

THE METAMORPHOSIS OF THE ASSOCIATE'S LIMITED LIABILITY FOR THE OBLIGATIONS OF THE COMPANY UNDERGOING DISSOLUTION¹

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ABSTRACT:*The present article seeks to analyze the metamorphosis of the extent of the associate's liability for the obligations of the limited liability company, namely that liability which modifies its extent – from liability limited to the associate's contribution to the share capital it develops into unlimited liability to this contribution.*

The metamorphosis occurs in well-determined cases, namely when, in the fraud of the creditors, the associate abuses of the limited character of its liability and of the distinct legal personality of the company, this happening in the stage of dissolution which precedes liquidation. The analysis of the consequences of metamorphosis of the extent of the associate's liability having in view the benefit it should have brought to the amelioration of the business environment, is not a favourable one, because of its limited applicability, seen from double perspective: only to the associate in the limited liability company and only to the companies from this category undergoing dissolution which precedes liquidation.

KEY WORDS: *piercing the corporate veil; metamorphosis of the extent of liability, distinct legal personality of the company; fraud of creditors; limited liability; dissolution; liquidation.*

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1.INTRODUCTION

In accordance with the provisions of art.193 (1) of the Civil Code, the legal person stands liable with its own patrimony for its debts, except for the case where the law provides differently. In accordance with art.193 (2) of the Civil Code "*No person may invoke to a bona-fide person the quality of legal subject of a legal entity, if it is thus aimed to hide a fraud, an abuse of law or a detriment to the public order.*"

The doctrine (Cărpenaru, Piperea, David, 2014, p.72-73) (Catana, 2013,p.102) indicates the fact that the provisions of art.193 (2) are subsumed to the theory of "piercing

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the corporate veil" ²which means „passing beyond the limit of social responsibility for the company's obligations”³.

The matrix of the theory "piercing/lifting the corporate veil" can be concentrated in: „When a corporate form is used as an essentially unfair device- when it is used as-a sham- courts may act in equity to disregard the usual rules of law in order to avoid an inequitable result”⁴ and it complements the doctrine of "alter ego", in that the person towards whom the liability extends is the alter ego of the first debtor, while between the associate/administrator/company subsidiary and company there is such unity that their separation is impossible.⁵

Company law, insolvency law and fiscal law comprise proper applications of the piercing the corporate veil theory, namely the proper applications are given by the provisions under art.237 (1) of Law 31/1990 on trading companies, hereinafter called CL by the provision under art.169 of Law 85/2014 on the procedures of insolvency and prevention of insolvency and by the provisions under art.27 and 28 of the Code of Civil Procedure, art.27 and 28 on joint liability (Georoceanu & Apan, 2014, pp. 166-180).

2. PIERCING THE CORPORATE VEIL UNDER THE SPECIAL CIRCUMSTANCES PROVIDED BY ART. 237 (1) OF LAW 31/1990; REGULATION;

Pathological aspects of the legal person as legal subject represent the fundament of the exception to the rule of the limited liability of the associates for the obligations of the company.

In company law, the theory "piercing the corporate veil" was taken over in 2007, previously to the entrance into force of the new Civil Code. In addition the doctrine ascertains that "Company Law is one of the predecessors of stipulations of art.193 (2) of the Civil Code” (Cărpenaru, Piperea, David, 2014, p.73).

« Art. -237¹. - (1) Where an associate has unlimited liability for the company's obligations during its functioning, his liability for these obligations shall be unlimited even in the dissolution stage, and if applicable, in the liquidation stage.

(2) Where, during the functioning of the company, an associate is liable for the company's obligations, in the limit of his share capital contribution, his liability shall be limited to this contribution even in the dissolution stage and if applicable, in the liquidation of the company stage.

(3) The associate that, in fraud of the creditors, abuses the limited character of its liability and of the distinct legal personality of the company, shall be unlimitedly liable for the outstanding obligations of the dissolved, respectively liquidated company.

² For an extensive interpretation of the provisions of art.193 (2), which would allow for the coverage of all hypotheses of piercing the corporate veil outlined in the foreign doctrine, reunited by the author, and for the sanction of unforceability of the legal person in relation with the third parties of good faith, see Butusina, 2013, pp.91-95) ;

³ The rule developed also in Adam & Savu, 2010, p.866, footnote 3, and the doctrine therein cited, and also in Butusina, 2013, p.84 indicate that the theory of piercing the corporate veil was extended into the national law following its inclusion into art.193 (2) of the Civil Code, and is applicable to any legal person, this article becoming common law in this field;

⁴ In *Mancorp, Inc.v.Culpepper*, 802 S.W.2d 226(Tex.1990) cited in Miller, 2014, p.50.

⁵ See doctrine indicated in Miller, 2014, chapter 7.2, p.8.

(4) The associate's liability becomes unlimited in the conditions stipulated at art.(3), especially when he uses the company's assets as if they were his own, or if he diminishes the assets of the company to his own or third party benefit, knowing or having to know the fact that in this way the company is not able to fulfill its obligations."

Art. 237¹ (1) and (2) mainly reiterates, through the mechanism of simetry, the principle of the associates' extent of liability for the obligations of the company, limited liability for certain types of companies already identified and respectively unlimited liability for other certain types out of those regulated by CL, principle which is applicable for the period the company is carrying out its activity as well as for the dissolution stage or/if the case, the liquidation stage.

By exception from the mechanism of the simetry of the liability extent, paragraphs 3 and 4 of art. 237¹ of the CL provide for the associate of the limited liability company, situation which normally would have fallen under the provision of the associate's limited liability as established by the law, the hypothesis of the associate which in the fraud of the creditors abuses of the limited character of its liability and of the distinct legal personality of the company.⁶ The associate, in this case, shall have unlimited liability for the outstanding obligations of the dissolved, respectively liquidated company.

Hence, paragraphs 3 and 4 of art.237¹ of the CL provide the hypothesis of metamorphosis of the associates' liability for the obligations of the company, as the extent of the liability is modified from limited character – limited to the associate's contribution to the share capital, to unlimited character, a situation that happens when, in fraud of creditors, the associate abuses of the limited character of his liability and of the distinct legal personality of the company⁷, especially as in the example where, the associate uses the company's assets as if they were his own, or if he diminishes the assets of the company to his own or third party benefit, knowing or having to know the fact that in this way the company is not able to fulfill its obligations towards the creditors.

The two types of situations provided by art. 237¹ (3) „only as examples and not in an exhaustive manner”(Adam & Savu, 2010, p. 869) and having in view the final assertion of the same article that the associate knowing or having to know the fact that in this way the company is not able to fulfill its obligations, in most cases express the associate's "tentacles" stretched over the patrimony of the company, and enshrines the pathology of the tandem associate-company in the fraud of the creditors.

The metamorphosis of the extent of the associates' liability for the obligations of the company, residing in that the liability transforms by changing its extent, in certain well determined conditions becoming unlimited, is provided in order to protect the creditors, because the company, due to the acts performed by the associate, is not able to fulfill its obligations towards the creditors from the company's own patrimony, an aspect which should be known by the associate. The metamorphosis is generated by the performance of one of the acts stipulated by art.237¹ (3) (4) .This time again there is an "adjacency" of another patrimony which is the associate's personal patrimony, with the creditors of the company. The associate's personal patrimony will pertain to the creditors as a consequence of certain acts performed by the associate.

⁶ The notions of „abuse” and „fraud” as used in the above cited text of the law are developed in Adam & Savu, 2010, p.868.

⁷ For the aspects which form the elements of the fictitious company see Piperea , 2012, p.191-2014.

3. THE CONCEPT OF FRAUD OF THE DEBTORS VS. THE FRAUD OF THE COMPANY

The hypothesis provided by art.237¹ (3) consists of "piercing the corporate veil", meaning to go beyond this veil and following an analysis of the acts and facts to attach the liability to the associates of the limited liability company, in order to cover the debts, if in frauding of the creditors, the associate(s) abused of the limited character of his liability and of the distinct legal personality of the company. "The abuse for the fraud of the creditors" is the determined wording of this judicial mechanism and is subsumed here through two cryptical components as judicial concepts, and which were exposed by the doctrine, but which are completely absent from the case law: - the abuse of the limited character of the liability; - the abuse of the distinct legal personality of the company.

The example provided by art.237¹ (4) is definitely meant to support those who will ask for its application within the legal action initiated before a court, because the example takes us from the abstract notions of "abuse" and "fraud" to the description of actual ways that attract abuse in the fraud of creditors: - the associate uses the assets of the company as if they were his own patrimony; - the associate diminishes the assets of the company to his or a third party's benefit. Therefore, the harmful, toxic cohabitation between the company patrimony and the associates is thus sanctioned .

In practice, the economic reality at national level was and still is sprinkled with numerous cases of fraud of the creditors, which required the initiation of a legal action for piercing the corporate veil, and even if there are plenty of examples of the hypotheses indicated in art.237¹ , these are not focused on a restricted scope that has in view only the stage of dissolution, respectively liquidation of the limited liability company⁸, a hypothesis regulated as indicated in 2007 (Danisor, 2011, p.54-57).

For these reasons, a case law around the notion of "fraud" has not germinated and developed on this limited level, and neither has the doctrine regarding this notion, doctrine which did not develop in this area but in the one regulated by art.222 (1) letter (d) of the CL.

In the case where the associate-administrator of a a limited liability company or a general partnership, commits fraud in the damage of the company, the sanction applicable is the exclusion of the associate-administrator from the company: „ Art. 222(1)The associate in a general partnership, limited partnership or limited liability company, may be excluded from the company if: d) the associate-administrator commits fraud to the loss of the company, or makes use of the registered signature or the share capital for his or other's benefit."

We mention here the requirement of the double capacity that must be held by the person in order for the provisions of art.222 (1) letter (d) to be applicable, namely the capacity of associate together with that of administrator, and if this double capacity requirement is not fulfilled than it is not granted the passive capacity within the exclusion

⁸ For the opinion according to which the provision of art.237¹ are also applicable to the one-man limited liability company, see Cârpenaru, Piperea, David, 2014, p 72. Otherwise the same doctrine ascertains that this type of company is perceived by most persons that represent it, as a means of "duplicating personality", and the separation of patrimonies between the natural persons's own patrimony and the patrimony of the limited liability company, as not existing. An individual can be a sole associate only in one limited liability, one-man, company, in accordance with Law 31/1990.

legal procedure, and also the scope of the above cited provisions shall be limited to the case of the general partnership, limited partnership and limited liability company.

We also point out from the beginning, the distinction between the centres of interest, between the end-point of CL in the hypothesis under art.237¹ and that under art.222 (1) letter (d). While the first hypothesis is centered around consumer protection, its applicability being explained through the acts that lead to the fraud of the creditors and are carried out in a stage when the company stopped carrying out its economic activity and when there are only drawn the papers necessary for the liquidation, the second hypothesis is carried out during the functioning of the company and is centred on the protection of the company's interests, its applicability being attracted by the commitment of those acts which fraud the company. Also, if the person responsible for the respective act, in the hypothesis of art.237¹ is the liquidator or the creditors, and in the hypothesis under art.222(1) letter (d), the persons responsible for the respective act are the associates.

The notion of „fraud to the creditors” is subsumed, in accordance with Adam & Savu, 2010 (p. 868-867) through three elements: the objective side action/omission; the subjective side: the existence of the intention and the prejudice of the creditors, and the notion of "fraud of the company" is subsumed, in accordance with Cărpenu, Piperea, David, 2014, (p.761), through the same two elements but are different from the first notion through the third element, the prejudice made to the company".⁹

In correlation with the above cited text from the law - art.222 (1) letter (d) of the CL, the types of fraud are illustrated by the case law, (Sauleanu, 2012, p.150) hence it is possible to turn to this landmark in order to complete the definition of the notion "fraud" in relation with the provisions of art.237¹ (3) and (4).

In order to complete the image of the dimension and specifics of fraud, it is useful to turn to the case law of the Supreme Court of Justice and Cassation which reveals the following case law perspectives on the notion "fraud":

- *"The law does not distinguish regarding the dimension of the fraud, the number of fraudulent acts committed, the accused administrator's behavior after having committed the fraud as maintained by the appellant meaning to point out that the administrator compensated for the damage caused. In the absence of any legal condition, the criticism brought by the appellant to the court for not classifying the act does not have legal grounds and at the same time it opposes the element of trust on which are based the partnerships, the limited liability companies as well as the company under discussion, which is a partnership and also a share capital company. The same type of trust is an inherent part of the relationship between the associate-administrator and the administered company, the affecting of which does not assume for a proportionate ration with the dimension of the fraud or with the subsequent correcting acts of the respective accused administrator"*¹⁰.

- *"In this case, the associate-administrator's renunciation of the company's right to claim a debt from the debtor SC S.T., renunciation that was acknowledged within the dispute pending between the two companies, closed through judgement no.6733 of 17*

⁹ We did not intend to analyze from criminal perspective the notion „fraud”, for the enlargement of which see Turcu & Botina, 2013, pp.259-294; Corlateanu & Rotaru, 2010, pp.224-235.

¹⁰ Decision no.3883 of 12 November 2013, Supreme Court of Justice and Cassation, Civil Chamber II, accessed on <http://www.scj.ro/SE%20rezumate%202013/SC%20II%20dec%20r%203883%202013.htm> on 14.07.2014;

*August 2005 issued by the Bucharest district court division no.3, constitutes a behavior that does not follow the coordinates and rules of best interest of the company because at the time when the claimed right was given-up there had not been carried out any compensation for the possible debts owed to each other by the two companies."*¹¹

*- "Fraud can also be considered, in principle, any intentional action or omission carried out by the associate-administrator. The sanction of exclusion can be enforced on the associate-administrator for the actions of omissions carried out to the detriment of the company, hence for a misbehaviour committed intentionally. The subjective element results from the wording employed in the text and from the nature of the sanctioned acts, namely the intention, as the author of the acts had in view or accepted a profit resulting from his illegal acts. In this case, it was not proved the element of intention in committing the two acts on which the fraud was claimed and grounded. Negligence and inability in business could not be considered fraud as long as these acts are lacking the intentional character that could qualify them as fraud. At the same time it could not be proved the prejudice caused to the company."*¹²

In accordance with the normal duration of operation of the company, the "sanction-remedy"¹³ for the protection of the company's interest, where the associate-administrator commits fraud to the damage of the company, in the limited liability company and in the general partnership this is represented by the exclusion of the associate-administrator from the company, this sanction being applicable exclusively by the court of law, as provided by CL.¹⁴

At the same time, by the submission of a claim within the action for exclusion, the associate-administrator who committed fraud to the damage of the company can be obliged to compensate for the prejudice caused to the company, a prejudice which shall be recovered from the natural person's own patrimony who has a double role as associate and also administrator.

Consequently, the associate's limited liability for the company's obligations goes through a metamorphosis, changing into unlimited liability, for the company undergoing the dissolution/liquidation stage of insolvency (as indicated), in the hypothesis regulated by art.237¹ (3), (4), while in the hypothesis regulated by art.222 (1) letter (d), the associate/administrator of the limited liability company, general partnership and limited partnership that carry out economic activity, the liability of the associate is not extended, but the associate-administrator may face exclusion from the company and may be forced to pay the prejudice.

¹¹ Decision no.173 of 25 January 2008, Supreme Court of Justice and Cassation, Commercial Chamber, accessed on http://www.scj.ro/cautare_decizii.asp on 03.07.2014;

¹² Decision no.320 of 1 February 2008, Supreme Court of Justice and Cassation, Commercial Chamber, accessed on <http://www.scj.ro/SE%20rezumate%202008/SE%20r%20320%202008.htm>, on 03.07.2014;

¹³ Thus named and widely developed in Catana, 2003, pp.90-107;

¹⁴ Thus named mentioning that the distinctive elements of this action as well as the procedural framework of the action for exclusion are not subsumed to the present theme of research and shall not form the subject of this analysis.

4. UNIQUE MEANS TO APPLY THE METAMORPHOSIS OF THE LIABILITY EXTENT FROM THE COMPANY TOWARDS THE ASSOCIATE'S PATRIMONY

The doctrine (Cărpenaru, Piperea, David, 2014, pp.72-73 and Butusina, 2013) gives special attention to an unconventional action – „action for the ascertainment of the unlimited liability of the associate” who committed the acts provided by art.237¹ (3), (4), *this being an action subsumed, as type, to the one which is directed towards lifting the corporate veil – as a species.*

In accordance with the doctrine, the jurisdiction (Cărpenaru, Piperea, David, 2014, p.72-73) in this matter belongs exclusively to the court of law, precisely to the common law judge, within the dissolution proceedings followed by liquidation. Within the bankruptcy proceedings¹⁵, the jurisdiction belongs to the syndic judge and the purpose of the action is to ascertain the unlimited liability of the associate who committed the acts provided by art.237¹ (3), (4).

Such an action within the dissolution proceedings followed by liquidation, if admitted by the court, it is considered to be the remedy which may lead to the switch of liability from the company to the associate, followed by the forced execution of the associate's patrimony. Now the case law, by virtue of its creating role, is to reflect such doctrinary hypothesis.

The legal fundament related to art.237¹ (3), (4), *may constitute the grounds for passing the action only up to the stage of dissolution/liquidation of the limited liability company.*

The insolvency proceedings has its own mechanism for extending, elongating the liability for the obligations of the company towards the associates' patrimony, so basically has its own mechanism for piercing the corporate veil, namely attachment of liability to the persons that generated the insolvency state – art.138 of Law 85/2006 correspondent of art.169 of Law 85/2014 that repeals Law 85/2006.

But this action will prove its utmost efficiency within the dissolution and liquidation proceedings, only as long as it is used fulfilling the condition that access to the company documents is provided and that the company operations can be discovered¹⁶, and also here we reaffirm the observation on the limited applicability of the action in the case of limited liability companies even more as in this stage a liquidator is named.

De facto, this action is structured towards proving the committing the actions stipulated at art. 237¹ (3) and (4) or any other action having similar consequences, the fraud of the creditors; case law has demonstrated that the actions/omissions of the associate which result in frauding the company and which serve as an example, are of various types and are continuously diversifying.

5. CONCLUSIONS

The analysis of the consequences of metamorphosis of the extent of the associate's liability for the company's obligations, as provided by art.237¹(3) and (4), having in view the benefit it should have brought to the amelioration of the business environment, is not a

¹⁵ Being excluded according to the doctrine, the period of observation and the period for judicial restructuring, Carpenaru, Piperea, David, 2014, p.72;

¹⁶ To prove such action during the normal activity of a company would create numerous difficulties for the applicant.

favourable one. This metamorphosis is triggered by its limited applicability, seen from double perspective:

- applicability only in the stage of dissolution, followed by the liquidation of the company, being inadmissible during its functioning;
- applicable only for the limited liability company, other types of companies named by Company Law being excepted from application, such as the share companies, an aspects highly and legitimately criticized by the doctrine.¹⁷

The position of creditors in relation to the obligations of the dissolved company, respectively liquidated company to the personal patrimony of the associate, is operated in cases when the associate committed the acts provided by art.237¹(3) and (4) has legitimate grounds, and their protection would require an extension of the applications of the theory of piercing the corporate veil in company law.

The theme of the study is relevant for the foreign investors, having in view that at national level the theory of piercing the corporate veil is covered by various regulations and doctrinary interpretations. Or, since they make investments in Romania, it is necessary that they are aware of the extent of the application of this principle in company law.

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¹⁷ See Cârpenaru, Piperea, David, 2014, p.72 which proposes the extension to the share companies.

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