

PIERCING THE CORPORATE VEIL IN MEXICO

By Romelio Hernández, HMM Legal
Www.hmhlegal.com

DISCLAIMER: The information you obtain in this article is not, nor is it intended to be legal advice. Our Law Office [HMM Legal] will only provide legal advice after having entered into an attorney client relationship. It is imperative that any action you take be done on the advice of counsel, and not based solely upon this article.

I. INTRODUCTION

It is well known that in the law of corporations, shareholders' responsibility is generally limited to that of paying capital stock issued to them. For that reason, corporate liability for stockholders will only result from such unpaid capital stock.

Since a corporation is treated as another person, it is legally provided that individuals behind it as shareholders will not be liable for corporate debts, nor will they be liable for any of the corporate acts or obligations even if they are considered unlawful. At least that is how our system through statutory law, courts' opinions and legal scholars has been treating this matter until today, where case law (*jurisprudencia*) proves that separate existence between corporations and shareholders is well recognized and preserved.

II. LIMITED LIABILITY

Limited liability in business through the use of a corporate entity with separate existence of that of its owners (called shareholders) has been a proper benefit given by law to individuals since the 19th century, with the primary intent to promote commerce and industrial growth. The rule allows for an investor (or shareholders) to make capital contributions to corporations without subjecting their personal wealth to the risk of the business.

Because of this rationale, the State (through statutory law) will grant corporate status and limited liability to the individuals behind it, asking only in exchange that the corporate business and its purpose are always lawful and that the principals of basic fairness when dealing with other parties are well observed.

Unfortunately, such expectations will not always be accomplished. Worst yet, there will be cases on which, through an abuse of the privilege of corporate status, fraud and other unlawful acts will be committed.

III. CORPORATE ABUSE

As an example, there will be times when a corporation will be illegally formed just in order to limit one individual's liability in some specific type of business – since our legal system does not allow one-member only corporations –.

It will show that most of the time, such individuals will the majority of the issued capital stock and another person will help in the business or presumably invest figuring as a small or insignificant shareholder, therefore helping with proper compliance of State Law which asks for a minimum of two founders or incorporators (The Mexican Corporations Law, known in Mexico as *Ley General de Sociedades Mercantiles*).

As a result of such strategy, the mayor stockholders will gain unlimited control over the company treating it at their will and with special intention of benefiting themselves only. The consequence of this practice will be exposed in different ways: commingling of assets and corporate funds with those personal from the shareholders; failure to maintain separate and adequate corporate records; failure to capitalize the corporation adequately; etc. These and many more will be symptoms of this behavior of total disregard of corporate interest.

At the end, such unlawful practices will inevitably result in an unwanted and absurd economic situation for the company keeping it from fulfilling its obligations while on the other hand, their controlling shareholders will inexplicably and unjustly have develop a wealthy lifestyle.

IV. THE ALTER EGO DOCTRINE

When in any given matter, it shows that a corporation has been a mere conduit or instrument to commit fraud a typical case of disregard of the corporate legal entity will be at hand, and it will be necessary to search for new ways and legal remedies to solve such problems.

Through the use of the *Alter Ego Doctrine* Courts throughout the US have found an equity based procedure that gives way for settling these disputes in a more efficient and fairly manner. In cases

where the applicable criteria are met, Courts will *pierce the corporate veil*, disregarding the separate existence of a corporation entity and treating it and its shareholders as the same person. Again, the purpose will be to protect the rights of third parties when dealing with a corporation in order to avoid fraud and an abuse of the privilege of corporate status.

Court criteria for piercing the corporate veil will differ from time to time, but when such a solution is taken an important rule to be considered will always be the fact that there is so much unity of interest and disregard to the corporate form that separate existence no longer exists. Also, such remedy will only be taken in cases when, if no disregard was applied, an unjust and inequitable result would follow.

V. LEGAL REMEDY IN MEXICO

Until today there is no court opinion in Mexico that intentionally and directly tends to give solution to corporate abuse problems by disregarding the corporate entity and finding its shareholders liable for corporate debts.

Nevertheless, we strongly believe that proper legal tools already exist in our legal system and that through cautious and smart use of them legal practitioners will be able to pierce the corporate veil in their quest of finding fairly solutions to such problems.

Indeed, through proper establishment of causes actions based upon civil institutions that sanction fraud like *actio pauliana*, *simulation* and general known *nullity* actions, along with an abusive use of rights theory and total disregard to good faith principals mandatory in commerce, judicial remedies can be found to disregard the corporate entity and held shareholders liable for corporate debts.

Cases presented before our Courts will be analyzed and ruled on a time-to-time basis, with rulings totally independent from previous precedents and previous criteria. Therefore, we truly consider that with proper counseling and strategic approach the Alter Ego Doctrine could be well applied in Mexico.

This material has been provided as free educational message by HMM Legal. We invite you to send us your comments or to call us for a free consultation. If you have any questions please call us at +52 (664) 685-1387, 685-9196. You can also email us at info@hmmlegal.com. If you would like further information about our firm or our educational handouts, please visit us at www.hmmlegal.com