>50</sup> established fairly conclusively that piercing is not available, unless its purpose was to work a 'fraud upon the law' by some abuse of the privilege of incorporation. The New York case that set the basis for a reluctance to pierce, indeed perhaps throughout the U.S., is that of *Walkovsky v Carlton*,<sup>51</sup> sometimes called the '*New York Taxicab Case*'. In this case a shareholder (Carlton), established ten different companies, each with the statutory minimum insurance of US\$10 000, to individually hold two taxis, (described in the case as basically hacks). The arrangement spread the risk away from the shareholder so that an injured party was left uncompensated. Each company had been deliberately undercapitalised and underinsured, despite the risks, so that a tortfeasor's claim of US\$500 000 exceeded the assets of the whole group of companies.

The case basically indicated that a company could use the corporate structure to minimise their liability, and once established was under no obligation to maintain any

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<sup>46</sup> William P. Hackney and Tracey G. Benson, 'Shareholder Liability for Inadequate Capital' (1982) 43 *University of Pittsburg Law Review* 837, 859. They suggest that one of the most important factors in corporate veil piercing is inadequate capitalisation.

<sup>47</sup> See, eg, study by Thompson, 'Piercing the Corporate Veil: An Empirical Study', above n 7.

<sup>48</sup> Cathy Krendl and James Krendl, 'Piercing the Corporate Veil: Focusing the Inquiry' (1978) 55 *Denver Law Journal* 1: 'As a result of initial undercapitalization or because the subsidiary is operated in an unprofitable manner, the parent ends up with all the fruits of their combined business activities and the subsidiary is left insolvent'.

<sup>49</sup> Presser, above n 42, 2-291.

<sup>50</sup> 244 N.Y. 84, 155 N.E. 58 (1926).

<sup>51</sup> 18 N.Y.2d 414, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966). It could be said the case is often quoted, or perhaps it is a notorious example of deliberate undercapitalisation.

level of capital. The case is often referred to as a notorious use of the corporate form which does not explain when a court might pierce for undercapitalisation. Noting however that while the majority of the court refused to pierce on the grounds of undercapitalisation alone, the court did not categorically state that they would never pierce if there were some other factors present.

Interestingly in this case, the New York court of appeals remanded the case to allow Walkovsky to amend his claim, and suggested that the defendant might be liable under the alter ego doctrine. The plaintiff did not re-present the amended cause and no further action was taken by Walkovsky, so it is presumed that the parties settled.<sup>52</sup> This has led some writers to suggest that the New York jurisdiction might under some other circumstances pierce the veil.<sup>53</sup>

There is no clear jurisprudential rule from American case law as to when the courts will pierce for undercapitalisation, either at state or federal level. Courts may pierce where there are a number of grounds to do so, including undercapitalisation.<sup>54</sup> But undercapitalisation appears to be more indicative of bad shareholder behaviour than any type of primary proscribed behaviour.<sup>55</sup> The successful piercing cases indicate that there has been a dominating shareholder who has misused the corporate form by not observing formalities such as meetings or appointing officers.<sup>56</sup>

The U.S. courts do take into account undercapitalisation when considering whether to pierce, not as a sole basis but considered along with a number of other factors.

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<sup>52</sup> Bainbridge, above 44, 484.

<sup>53</sup> *Walkovsky v Carlton* 607 F.2d 582 (2d Cir. 1979), 588. The court stated: 'We know of no New York authority that disregards corporate form solely because of inadequate capitalization'. Note the comment in the later case of *Gartner v Snyder* where the court suggested that they might pierce if there are a number of factors present, including undercapitalisation.

<sup>54</sup> *Hickman v Hyzer* 401 S.E.2d 738, 740 (Ga. 1991) 'For undercapitalization of a corporation to justify piercing the corporate veil, it must be coupled with evidence of an intent at the time of capitalization to improperly avoid future debts of the corporation'; *Collett v American Nat'l Stores Inc*, 708 S.W.2d, 287: 'Making a corporation a supplemental part of [an] economic unit and operating it without sufficient funds to meet obligations to those who must deal with it would be circumstantial evidence tending to show either an improper purpose or reckless disregard of the rights of others'.

<sup>55</sup> *Scott v AZL Resources Inc* 753 P.2d 897, 901 (N.M. 1988) 'Undercapitalization of a subsidiary is a factor to be considered in determining whether there was an improper purpose'.

<sup>56</sup> Thompson, above n 7, 387.

## **V THE PROBLEM OF UNDERCAPITALISATION**

The granting of the corporate entity and limited liability encourages entrepreneurship, investment and risk taking which underpins business in Australia (and in other jurisdictions).<sup>57</sup> However, if shareholders do not adequately capitalise for potential obligations,<sup>58</sup> then unsatisfied creditors might argue this is not acting fairly in good faith, considering potential damage that could be caused.<sup>59</sup> This is sometimes referred to as risk shifting by company insiders to outsiders who deal with the company.<sup>60</sup> The price of limited liability claimed by shareholders is that they risk a reasonable amount of capital sufficient and commensurate with its activities to conduct a corporate business.<sup>61</sup>

Of further concern is that undercapitalising of a company is particularly unfair on tort creditors, since they have had no choice in dealing with the company, nor build in any risk margin in their dealings like contract creditors. Undercapitalisation in itself could be the sole basis for piercing, or at least one factor amongst others when deciding if to pierce.

### ***A The Privilege of Incorporation***

A prime reason for some observers to claim undercapitalisation as a requirement on a company, and in turn a reason to pierce the entity if it does not meet that obligation, is

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<sup>57</sup> This is the classic criteria justifying limited liability outlined by Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (1991) 41.

<sup>58</sup> Gelb, above n 2, 3: eg, 'not trifling amounts'.

<sup>59</sup> Eric Fox, 'Piercing The Veil Of Limited Liability Companies' (1994) 62 *George Washington Law Review* 1143, 1159: 'When a state confers a privilege on a corporation, it does so because it believes that granting this privilege will benefit the public by contributing to economic growth. A court that subscribes to the privilege theory of the corporate personality, therefore, will be more willing to prevent corporations from damaging the public weal due to inadequate capitalization'.

<sup>60</sup> Downs, above n 23, '[creditors]...should [not] be permitted to shift the risk and responsibility for such occurrences to the victims or the general public by operating the business as a corporation without sufficient capital or insurance to cover foreseeable risks'.

<sup>61</sup> Robert Dye, 'Inadequate Capitalization as a basis for Shareholder Liability: The California Approach and a Recommendation (1972) 45 *Southern California Law Review* 823, 833: argues that limited liability is to encourage investment '...by giving some bottom line to risk'; Contra *ibid* 835-6: '...allowing incorporation without capital requirements means that parties can set up with minimal capital'.

that the corporate form is a privilege. This is a social model which does not focus on the primacy of shareholders but encompasses theories promoted by feminists, communitarians and even 'enterprise entity' proponents.<sup>62</sup> If the company is a social construct and a concession in return for good behaviour, then some minimum standards of capital may be expected. Of course at the other end of the spectrum is the contractarian idea of the company which is designed to facilitate economic certainty, requiring only compliance with existing legal principles.

Judge Keating, the dissenting judge in the much discussed U.S. taxi cab case of *Walkovsky v Carlton*,<sup>63</sup> outlined the concept of the privilege of the company (amongst other matters). He noted that taxis were on the street 24 hours a day and continually drained of any income, he subsequently pondered whether:

The issue presented by this action is whether the policy of this State, which affords those desiring to engage in a business enterprise the privilege of limited liability through the use of the corporate device, is so strong that it will permit that privilege to continue no matter how much it is abused, no matter how irresponsibly the corporation is operated, no matter what the cost to the public. I do not believe it is.

The social argument is that if shareholders claim the privilege of limited liability,<sup>64</sup> they must purchase it by risking minimal capital and not transposing the greater part of risk to others.<sup>65</sup> A company which does not provide capital commensurate with the level of risk undertaken should not have the privilege of separate entity.<sup>66</sup>

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<sup>62</sup> E Merrick Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145.

<sup>63</sup> Judge Keating, above n 1, 10.

<sup>64</sup> Dye, above n 61, 838.

<sup>65</sup> Meiners et al, above n 8, 1040: 'However, even if creditors are sometimes better risk-bearers, limited liability also shifts risks in other situations to claimants who had no choice in dealing with the enterprise (eg, tort victims or small uninformed creditors). To this extent, limited liability shifts some costs of doing business away from the corporation to other parts of society'.

<sup>66</sup> Dye, above n 61, 836.

Such a view is not without its critics. One critic of privilege theory is Michael Douglas,<sup>67</sup> who particularly denigrates this theory as a basis for piercing on the grounds of undercapitalisation. Douglas does not believe a company is under any duty to carry out public functions in the public interest, including any obligation to provide adequate capital.<sup>68</sup> Douglas, along with many other writers views a company as more akin to a contract,<sup>69</sup> the state grants a charter to a company and this is not a privilege but an efficient way to arrange contractual relationships. This is the contractarian view of the company, the state does not become involved except to resolve contractual disputes, or enforce and prosecute stipulated law. Parties, when entering into contracts with the company make their own informed assessment of the capital of the company, alternatively tort creditors should sue for breaches of their rights.

### ***1 Tort Creditors Versus Other Creditors***

Undercapitalising, or underinsuring, a company so that it's unable to meet its obligations means the creditors will have to liquidate the company to retrieve money or compensation that is owed to eg, employees, trade creditors, the tax office, injured parties and lenders.<sup>70</sup> This is particularly so for voluntary creditors, Easterbrook & Fischel point out that: '...where high transactions costs prohibit those affected by risky activities from charging an appropriate risk premium ... the probability that firms with limited liability will undertake projects with an inefficiently high level of risk increases'.<sup>71</sup>

A voluntary creditor can assess credit worthiness of a company, take some security (or procedures) for their risk or alternatively to build in some interest compensation to cover the risk. Sophisticated creditors may have the means and power to bargain,<sup>72</sup>

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<sup>67</sup> Michael Douglas, 'To Know a Veil' (2000) 26 *Iowa Journal of Corporate Law* 41, 41.

<sup>68</sup> *Ibid* 57.

<sup>69</sup> Fox, above n 59.

<sup>70</sup> Jeffrey Gordon, 'The Mandatory Structure of Corporate Law' (1989) 89 *Columbia Law Review* 1549, 1556: Undercapitalisation prompts a discussion of company models and assumptions that everyone has equal access to information, which is not so for the tort creditor.

<sup>71</sup> Hackney and Benson, above n 46, 859.

<sup>72</sup> See, eg, taking a personal guarantee: effectively piercing the veil by making an individual personally liable.

and consequently, on an equitable basis,<sup>73</sup> should assume the risk. While shareholders shield themselves behind the corporate entity, it is the involuntary creditors who suffer from undercapitalisation.

The argument for distinguishing undercapitalisation as an issue for corporate tortfeasors, and possibly ultimately the shareholders, is that the company has a duty to either adequately capitalise or insure the company to compensate those affected.

More seriously the closeness of the population and advent of large scale production may exacerbate the seriousness of potential injury to those living near the business, or perhaps using their products. Hansmann & Kraakman<sup>74</sup> suggest that: 'Changes in technology, knowledge, liability rules, and procedures for mass tort litigation have for the first time raised the prospect of tort claims that exceed the net worth of even very large corporations'.

Even Douglas Bainbridge, who would expressly abolish veil piercing, would allow some liability in the case of misrepresentation: 'If the shareholder in some way deceived the creditor into believing that the corporation had adequate assets to cover its obligations and the creditor, relying on that misstatement, failed to demand a personal guarantee, the shareholder ought to end up being held liable'.<sup>75</sup> This would particularly be so where the shareholder has siphoned funds out of the firm so that it is ex post undercapitalised.

Piercing is problematic because if a creditor is able to go beyond the assets of the company, then this is in a sense re-writing the contract they voluntarily entered into. Much would depend if there was a consensual relationship in an arms length negotiation, or if it was forced.

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<sup>73</sup> Dye, above n 61, 836.

<sup>74</sup> Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 101 *Yale Law Journal* 1879, 1880.

<sup>75</sup> Bainbridge, above n 44, 503.

***B Arguments Against Undercapitalisation as a Means of Piercing***

***1 Limited Liability***

One basic argument against enshrining undercapitalisation as a basis for piercing, is that it effectively removes limited liability from a company, which in turn destabilises entrepreneurship by effectively making the shareholders guarantors for the company.<sup>76</sup> The shareholders, both passive and active, must then monitor the company for its capital adequacy,<sup>77</sup> which basically re-writes creditors contracts. Similarly Bainbridge notes: ‘Where a contract creditor fails to bargain around the limited liability default rule, there is no justification for giving it a second bite at the apple through a veil piercing remedy’.<sup>78</sup> Voluntary creditors must assume a normal level of risk.<sup>79</sup>

Frank Easterbrook & Daniel Fischel,<sup>80</sup> gave five reasons for limited liability which are fairly consistent with their argument that shareholders should not be liable for undercapitalisation. While the writers acknowledge the problem of undercapitalisation and involuntary creditors,<sup>81</sup> they note that shares are traded on the basis of company profits, not on the risk of the company’s inability to meet its obligations, nor the wealth of the ultimate shareholder in the instance of piercing. Enshrining undercapitalisation would destabilise the whole purpose of a company as an investment vehicle which encourages risk taking,<sup>82</sup> both by active and passive shareholders.<sup>83</sup>

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<sup>76</sup> Whether or not they have the expertise.

<sup>77</sup> This is the classic Easterbrook and Fischel proposition, above n 7.

<sup>78</sup> Bainbridge, above n 44, 517. Despite Thompson’s finding that court pierce more frequently in contract law cases: Thompson, ‘Piercing the Corporate Veil: An Empirical Study’, above n 7, 1058.

<sup>79</sup> Hackney and Benson, above n 46, 888.

<sup>80</sup> Easterbrook and Fischel, above n 57.

<sup>81</sup> *Ibid* 113.

<sup>82</sup> Dye, above n 61, 838: If the law fails to differentiate between the risk-taking of creditors and the speculation of shareholders, credit transactions, which the law encourages by other legal devices, will be discouraged.

<sup>83</sup> Hackney and Benson, above n 46, 852.

Grantham and Ricketts<sup>84</sup> similarly when referring to tort liability on directors, point out that holding directors personally liable is contrary to the foundations of company law:

The primary purpose of the set of rules which makes up company law is to ensure that principles of law generally applicable, such as those of torts, are applied to a different and non-natural entity in a particular manner, which usually means that their application is limited.

## **VI COUNTERING THE MINIMUM CAPITAL ARGUMENT**

If legislation, or common law, is to impose some standard of capitalisation then what is an appropriate amount? A company may be established with substantial capital at its registration but slowly dissipate that capital, either through unfortunate trading, or because the controllers have siphoned off funds through excessive dividends, remuneration, loans to themselves or other companies, or even contracts with related parties.<sup>85</sup> If capital was adequate at the commencement of a company, is there any duty to maintain that capital, to increase it as the enterprise changes,<sup>86</sup> or even to stop trading if capital is diminishing? If capital is lost through no fault of the controllers, should this be considered within the definition of undercapitalisation?<sup>87</sup>

Legislating to require companies to internalise the assessment and provision of adequate capital could be argued to be unreasonable and based on uncertain and hazy standards, particularly if there were no initial requirements for capital, or further if the enterprise appeared to have minimal risks. Assessment as to what is adequate and feasible is often only possible in hindsight. Further, if the court decides that undercapitalisation is an issue, on what basis does a court make an order to impose

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<sup>84</sup> Ross Grantham and Charles Rickett, 'Directors' "Tortious" Liability: Contract, Tort or Company Law?' (1999) 62 *Modern Law Review* 133.

<sup>85</sup> Noting that the *Corporations Act 2001* (Cth) has many such provisions.

<sup>86</sup> Easterbrook and Fischel, above n 7, 114: Who argue that this has significant administrative costs for smaller firms.

<sup>87</sup> Hackney and Benson, above n 46, 652: Who argue along the lines that if the legislature has not set minimum capital, insurance, replacement of capital then there is no requirement on a company to do so.

liability on the controllers or shareholders?<sup>88</sup> Is an order to be proportional to the wealth or holdings of each shareholder, or on some other basis, what amount of capital needs to be collected? This is quite problematic in practicality.

The *Walkovsky v Carlton*<sup>89</sup> taxicab case, while discussed in terms of gross undercapitalisation, was essentially an underinsured company operating to the letter of the law, a situation remedied post *Walkovsky v Carlton*.<sup>90</sup> Authorities can mandate minimum levels, though this not without its difficulties; if mandated insurance is too high, then this might increase risky behaviour, eg, Easterbrook & Fischel suggest: ‘The purchase of insurance has the effect, however, of creating a contract creditor where none may have existed before. The insured corporation must pay (through higher premiums) for engaging in risky activities’.<sup>91</sup> Other difficulties can arise where the state begins to mandate insurance levels in that it sets a barrier for entry into certain activities. Alternatively it might result in the insurer determining who gets insurance and at what premium, again setting barriers.<sup>92</sup>

Easterbrook & Fischel point out that if regulators set capital requirements too high, this will impede entry into the market and encourage monopoly and high prices.<sup>93</sup> Will a company have to post a bond equivalent to the capital risk?<sup>94</sup> Furthermore, this will mean that business must invest in assets that are not risky in order to cover their other activities, this shifts investment away from risk taking to safer investments<sup>95</sup> - an overall situation which may not be in the best interests of society.

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<sup>88</sup> Hackney and Benson, above n 46, 652: who point out the issue of whether shareholders should be responsible for misrepresentation when there is no duty of disclosure.

<sup>89</sup> Above n 1.

<sup>90</sup> Above n 1, see comments in Bainbridge, above n 44, 525.

<sup>91</sup> Easterbrook and Fischel, above n 7, 108. Though the authors also state that ‘Whether the social costs of regulation exceed to social costs of excessively risky activities is an empirical question. The desirability of regulation cannot be established simply by identifying the potential incentive to engage in overly risky activities created by limited liability’.

<sup>92</sup> Ibid 115: the barriers may be greater than minimum capital requirements.

<sup>93</sup> Ibid 114.

<sup>94</sup> Richard Posner, ‘The Rights of Creditors of Affiliated Corporations’ (1976) 43 *University Chicago Law Review* 499.

<sup>95</sup> Which Easterbrook and Fischel points out is a social cost, above n 10.

## VII CONCLUSION

The first question to ask is whether Australia has a problem whereby companies are deliberately undercapitalising so that voluntary and involuntary creditors are left unpaid in the event of a company windup.<sup>96</sup> Voluntary creditors can take precautions,<sup>97</sup> but the issue of involuntary creditors is more problematic, the James Hardie case is one instance of a parent company inadequately capitalising a body which was to pay compensation.<sup>98</sup> The behaviour of the James Hardie company is not widespread in Australia, and public and government pressure ultimately forced the parent to adequately fund its medical subsidiary<sup>99</sup> - though smaller companies are unlikely to respond to such pressure. Australian case law shows little evidence of undercapitalisation being mentioned as a problem, other than as dicta to show that a company was heading for insolvency.<sup>100</sup> Neither has Australian jurisprudence developed the idea of corporate privilege requiring specific duties such as adequate capitalisation.

Australian law has focused on the behaviour of controllers and company solvency, rather than developing any idea of initial undercapitalisation. Personal liability applies for insolvent trading,<sup>101</sup> fraudulent diversion of funds<sup>102</sup> and for a host of other duties imposed by Australian legislation, though admittedly of little use to creditors, are still

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<sup>96</sup> See Ian Ramsay, Paul James and Potat Siva, 'Insolvent Trading - An Empirical Study, Centre for Corporate Law and Securities Regulation' (Research Report, University of Melbourne, 2004) 1-2. The authors found very few cases dealing with insolvency, eg, 103 with only 15 in the 1990s, though cases heard resulted in a 75 per cent success rate against the defendant.

<sup>97</sup> Niall Coburn, 'The Phoenix Reexamined' (1998) 8 *Australian Journal of Corporation Law* 1: eg, makes some suggestions on 'reducing exposure to phoenix companies'. These include taking a personal guarantee, not letting debts balloon out over 60 days. Noting that from his study most unsatisfied debts were small amounts.

<sup>98</sup> Commonwealth, *Research Note: Information, Analysis and Advice for the Parliament 2004-05*, No 12 (2004) 1.

<sup>99</sup> See discussion in David Parker, 'Piercing the veil of incorporation: company law for a modern era' (2006) 19 *Australian Journal of Corporate Law* 35.

<sup>100</sup> A search of <austlii.edu.au> and <lexis.nexis.com.au> gives the occasional reference but only really in relation to issues of insolvency.

<sup>101</sup> Section 588G, *Corporations Act 2001* (Cth).

<sup>102</sup> Related party transactions, *Corporations Act 2001* (Cth), div 2E.

a disincentive to bad management behaviour. Bankruptcy provisions also impose duties on the controllers of a company.<sup>103</sup>

Another alternative to issues of capitalisation is to set mandatory insurance requirements for companies, particularly on those in dangerous industries. In Australia every state for instance requires that vehicles, taxis for instance, must have a minimum amount of insurance. Unlike the *Walkovsky v Carlton*<sup>104</sup> case, there would be sufficient funds to compensate an injured pedestrian, and no need to pierce. The authorities use empirical data to measure the risk for employees and outsiders, and to stipulate what is adequate without any reference to operating capital. This is one step towards getting companies to internalise the costs of running the business, to provide adequate insurance and to increase the insurance as the nature or risk of business changes.<sup>105</sup> The challenge is to guess into the future whether a product such as asbestos, considered benign at the start of the century, may later be considered to be a dangerous product/industry requiring greater levels of mandatory insurance.

Ultimately it is up to creditors to determine their own interests and build in a risk factor, though this is not available to involuntary creditors who may have been injured by an undercapitalised company. Discussions of whether a company (and its controllers) have a duty to be adequately capitalised for these creditors has much to do with whether one believes the corporate form is a privilege.

There are two potential approaches to the issue of undercapitalisation of a company and its unsatisfied creditors. One approach is to regulate, either on an industry/product standard, or on individuals such as the shareholders/controllers. Alternatively (or as well) corporate legislation might be framed so as to allow for the possibility of

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<sup>103</sup> Bainbridge above n 44, 481: regarding fraudulent transfers. Similarly employees do have certain rights under the law and against the company: pt 5.8A *Corporations Act 2001* (Cth) which preserves superannuation rights.

<sup>104</sup> Above n 1.

<sup>105</sup> Chris Gosnell, 'The Personal Liability of Corporate Agents: Who Should Bear Pure Economic Losses?' (1997) 55 *University of Toronto Faculty of Law Review* 77, 130: eg, to value it sufficiently for insurance by adequately pricing the risk.

piercing where there has been egregious behaviour by the promoters of an undercapitalised company.

It might be possible to regulate the level of company capital by mandating that companies must have sufficient capital according to reasonable standards, though pre-determining a mandatory minimum may be difficult. Similarly there is also the difficulty of determining whether the duty should be on the controllers of the company, whether or not they are shareholders. One author has proposed liability for inadequate capital should be proportional to the amount of capital reasonably adequate for the operation of the company, thereby avoiding shell companies.<sup>106</sup> Controllers would pre-estimate the appropriate capital, though legislation might cap the ultimate level of damages. This might be more particularly used as part of enterprise liability where there are groups of companies.<sup>107</sup> This system does not ensure adequate compensation but may prompt more care from company controllers, though of course it dampens entrepreneurship in the case of smaller individual operators.

Where a company fails to compensate a creditor, and this can be assessed as due to deliberate undercapitalisation of the company, then the controllers of the company should not be permitted to hide behind the corporate veil. Leaving aside the difficulties of assigning liability to controllers who are not shareholders and further problems such as whether capital was adequate originally or has been dissipated etc, such piercing is based on the idea of unfairness which is not a developed doctrine in Australia.<sup>108</sup> Nevertheless the issue of undercapitalisation might be considered along with issues of insolvency so that something like a 'code' might be implemented to cover various circumstances and to give rights to potential creditors. One such 'list' or

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<sup>106</sup> Bainbridge, above n 44, 899.

<sup>107</sup> At least one European country does not allow for the limitation of liability with respect to wholly owned subsidiaries. See eg, Maurizio Bernardi, *The Bankruptcy Laws of Italy*, in *European Bankruptcy Laws*, 104-5. Cited in David Leebron, 'Limited Liability, Tort Victims and Creditors' 91 *Columbia Law Review* 1565.

<sup>108</sup> Courts generally will not pierce for unfairness in the absence of sham transactions. *Ascot Investments Pty Ltd v Harper* (1981) CLR 337. *RMS Glazing Pty Ltd v The Proprietors of Strata Plan No 14442* (Unreported, Supreme Court of New South Wales, Cole J, 17 December 1993).

‘guideline’ for dealing with an undercapitalised, and consequently insolvent, company was suggested by the authors Hackney & Benson,<sup>109</sup> the adapted list is as follows:

1. Voluntary creditors who have access to company information or can be classed as sophisticated creditors, are restricted in their actions against the directors or shareholders.
2. If a controlling shareholder acts in a way that misleads a creditor to believe the corporation, or an affiliate, is a properly capitalised body, then the shareholder should be held responsible, even if the remedy is a common law one, perhaps for deceit.
3. Controlling shareholders who enter into transactions with an undercapitalised corporation which are not at arms length, will be personally liable for all obligations to voluntary and involuntary creditors.
4. Where a corporate creditor is a major shareholder, then their claims should be subordinated to other creditors if they had misused that position. The creditors must demonstrate the misuse of the corporate form.
5. Liability for undercapitalisation should only apply to active shareholders who participate and control a company, rather than passive shareholders.
6. Parent companies who deliberately undercapitalise their subsidiary should be liable like any other shareholder, group liability should extend beyond mere trading while insolvent.
7. Tort creditors or involuntary creditors may have the right of compensation if a court finds the company operated with insufficient capital given the nature of the risk or harm according to industry standards.

Putting such a set of principles into practice is another matter and would involve extensive interpretation by the courts to ascertain the meaning of such sections.

Ultimately, issues of undercapitalisation are contentions around the perception of a company what a company actually is. If a company is a mere economic construct to

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<sup>109</sup> Hackney and Benson, above n 46, 872.

facilitate contractual relations between parties, then parties judge their own interests and contract accordingly. Imposing standards of undercapitalisation in such instances is intrusive retrospective regulation of private bargains. Alternatively if the observer holds that a company is a gathering of stakeholders within and outside the company structure, then a company is expected to have a minimum (mandated) level of obligations to those who deal in good faith with the company, particularly tort creditors. Given that Australian company legislation does not actually state the social role of the company, perhaps a starting point might be to actually have some foundation principle of the purpose of a company – deliberate undercapitalisation may, or may not be, an issue. Australia might well take note of American jurisprudence that allows undercapitalisation as one factor to consider in whether the privilege of the corporate form has been abused. While undercapitalisation might not be a basis in itself for action, it could be one of the indicators that a court may use when assessing whether the corporate form has been misused.