Asia Pacific Law Review

Routledge
Taylor & Francis Group

ISSN: 1019-2557 (Print) 1875-8444 (Online) Journal homepage: https://www.tandfonline.com/loi/rplr20

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Kimberly Bin Yu & Richard Krever

To cite this article: Kimberly Bin Yu & Richard Krever (2015) The High Frequency of Piercing the Corporate Veil in China, Asia Pacific Law Review, 23:2, 63-87, DOI: 10.1080/10192557.2015.11745936

To link to this article: https://doi.org/10.1080/10192557.2015.11745936

Published online: 20 Jul 2016.

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The High Frequency of Piercing the Corporate Veil in China

Kimberly Bin Yu*[*] and Richard Krever*[**]

Abstract

Implicit in the company laws of common law jurisdictions is the notion of the corporate veil and the insulation of company shareholders from liability for debts of the company. The veil is not sacrosanct, however, and in appropriate circumstances courts will allow company creditors to pierce the veil and recover debts of the company directly from its shareholders. In contrast, the company legislation of China, supplemented by quasi-legislative rulings by the Supreme People's Court, provides company creditors with an explicit right to pierce the corporate veil and pursue shareholders for satisfaction of company debts. While the rate of corporate veil piercing in China is much higher than that of other countries, as a previous study has found for the years 2006–2010 and which this study shows has continued in the years 2011–2014, it is not entirely clear that the difference is attributable only to the use of statutory remedies in preference to judicial doctrines used elsewhere. The result might also be a consequence of judicial interpretations of the law that go well beyond its literal and intended scope.

[*] Vice-researcher, Sun Yat-Sen University, Guangzhou, China; Visiting Fellow, Monash University, Melbourne, Australia. This paper was supported by a grant provided by the Guangdong Provincial Government, China.

[**] Monash University, Melbourne, Australia.

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I. Introduction

The principle of the corporate veil – that a company's shareholders are separate from the company they own and its debts and obligations – has endured well since its origins more than four centuries ago. Remarkably, the principle fundamental to the success of the corporate form as the primary mechanism for accumulation of capital and the development of modern economies is not set out in the company laws that create companies as the separate legal persons. Rather, since the time of *Salomon v Salomon*[1] the principle has been a creature of judicial doctrines, a logical extension of the consequences of separate legal personality endowed by company legislation.

In the century since the doctrine was first articulated, the courts have largely upheld the sanctity of the corporate veil, rarely intervening to impose liability on a company's owners for actions or liabilities of the company, particularly its debts to creditors. The principle is not entirely sacrosanct, however. While the statutes may not provide authority for piercing the veil, the common law does, primarily through judicial doctrines that can push aside the veil in a limited number of cases.[2] Scholars have classified the exceptions using a range of different labels – agency, fraud, sham, and so forth[3] – but they share a common theme as cases where a shareholder has acted unconscionably or it would otherwise be grossly unfair to a company's creditors to allow a shareholder to hide behind an interposed entity that had been deliberately used to avoid liability. At the same time, in some, but not all, common law jurisdictions, courts are more willing to look at the economic reality of a group of companies being a single economic entity and weaken the veil in respect of liabilities resulting from intra-group transactions.[4]

At first glance, the company law underpinning China's path to economic modernisation largely resembles company laws in more advanced economies. In two respects, however, it deviates from Western company laws. The first notable difference is the source of authority for piercing the corporate veil. In

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1 *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL).

2 See Robert B Thompson, 'Piercing the Corporate Veil: Is the Common Law the Problem?' (2005) 37(3) *Connecticut Law Review* 619.

3 See Ian M Ramsay and David B Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19(4) *Company and Securities Law Journal* 250; Hui Huang, 'Piercing the Corporate Veil in China: Where is it Now and Where is it Heading?' (2012) 60(3) *American Journal of Comparative Law* 743.

4 See Robert Baxt, 'The Corporate Veil in Tax Law – The Legal Perception of Companies as Separate Entities' (1984) 3(1) *Australian Tax Forum* 239.

common law jurisdictions, as noted, instances of creditors successfully piercing the corporate veil are based on judicial doctrines setting out exceptions to the sanctity of the corporate form. In contrast, in China authority for piercing the corporate veil is found in the company legislation and quasi-legislative rulings by the Supreme People's Court. The second key difference is a rule that applies in the case of single shareholder companies, and in stark contrast to the law of common law jurisdictions, reverses the presumption of liability from the norm adopted in the common law world, shifting the onus of proof from plaintiff (the creditors) to defendant (the company owner).

Data gathered to date suggests that litigants seeking redress for company obligations from the company's shareholders are far more likely to succeed in China than in other jurisdictions. This raises the question whether the different success rates are due to different law or different attitudes towards the sanctity of the corporate veil in a former socialist country which knew no private companies for its first three decades, leading to judicial interpretations in favour of creditors that are much broader than the text of the law and its intended scope.

II. Judicial and Legislative Rifts in the Corporate Veil

A. The development of company law

The nationalisation of the economy following the establishment of the People's Republic of China along with the replacement of all former law with socialist legislation left China without the need for companies or company law.[5] That need arose again in late 1978 when the Central Committee of the Communist Party of China adopted Deng Xiaoping's 'open door' policy and China began its shift to a 'socialist market economy'.[6] The following year, private enterprise was allowed once more in China and the market economy began its revival.

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5 The history of China's company law and the ad hoc solutions initially adopted to facilitate recognition of companies are reviewed in William C Kirby, 'China Unincorporated: Company Law and Business Enterprise in Twentieth-Century China' (1995) 54(1) *Journal of Asian Studies* 43. The actual period in which private companies disappeared was between 1956 and 1978, based on rules adopted earlier; see the Provisional Rules for Private Enterprise (1950) and Provisional Rules for Private and State-owned Joint Venture Enterprises (1954).

6 This followed a resolution of the Third Plenary Session of the Eleventh Central Committee of the Communist Party. Technically, therefore, the shift was thus a decision of the ruling party, not the legislature or executive.

As was often the case in transitional China, the legislature moved several steps behind the market in respect of company law. Almost immediately after the liberalisation of the economy, businesses collected capital and operated as *de facto* companies. Some parts of the government were quick to recognise the developments on the ground. The new enterprises were, for example, subject to provisional income tax laws enacted in the period from 1983 to 1985.[7] A *de jure* legal basis for the new type of entity took longer, however. First to be recognised implicitly were companies with foreign ownership by their inclusion in laws regulating joint enterprises with foreign and Chinese counterparts, initially by way of joint equity or jointly owned enterprises,[8] then by way of wholly foreign-owned enterprises registered in China,[9] and finally by way of contractual joint ventures akin to market economy joint ventures.[10] Similar implicit acceptance of company or *quasi*-company forms for domestically-owned businesses came in a series of laws (issued by the National People's Congress) and regulations (executive directives issued by the State Council or executive, with the force of law) issued to govern the operation of 'enterprises' owned by state entities, collective organisations and private owners.[11]

The wheels of legal reform turned far too slowly for supporters of economic reform and, in 1990, when the country still lacked a formal corporate law that would establish and recognise companies as legal persons separate from their state, collective or private owners, Shanghai opened the first post-revolution stock exchange in China, followed a year later by the Shenzhen stock exchange. The impetus for the law to catch up with developments on the ground came in 1992, when Deng Xiaoping, Vice-Chairman of the Communist Party's Central Committee and the driving force behind modernisation in China, in a famous southern tour speech aligned economic development with the use of the corporate form of business. The State Council directed the Standing Committee

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7 The development of the tax rules is reviewed in Li Jin and Richard Krever, 'Globalization and Modernization as Drivers for Tax Reform in the Socialist Market Economy' (2010) 11(2) *Theoretical Inquiries in Law* 687.

8 Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (1979).

9 Law of the People's Republic of China on Wholly Foreign Owned Enterprises (1986).

10 Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures (1988).

11 Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People (1988); The People's Republic of China Rural Collective Ownership Enterprise Regulations (1990); The People's Republic of China Urban Collective Ownership Enterprise Regulations (1991).

of the National People's Congress to prepare a company law and in December 1993 China's first post-revolution company law was enacted, with effect from 1994.[12] That law was amended by the National People's Congress in 1999 and 2004 and further and very substantially amended in 2005, with further amendments enacted in 2013.[13]

The 1993 Company Law,[14] like all Chinese laws, was skeletal in nature, setting out general principles but providing little detail on the application of the law to particular situations. The legislation amounted to about 15 standard letter-sized pages. In other areas of law such as tax law, the law enacted by the National People's Congress is given some substance with 'Implementation Regulations' issued by the State Council, the equivalent to the executive Ministry elsewhere. However, this did not happen (and has not since happened) in company law.

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[12] Company Law of the People's Republic of China, adopted at the Fifth Session of the Standing Committee of the Eighth National People's Congress on 29 December 1993 ('Company Law'). The key features of the law are discussed in Alison Chan, 'East meets West: A discussion of China's Company Law from an Australian perspective' (1999) 10(3) *Australian Journal of Corporate Law* 290. See also Chuan Roger Peng, 'Limited Liability in China: A Partial Reading of China's Company Law of 1994' (1996) 10(1) *Columbia Journal of Asian Law* 263. From 1992 until 1994, companies were in theory primarily subject to regulation under two 'Guidance' notices, the 1992 Guidance for Limited Liability Company and the 1992 Guidance for Shareholding Company, enacted by a State Council body, the People's Republic of China State Commission for Restructuring the Economic System. Companies listed on the Shenzhen and Shanghai stock exchanges were subject to company regulations issued by the local governments.

[13] Revised for the first time on 25 December 1999 at the 13th Session of the Standing Committee of the Ninth People's Congress on Amending the Company Law of the People's Republic of China; revised for the second time on 28 August 2004 at the 11th Session of the Standing Committee of the Tenth National People's Congress; revised for the third time on 27 October 2005 at the 18th Session of the Tenth National People's Congress of the People's Republic of China; revised for the fourth time on 28 December 2013 at the Sixth Session of the 12th National People's Congress.

[14] For a comprehensive analysis of the 1993 Company Law, see Robert C Art and Minkang Gu, 'China Incorporated: The First Corporation Law of the People's Republic of China' (1995) 20(2) *Yale Journal of International Law* 273; Tan Lay Hong, 'Corporate Law Reform in the People's Republic of China' (1999) 10(3) *Australian Journal of Corporate Law* 238. The evolution of the Chinese 'enterprise' concept into the formal company law in the 1993 reform is explained in Jian Fu, 'The Enterprise Concept in Chinese Law and its Application in PRC Company Law' (1998) 8(3) *Australian Journal of Corporate Law* 266.

The 1993 Company Law established two types of companies, a limited liability company and a joint-stock company, conferring on them status as separate independent legal persons.[15] The former could have as few as two shareholders (or a single shareholder if the shareholder was the government) and was prohibited from having more than 50;[16] the latter required a minimum of five shareholders and had no limit on the maximum number of shareholders.[17] Provided it met the listing requirements, a joint-stock company could apply for listing on the Shanghai or Shenzhen stock exchanges.

The law established minimum capital contribution requirements for companies. There was no upper limit and a company with contributed capital in excess of the required minimum could reduce capital (but not below the minimum imposed by statute) with shareholder approval. The Company Law went one step further than counterparts in Western market economy company laws, which commonly impose the condition that capital reductions must not materially prejudice a company's ability to satisfy its liability to creditors, by requiring notification to creditors of any intended capital reduction.[18] Sanctions for non-compliance with the minimum capital or capital maintenance rules were limited to financial penalties and orders that any deficit in initial equity contribution or any unauthorised reductions of capital be rectified. By restoring some funds to the company, the rectification rules in theory provided an indirect avenue of recovery for creditors who had commenced actions against a company for recovery of a debt. They provided no direct action against the shareholders who had benefited from the reduction in capital, however.[19] As in common law countries, in the absence of any direct statutory relief, it was possible in some circumstances to rely on judicial intervention to pierce the corporate veil. The legal framework changed dramatically, however, in 2005 when amendments to the company law introduced a statutory right for creditors to pierce the corporate veil and seek recovery of a debt directly from a company's shareholders. Analysis of the corporate veil in China is thus divided into two periods: from 1993 until 2005, when creditors' actions against company shareholders were based on judicial look-through doctrines and from 2005 until today, when creditors' actions against company shareholders have been based primarily on statutory remedies.

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[15] Company Law, art 3.
[16] *Ibid*, art 20 (as it stood in 1993).
[17] *Ibid*, art 75 (as it stood in 1993).
[18] Company Law, art 186.
[19] *Ibid*, arts 208, 209 and 217.

B. Judicial remedies – 1993 until 2005

Even before the Company Law came into effect and the concept of companies as legal persons separate from their owners was introduced into Chinese law, Chinese commentators began to look at foreign experience with veil piercing[20] and soon after the law's enactment the judiciary took the first steps to pierce the corporate veil on behalf of creditors. The path taken by the Court was significantly different from its Western counterparts, however. Unlike Western judicial systems that separate the judicial function entirely from the legislative and executive branches of government, the Supreme People's Court is enabled with a legislative role as well as an adjudicative role. Chinese law does not explicitly include a precedent system making judgments of higher courts binding on lower courts. It does, however, provide the Supreme People's Court with the power to issue 'Opinions' in response to queries from lower courts[21] and these pronouncements have the full effect of law, equal in status to a law passed by the legislature, the National People's Congress.[22] In the event of an overt conflict between an Opinion and statutory law, the courts will adopt the approach set out by the Supreme People's Court.[23] Separately, and as a phenomenon with no counterpart in common law jurisdictions, wearing a *quasi*-legislative hat, the Supreme People's Court can issue, through a legislature-like arm, 'Interpretations' that fill in the *lacunae* in the skeletal laws passed by the National People's Congress.[24]

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[20] Sibao Shen, 'A Discussion of the Principles of Piercing the Corporate Veil in English and American Law' (No 4, 1992) *Journal of the University of International Business and Economics* (in Chinese) 30.

[21] Organic Law of the People's Courts of the People's Republic of China, as amended in 2006, art 33.

[22] The Law on Legislation of the People's Republic of China, art 43; and Organic Law of the People's Courts of the People's Republic of China, art 33, as amended in 2006.

[23] Shibing Cao, 'The legal status of decisions and judicial interpretations of the Supreme Court of China' (No 3, 2006) *China Legal Science* 175 (in Chinese) (translated and reproduced in (2008) 3(1) *Frontiers of Law in China* 1.

[24] The Law on Legislation of the People's Republic of China, art 24. The Standing Committee of the National People's Congress also has the power to issue a legal interpretation that has a binding effect similar to legislation. To date, only the Supreme People's Court has issued an opinion on piercing the corporate veil.

The system of direct law-making by the judiciary or law-making via opinions appears to leave litigants with no avenue of appeal for judicially-based laws. At first glance, this appears inconsistent with Western notions of laws passed by parliaments and regulations issued by executives with systems that allow persons dissatisfied with the application or interpretation of the laws to appeal these issues to courts that sit entirely separate from the legislature and executive. In a sense, however, the system is the equivalent of the process in common law jurisdictions where the courts have stepped in to fill statutory *lacunae* with judicial doctrines that become binding precedents. In theory, as in common law countries where appeals can be brought before the highest court using arguments inconsistent with precedent in the hope that the court will distinguish new facts from a prior precedent or even reverse a precedent in exceptional cases, litigants in China can appeal decisions seeking outcomes different from an established opinion. However, the likelihood of this happening in China is slight.

The Supreme People's Court's first move to unwind the corporate veil, in 1994, took the form of an 'Official Reply' to a query from a provincial appeal court in Guangdong province.[25] The provincial court had sought advice from the Supreme People's Court in a case where creditors of a failed company had brought an action against the company's shareholders for debts owed by the company and it had been demonstrated that the owners had failed to meet the minimum capital requirements. Rather than rely on the additional payment remedy in the Company Law, the Court declared that as the shareholders had not contributed the minimum capital required, the company had never been created as a matter of law, notwithstanding the incorporation licence it had been issued. Since the company did not exist as a separate person, the company's purported actions must have been those of the shareholders and the Court ruled it was thus possible for the creditors to sue the shareholders directly for debts of the company.

Seven years after its initial move to unwind the corporate veil, the Supreme People's Court acted again, this time with an 'Interpretation'. The 2001 Interpretation addressed the question of debts owed by companies that had been owned by selected government bodies such as the army and police.[26] After the enactment of the Company Law, these government departments had established

[25] Supreme People's Court, 'Official Reply of the Supreme People's Court on the question of which persons bear liability when incorporation of a subsidiary is cancelled or invalidated' (1993).

[26] Supreme People's Court, Interpretation (2001) No 8, 'Judging debt and insolvency cases brought against companies that were formerly owned by the army, police and other government and court agencies' (2001).

a number of companies housing commercial enterprises not directly connected with their primary government purposes. Following political directives for these departments to shed ownership of companies, the government bodies began the process of dissolving the companies they had established, often without providing for repayment of debts owed by the companies. The Interpretation reinforced the effect of the 1994 Reply, stating that in any case where the company law requirements for establishment of a valid company had not been met, creditors could pursue the phantom company's 'owners' (the government departments that had purported to establish companies) directly to recover the debts.

Not long afterwards, in 2003, a further Interpretation released by the Supreme People's Court created law in respect of shareholder liability in the case of company 'divisions'.[27] The Company Law provided for a company reorganisation described in the law as a division of a single company into two or more new companies (or one or more new companies plus the original company). Prior to dividing a company and allocating a portion of the original company assets to the new company or companies, the original company was required to notify all the company's creditors of the planned division, with the creditors entitled to elect between repayment of outstanding debts or guarantees of repayment before the division could take place.[28] If the creditors' rights were not respected, the division could not take place as a matter of law. Nevertheless, divisions without notification to creditors did take place, particularly in the case of state-owned enterprises, and often the reorganisations left the original companies with outstanding debt obligations while the assets of value had been shifted to new companies. In theory, the division was invalid if the division process had not included notification to, and agreement of, creditors. Where an invalid division took place, the creditors were able to sue the original company as if it still owned the assets. In practice, however, the assets were now sitting in a new, albeit non-legal, entity and recovery of outstanding debts from the original creditor company would be problematic at best. The Supreme People's Court Interpretation short-circuited the procedure by indicating that the creditors could sue the shareholder of the original company (a state body) directly, bypassing the creditor company, as the shareholder had failed to ensure the company complied with its obligations with respect to a proper division.

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[27] Supreme People's Court, Interpretation of Supreme Court Judges Committee Conference (2003) No 1259, 'Judging lawsuits brought against formerly state owned enterprises that are split into separate companies' (2003).

[28] Company Law, art 185, as the amended law stood at the time.

The first two pronouncements of the Supreme People's Court that opened the door to piercing the corporate veil in China both involved cases in which it could be argued there was no valid company interposed between shareholders and creditors and thus no genuine veil for the shareholders to hide behind. The situation set out in the third pronouncement, the 2003 Interpretation, was different. The company in this case was real and the only invalid aspect was the shift of assets to a separate entity. The practical reality, however, was that creditors could not effectively pursue the stripped company for redress. The judicial authorisation for actions directly against the shareholders was thus a significant step forward in terms of weakening the corporate veil. The judicial initiative had opened the door for further steps by the legislature, building upon calls for intervention from a number of quarters.[29]

C. Statutory remedies – 2006 to date

By the middle of the first decade in the new millennium, China had clearly crossed the threshold from a socialist to a largely market economy, albeit a market economy with a disproportionate role for preferentially-treated state-owned enterprises. Legislation drafted in the earlier transition period, including the Company Law, was proving increasingly inadequate for modern needs, particularly in terms of emerging corporate transactions and restructurings as the market economy matured and foreign and large Chinese investors rationalised holdings. The success of the market economy had led to great wealth, but that wealth was not distributed equally and reports regularly emerged of weaker economic players being exploited by those with more clout. As the National People's Congress drafters sat down to rewrite the Company Law in 2005, they faced pressure from some quarters for better safeguards in the law to protect creditors at the mercy of sometimes unscrupulous entrepreneurs hiding behind the company form.[30]

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[29] Important elements of the Chinese literature are reviewed in David Albert, 'Addressing Abuse of the Corporate Entity in the People's Republic of China: New Thoughts on China's Need for a Defined Veil Piercing Doctrine' (2002) 23(4) *University of Pennsylvania Journal of International Economic Law* 873; Sibao Shen, 'Lessons on Piercing the Corporate Veil from English and American Law', *Legal Daily*, 1 January 2004 (in Chinese).

[30] Advocates for greater protection included a number of authors of academic papers calling for statutory measures to pierce the corporate veil. See eg Ciyun Zhu, 'Doctrine of Denial of Corporate Personality and its Application to the Single Shareholder Company' (No 5, 1998) *Law Review* 55 (in Chinese); Ciyun Zhu, 'Impact of the Single Shareholder Company on Traditional Companies' (No 1, 2002) *China Legal Science* 103 (in Chinese); Sheng-xuan Guo, 'The Denial of a Company's Personality' (No 3, 2000) *Legal Science* 85 (in Chinese).

The 2005 version of the Company Law,[31] effective from 2006, clearly shifted China's company law to a more modern footing.[32] Among the changes was removal of the requirement as to the minimum number of shareholders for limited liability companies, opening the door to incorporated sole proprietorships. The notion of a single shareholder company sat uneasily with some legislators, largely attributable to misconceptions about the nature of companies and company capital. Among other things, those resistant to the reform incorrectly perceived a higher risk from a *de jure* single shareholder company than from a *de facto* single owner company with other nominee shareholders on the register. They also confused paid up capital with security, thinking that capital serves as a guarantee fund for creditors, not understanding that it is expended on expenses and assets.[33] To attract sufficient support for the elimination of the minimum shareholding rule, the government agreed to adopt discrete rules aimed at this type of limited liability company, known in the law as a 'one-person limited liability company',[34] though the single owner could be another legal person.

While they may have been confused about the relative risks of companies with single shareholders and companies with more shareholders but a single controlling shareholder, the legislators quite rightly realised they were opening a door to possible exploitation of the company form by unincorporated small business owners whose creditors might not even realise they were dealing with a company. The result was calls by a number of delegates in the National People's Congress for adoption of explicit veil-piercing rights in the law for creditors of one-person companies. The proposals were opposed by some executive bodies,

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[31] In practice, major revisions of the Company Law such as the 1999 amendments and 2005 amendments resulted in wholesale redrafts of the law. These are nevertheless treated as amendments and technically the law remains the 1993 Company Law, albeit now largely unrecognisable from its original form.

[32] The law is reviewed in Steven M Dickinson, 'Introduction to the New Company Law of the People's Republic of China' (2007) 16(1) *Pacific Rim Law & Policy Journal* 1; KL Alex Lau, 'Chinese Limited Liability Companies under the New Company Law' (2006) 36(3) *Hong Kong Law Journal* 633; Chen Luyang and Li Zhongshu, 'The New Version Company Law of PRC: Introduction, Comparison, Analysis and Criticism' (2007) 18(5) *European Business Law Review* 1193.

[33] Gordon Chan, 'Rethinking the legislation for one-person companies in China' (2012) 33(3) *Company Lawyer* 87. A substantial empirical study in the United States found that under-capitalisation was not the basis for piercing the corporate veil in that jurisdiction: see Jonathan Macey and Joshua Mitts, 'Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil' (2014) 100(1) *Cornell Law Review* 99.

[34] Company Law, art 58.

apparently with some reservations,[35] but the Congress delegates pressed hard for veil-piercing rules and the 2005 amendments introduced three measures that provided creditors with an explicit right to pierce the corporate veil and recover directly from shareholders. These measures extended in different circumstances a right for creditors to pierce the corporate veil and pursue shareholders of all companies from single shareholder companies through (in theory) to listed public companies.

The first of the new measures, article 20, paragraph 3 of the Company Law, established a broad right of creditors to pursue shareholders of both limited liability and joint stock companies, including listed public companies, for debts incurred by the company. It states:

> Where a shareholder of a company evades the payment of its debts by abusing the independent status of the legal person or the shareholder's limited liabilities, if it seriously injures the interests of any creditor, the shareholder shall bear joint liability for the debts of the company.

The second measure, article 63 of the Company Law, only applies to single shareholder companies.[36] It states:

> If the shareholder of a one-person limited liability company is unable to prove that the property of the one-person limited liability company is independent from his own property, he shall bear joint liabilities for the debts of the company.[37]

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[35] For example, the State Assets Supervision and Administration Commission, a body under the State Council, the highest executive body in China, published a research report that favoured the view of National People's Congress delegates that there should be greater piercing of the corporate veil. See Zhang Qiong (ed.), *Research Report on the Amendment of the Company Law* (SASAC, 2005) (in Chinese), pp 20, 106.

[36] Legislative amendments in December 2013 resulted in what had been article 64 being renumbered as article 63. References to the provision in most of the articles cited in this paper will thus refer to the provision as article 64. This paper refers to the article as article 63, including references to the period when it was article 64.

[37] For discussion of the measure, see Daxing Jiang, 'The Application of Piercing the Corporate Veil in Single-Shareholder Companies' (2006) 49(6) *East China University of Political Science and Law* 16 (in Chinese); Jianwei Li, 'Study on the Application of the Rule of Disregarding Corporate Personality to One-person Companies' (2009) 36(2) *Seeking Truth* 74 (in Chinese).

The third provision in the 2005 Company Law amendments relevant to the corporate veil concerns creditors of companies placed into liquidation or dissolution. The liquidation and dissolution procedures set out in Chinese Company Law differ from those of many countries by omitting the need for any independent person such as an independent liquidator to be involved in the process of dissolving a company. The Law does require the company to establish a special liquidation or dissolution committee to oversee the process but the committee can be composed entirely of shareholders of the company.

Article 190, paragraph 3 of the Company Law states:

> Where any of the members of the liquidation group causes any loss to the company or any creditor by intention or due to gross negligence, he shall make respective compensations.

The impact of the first limb of this article is unclear as the distribution of company assets by the liquidation committee cannot yield a loss *per se* for a company. It is clear, however, that distribution of assets when the company has outstanding debts is likely to lead to a loss by creditors. The article potentially gives rise to a piercing of the corporate veil to the extent that the provision could be used by a creditor to extract compensation from company shareholders for a debt owed by the company that cannot be satisfied by the company as a result of the dispersal of company assets by a liquidation group comprised of shareholders.

As might be expected, the new rules, particularly articles 20 and 63, attracted considerable attention and generated significant analysis at home and abroad.[38] The new rules were striking in a number of respects. The first was the fact that they existed at all. The legislators seemed not to appreciate the fact that veil piercing rules were not commonly found in company laws of other jurisdictions and their inclusion in the Company Law struck many outside observers as a remarkable development. The surprise may not be fully warranted. While it is true that veil piercing is not a feature of company laws in advanced common law jurisdictions, the premise itself is not radical. In a sense, the legislative initiative merely codified a right that had been developed by the judiciary elsewhere and given the different legal structure the rule was more logically included in a statute in the Chinese system.

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[38] Many key references in this respect are cited in Huang (note 3 above). See also Jiang (note 37 above); Xudong Zhao, 'Analysis of the Circumstances in which the Corporate Veil may be Pierced' (2011) 10 *Journal of the Application of the Law* 44 (in Chinese).

The second easily observed feature was the vagueness of articles 20 and 63. There was no certainty in the original Chinese version that was lost in translation – any way they were read, the parameters of the rules were indistinct. Again, while this may have made the statutory rule an easy target for criticism,[39] in some ways the result was no different from that in the common law world where judicial doctrines that allow piercing of the corporate veil have been described as an area renowned for uncertainty.[40] At the same time, the language merging actions of shareholders and companies does suggest the legislators perhaps had less appreciation of the significance of the status of companies as separate legal persons than the judiciary, which by this point had over a decade of experience in interpreting and applying company law. One view is that the vagueness was deliberate, to leave the measure open to adaptation to fit evolving social and economic changes.[41]

The final feature of significance, applicable only to article 63, was the remarkable shift of the onus of proof in the case of the single-shareholder company. Article 63 dismantles the corporate veil entirely if a creditor alleges the owner's property coincides with that of the company unless the company owner is able to prove otherwise.[42] The language in the provision is exceedingly opaque, applying when a company owner is unable to prove that company property is independent from the owner's property. As a strict matter of law, it is impossible for the company's property also to be the owner's property. Only one entity can be the legal owner of the property. In an ideal world, the sole proprietor who incorporates would transfer business assets to the new legal entity and receive equity interests as consideration for the transfer. In practice, of course, sole proprietors who incorporate rarely do this; they simply operate as a sole proprietor on Day One and a company on Day Two, with no change in legal title. If the business is then that of the company and it continues to use the owner's assets, in law the owner must be lending the assets to the company, presumably at a bargain zero interest rate. Article 63 clearly envisages 'independence' of assets to mean something other than legal title but there is no guidance as to what exactly it means.

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39 See eg Bradley C Reed, 'Clearing Away the Mist: Suggestions for Developing a Principled Veil Piercing Doctrine in China' (2006) 39(5) *Vanderbilt Journal of Transnational Law* 1643, 1667-1675; Mark Wu, 'Piercing China's Corporate Veil: Open Questions from the New Company Law' (2007) 117(2) *Yale Law Journal* 329, 333.

40 Huang (note 3 above), p 743.

41 Chao Xi, 'Piercing the Corporate Veil in China: How Did We Get There?' (No 5, 2011) *Journal of Business Law* 413 at 414.

42 The rule overrides the general rule in China's civil law which places the onus of proof on the plaintiff: see eg the General Principles of the Civil Law of the People's Republic of China, arts 123 and 126.

D. Recent judicial initiatives

Following the 2005 amendment of the Company Law, the Supreme People's Court has issued three Interpretations of the Law. Two of these touch on the issue of the corporate veil.

The first relevant Interpretation, issued in 2008, dealt with the obligation of liquidation group members to compensate a company or creditors of the company in case of loss resulting from intentional actions or gross negligence of the members.[43] The Law itself stated that a member of the liquidation group must 'make compensations' but provided no guidance on how this would be done. It could, for example, be read as requiring the liquidation group member to compensate the company for the value of distributed assets, leaving the creditor to continue an action against the company's restored value. Alternatively, it could be read as requiring the member to compensate creditors directly, removing the need for them to continue actions against the company.

The 2008 Interpretation resolved the ambiguity in the Law, stating that shareholders have joint and several liability with the company for the debts of the company where the actions of shareholders (whether or not they actually sit on a liquidation committee or similar body) imperil the interests of creditors. While the Interpretation overlapped directly with the legislative measure and could have simply set out the remedy mechanism for article 190, the Court chose to treat the Interpretation as an independent consequence of its interpretation of the law in its entirety. There is no mention in the Interpretation of article 190 or any other provision in the Company Law. The effect of the ruling, therefore, was to establish an independent breach of the corporate veil in cases where shareholders directly or indirectly participate in the process of rendering companies unable to satisfy their debts.

The second relevant Interpretation issued by the Supreme People's Court was much more limited than the first Interpretation, but again arguably much broader in effect than the underlying Law. This Interpretation, issued in 2011,[44] provides a remedy to creditors where shareholders have withdrawn funds from the capital of a company, implicitly leaving the company unable to satisfy its debts. It authorises a court to breach the corporate veil and hold the shareholders liable for the company's debts, limited to the value of capital that should be

[43] Supreme People's Court, 'Interpretation of the Application of the Company Law of the People's Republic of China to Some Issues (II)' (2008), ss 18, 19 and 20.

[44] Supreme People's Court, 'Interpretation of the Application of the Company Law of the People's Republic of China to Some Issues (III)' (2011), s 14, para 2.

restored to the company. The shareholders' liability is capped at the nominal capital amount of the company, however large the company's debts may be. Once again, the Interpretation made no reference to the statute and there is no attempt to anchor the liability established by the ruling in any provision of the Company Law. Unlike articles 20, 63 or 190, the Interpretation contains no condition that there be explicit or implicit fault on the part of a shareholder liable for compensation.

III. Empirical Findings

As has been noted, in the absence of general legislative authority for piercing the corporate veil, company creditors in common law countries must rely on judicial doctrines to obtain relief where the company shareholders are directly or indirectly responsible for the inability of companies to satisfy their debts. Empirical studies of the incidence and circumstances behind decisions by courts to find shareholders liable for debts of their companies are thus based on reports of court decisions. Although processing data may be time consuming, in common law countries where almost all appeal and many trial decisions are reported, investigators can be confident they are working with comprehensive and indicative data. While the authority in China for piercing the corporate veil may have been different from that of common law countries since 2006, the only source of information on the incidence of the practice remains, as is the case with common law jurisdictions, court decisions. Unfortunately, however, China has no comprehensive database of judicial decisions comparable to the case reporting systems in the common law world. Most judgments are released without written reasoning. Where reasoning is provided, the judgment remains a document of the court, not a public document. Those judgments that include reasoning are available from the courts for a fee and these are most often acquired selectively by persons interested in particular cases.

There is, however, a comprehensive database of all trial and appeal case decisions made available for purchase by Chinese courts that has been compiled by the Peking University.[45] The findings in the current study are based on an analysis of cases available through the Peking University collection, following the path of the only previous comprehensive study of Chinese cases where company creditors sought to pierce the corporate veil, the work by Professor Hui Huang

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[45] *Bei Da Fa Bao*, available at http://Chinalawinfo.com.

of the Chinese University of Hong Kong.[46] As Professor Huang pointed out, no database is perfect. In all jurisdictions, and in particular in China where there are cultural and social factors favouring compromises and settlements over litigation through to trial, databases of decisions may reflect only a portion of cases in which creditors were able to obtain compensation from a company's shareholders. In addition to this, the Chinese database is inherently less comprehensive than those available in common law jurisdictions, updated far more slowly, and, because it is compiled through a third source, carries a risk of errors or misclassifications.[47] It does, however, appear to capture a large number of cases on the topic relative to numbers in other jurisdictions[48] and is clearly sufficiently robust to generate data on the resolution of cases involving attempts to pierce the corporate veil.

Professor Huang's study covered the inclusive period 2006 to 2010, covering the first five years of statutory authorisation for piercing the corporate veil. He found that in the reported decisions Chinese courts were far more likely to make shareholders liable for debts of a company than their common law counterparts. In the period covered by that study, courts pierced the corporate veil in almost 69 per cent of cases, compared with creditor plaintiff success rates in common law jurisdictions revealed by other studies of 47 per cent in the UK, 40-48 per cent in the United States and 38 per cent in Australia.[49] The present study sought to extend the findings over the period 2011-2014 to discover whether any trends are revealed when the two periods are compared and to see how the courts have operated after the initial five years of bedding down the new law.[50]

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[46] Huang (note 3 above). Results were checked by the researchers to remove any duplicate cases where the database contained decisions in the same case from a lower court and an appeal court, with the highest level of court decision used in each case of duplication.

[47] Huang (note 3 above), p 747.

[48] *Ibid*, p 748.

[49] US: Robert B Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76(5) *Cornell Law Review* 1036 found a rate of 40 per cent. A later study, Peter B Oh, 'Veil-piercing' (2010) 89(1) *Texas Law Review* 81 found a rate of 48.51 per cent. The Thomson and Oh studies are reviewed in David Millon, 'The Still-Elusive Quest to Make Sense of Veil-Piercing' (2009) 89 *Texas Law Review* 15. UK: Charles Mitchell, 'Lifting the Corporate Veil in the English Courts: An Empirical Study' (1999) 3 *Company, Financial and Insolvency Law Review* (online supplement) 15; Australia: Ramsay and Noakes (note 3 above). For illustrative case studies of the US approach, see Tim Prudhoe and Jessica Notebaert, 'Piercing the Veil – An American Introduction' (2010) 16(9) *Trusts & Trustees* 727.

[50] All data for the 2006-2010 period is derived from Huang (note 3 above).

As with the previous study, the cases covered in the current one are based on actions brought against shareholders of limited liability companies. There are no cases reporting actions against shareholders of larger joint stock companies, which would include companies listed on public stock exchanges. Presumably this reflects the logistical difficulties that would be encountered pursuing shareholders of large companies as well as attributing fault or blame to more dispersed shareholdings.

Litigation started slowly following the adoption of statutory veil piercing rules but after five years there was an almost exponential increase in litigation. There were almost three times as many reported cases in the four years covered by this study (410) as in the five years covered by the initial study (117). As the frequency of cases involving attempts to pierce the corporate veil climbed, the success rate of creditors also rose. In the period covered by the initial study, creditors were successful in 69 per cent of cases reporting attempts to pursue company owners for debts of the company. In the later period covered by this study, the success rate for all companies had risen to 77 per cent.

A notable change between the periods is the proportion of cases involving single-owner companies compared with multi-owner companies and the relative success rates of litigants in both instances. In the period covered by the earlier study, stretching over the first five years of single-owner companies, only 15 per cent of the cases in which creditors sought to pierce the corporate veil involved one-owner companies. This rose to 22 per cent of piercing attempt cases in the later period surveyed for this article. Oddly, the proportion of single-owner companies dropped significantly in 2012 and 2014, two years with only a tiny number of single-owner cases making it to the reported decisions.

Creditors seeking redress against the shareholders of one-owner companies were more likely to succeed than creditors seeking compensation from the shareholders of multi-owner companies in both periods but the difference between success rates narrowed in the later period. In the period covered by the earlier study, courts pierced the corporate veil in 63 per cent of the cases involving multi-owner companies and 100 per cent of the cases involving single-owner companies. In the latter period, the success rate for creditors suing the owners of multi-owner companies climbed to 72 per cent while the success rate for creditors seeking to pierce the veil in single-owner companies fell slightly from 100 per cent to 96 per cent.

In terms of both numbers and success rates, 2007 was an anomalous year, with both the number and the proportion of cases in which creditors were able to pierce the company veil falling in the year. The number of cases involving multi-owner companies also fell in 2010 but the success rate of creditors actually rose in that year, reaching the highest rate for any year in the study, with more than four out of five creditor litigants enjoying success in shifting liability for company debts to shareholders.

The annual data for the later period covered by the current study is available for actions against both single-owner and multi-owner companies. However, the shorter time span of the period covered by this second study and the tiny number of cases against the shareholder of a single owner company (a single case) in the second and fourth year of the study may impact on conclusions based on the full data set for the second study period.

IV. Analysis of Statutory Veil Piercing Results

Chinese judges are clearly much more willing to pierce a company's veil and shift liability to its owners on the basis of statutory authority than their common law counterparts relying on judicial doctrines. They are also more willing to find abuse and look through one-owner companies than they are with multi-owner companies. There clearly is a story to be told about judicial attitudes and approaches, but it is difficult to discern the details of that story from judgments. Unlike common law judgments, Chinese case law reports are remarkably short. Some judgments in cases involving one-person companies are as concise as one page or 500 words. A usual case involving multi-owner companies may be a little over 1,000 words plus full citation of the legislation. In contrast, no eyebrows would be raised over a judgment exceeding 30 times that number of words in a common law veil piercing case.[51] Compounding the problem from the perspective of common law observers is the absence of any system of judicial precedent in China. Courts of all levels are free to reach decisions independently of one another, drawing on different doctrines or different reasoning. It is as a result possible for diametrically opposite holdings to be made in cases with seemingly similar facts.[52]

One avenue of analysis that would explain the higher success rate in China of creditors seeking to pierce the corporate veil is to assert that shareholders of private companies truly are more abusive in China than shareholders of similar companies in common law countries. The conclusion would sit well with a common perception of higher levels of corrupt or abusive behaviour[53] but

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[51] For example, the judgment of the United Kingdom Supreme Court in *VTB Capital plc v Nutritek International Corp* [2013] UKSC 5 comprised 36,120 words.

[52] See eg *Tang Yifang v Chengdu ZhinengdaKeji Ltd* (2011) Gaoxin Civil First Trial No 519; *Pinggao Group Ltd v Pingdingshan City TianheDianqi Ltd* (2011) Ping Civil List Trial No 114.

[53] See eg Andrew Wedeman, 'The Intensification of Corruption in China' (2004) 180 *The China Quarterly* 895.

there is no true evidence to support this conclusion. An alternative explanation is that judges have misread the legislator's intent and broadened the rights of creditors to pierce the corporate veil to a much greater extent than the legislators intended. The judiciary had once been exposed to socialist rhetoric and even if orthodox socialist dogma is no longer woven into the curriculum of law studies, they may be more likely to be suspicious of market behaviour than adjudicators who came to the bench from roles in a market economy and who accept as fact the self-correcting mechanisms inherent in the market that obviate or at least greatly reduce the need for judicial intervention. Again, there is no evidence to support this conclusion.

The most plausible explanation for the greater success rate of creditors in China that can be discerned from the brief judgments available is that the difference lies in the shift in the burden of proof in Chinese veil-piercing cases that is directly incorporated into the law in the case of liability by the owners of single-shareholder companies and which sits as a possible interpretation of the ambiguous language of the general rule authorising piercing of the corporate veil for limited liability companies.

With its mandated outcome that the owner of a single-shareholder company is automatically jointly liable for the company's debts unless the owner can prove there has been no intermingling of the company's property and the owner's property, article 63 explicitly shifts the onus of proof in a veil piercing case. It is not the creditor who must present proof that there has been abuse of the corporate form; it is the shareholder who must prove that his or her personal assets have been completely segregated from the company's property. The difficulty of doing this could help explain why creditors suing shareholders of single-owner companies can be very confident of success – the statistics show they will succeed in almost every case.

In contrast to the presumptive shifting of the onus of proof in the single-shareholder company case, the language of the general veil-piercing rule in article 20, applicable to all other limited liability companies and requiring a finding that the shareholder actively abused the independent status of a company, appears to establish a test not dissimilar from the general tenor of common law tests. The burden on creditors seeking to shift a company's liability to its shareholders in the common law world is proof on the balance of probabilities. To achieve this standard, a plaintiff would need to put forward evidence of the shareholder's subjective intent or objective behaviour that amounts to abuse. Article 20 allows a court to set aside the corporate veil where the shareholder of a company 'evades the payment of its [the company's] debts by abusing the independent status of the legal person'. The suggestion that a shareholder can evade payment of another person's debt (the company's debt) clearly implies that the debt would have been that of the shareholder but for abusive behaviour that led to the insertion of a company between the true borrower and the debtor. The measure imposing liability on shareholders acting in the capacity of

a liquidation committee, article 190, similarly requires evidence of intention or gross negligence on the part of the shareholder.

There is some evidence in the judgments (albeit limited given the brevity of analysis in published decisions) that courts have shifted the burden from creditors to the company and its shareholders more than the legislative language implies, a conclusion that would be consistent with the view of some scholars that the majority of the judges have not fully understood intended limitations to the veil-piercing rules.[54] The cases suggest that non-payment of debt by a company will be treated as *prima facie* abuse by the shareholders, leaving the shareholders to prove there was no abuse rather than requiring the plaintiff to show there was. The judgment of the Anhui Province High Court in *Shanghai Zhongbo Company (Appellant) v Anhui Water Conservancy Construction Engineering Corporation and Others (Respondents)*[55] may be considered a typical example of this tendency. The shareholders' defence in the case rested on an argument that debts could not be paid in the course of liquidation and the liquidation process had dragged on for a variety of reasons including complications from partial ownership of assets and difficulties dealing with competing claims by other creditors. The appeal court did not require the plaintiffs to show abuse; rather, the court indicated the defendants had failed to provide proof of the reasons offered for the delay and treated the non-payment for an extended period as abuse. In the same fact situation, a common law court might very well have come to a similar conclusion but first such a court would have required the creditor plaintiffs to prove abuse by showing there were no legitimate reasons for extending the liquidation period for such a long time.

Allied to the subtle shift of onus in veil-piercing cases is the complete absence in Chinese veil-piercing cases of any analysis of the responsibility of creditors to protect themselves. The starting assumption underlying company law in common law countries is that parties to a company credit loan transaction are equals. Shareholders decide whether they are satisfied with the amount of information provided by the company before investing. Creditors require appropriate payment schedules, third party guarantees and security interests in company assets before lending. Normally, courts are willing to pierce the sanctity of separate legal personality only in extreme cases, where creditors are genuinely unable to avail themselves of ordinary security measures to protect their loans.

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[54] Ciyun Zhu, 'Piercing the Corporate Veil: From Legislation to Practice' (2007) 1(2) *Tsinghua Law Review* 111.

[55] *Shanghai Zhongbo Company (Appellant) v Anhui Water Conservancy Construction Engineering Corporation and others* (Respondents), Anhui Province High Court (2011) Civil No 00007.

In contrast, by subtly shifting the onus of proof from outside creditors to shareholder-owners of companies, in effect to some degree implicitly extending to all limited liability companies the explicit onus of proof rule that applies to one-owner companies, Chinese courts may be adopting a Chinese understanding of the corporate veil quite different from that abroad. That understanding also shifts the fundamental assumption in market economies that, in the first instance, creditors have a responsibility to protect themselves and courts will only step in to pierce the corporate veil where company owners have abused the separate entity concept in a way that frustrates or makes it impossible for creditors to protect themselves properly. This is a development that should be monitored closely in the future to determine whether the trend will continue and whether there really is a divergence between Chinese and international understandings of the corporate veil or the recent patterns are a short-term phenomenon following the introduction of new corporate veil measures.

V. Moving Forward

While so many aspects of Chinese company law and the environment in which it is applied differ from counterparts in full market economies, it would be logical to assume that Chinese company law generally, and its approach to the corporate veil in particular, might gradually merge with international norms as the economy and legal system mature. As this study shows, however, there is no sign that the dramatic swing of the pendulum in China – extending liability for company debts to shareholders almost 100 per cent of the time in the case of single shareholder companies and more than 70 per cent of the time in the case of other companies – is shifting back to the prevailing approach found in mature market economies. To the contrary, the practice of piercing of the corporate veil to make shareholders liable for company debts continues to grow in China.

The factors that may warrant a more extreme approach to creditor protection in China – possibly higher levels of corruption and abusive behaviour by company owners – can equally be cited as risks that caution against extension of veil piercing where this necessarily involves empowering local courts. A significant concern is the extent to which the unique statutory and judicial bias in favour of creditors reflect views of the Chinese legislature and judiciary respectively that are fundamentally at odds with the conventional position in mature market economies. This understanding is that, apart from very limited circumstances, the legislature and courts should step back from interfering in the market and instead leave market players to protect their interests with appropriate security interests and credit investigations. Piercing the corporate veil is only warranted in the few cases in which borrowers have deliberately abused the corporate form to exploit the vulnerability of lenders who are unable to ascertain the true risks they face because of the borrower's deception.

It is unclear whether the heavy-handed paternalism evident in the statistics revealed by this study might ultimately interfere with the efficient allocation of investment capital through a fluid and flexible modern corporate finance market. Continuing monitoring of corporate veil cases in the courts will be an important tool to measure the extent to which Chinese company law diverges from a fundamental principle of market economy company law which places the onus firmly on creditors to show there may be special circumstances that warrant violation of the sanctity of the corporate veil.

Appendix: Corporate Veil Cases in China[56]

Table 1: 2006-2010, Limited Liability Companies other than Single Shareholder Companies

Year	Number of cases	Pierced	Not Pierced	Pierced (%)
2006	13	7	6	53.85%
2007	7	2	5	28.57%
2008	24	15	9	62.50%
2009	43	29	14	67.44%
2010	12	10	2	83.33%
Total	99	63	36	63%

[56] Sources: 2006-2010 data (Tables 1-3) reproduced from Hui Huang, 'Piercing the Corporate Veil in China: Where is it Now and Where is it Heading?' (2012) 60(3) *American Journal of Comparative Law* 743; 2011-2014 data (Tables 4-6) based on the authors' study. The Huang study did not provide an annual breakdown for outcomes in single-shareholder cases."

Table 2: 2006-2010, Single Shareholder Companies

Year	Number of cases	Pierced	Not Pierced	Pierced (%)
2006-2010	18 (15% of all cases)	18	0	100%

Table 3: 2006-2010, All Companies

Year	Number of cases	Pierced	Not Pierced	Pierced (%)
2006-2010	117	81	36	69%

Table 4: 2011-2014, Limited Liability Companies other than Single Shareholder Companies

Year	Number of cases	Pierced	Not Pierced	Pierced (%)
2011	15	12	3	80%
2012	53	39	14	73.85%
2013	186	129	57	69.35%
2014	64	48	16	75.00%
Total 2011- 2014	318 (78% of all veil piercing cases)	228	90	71.70%

Table 5: 2011-2014, Single Shareholder Companies

Year	Number of cases	Pierced	Not Pierced	Pierced (%)
2011	35	31	4	88.57%
2012	1	1	0	100%
2013	54	53	1	98.15%
2014	2	1	1	50%
Total 2011- 2014	90 (22% of all veil piercing cases)	86	6	95.56%

Table 6: 2011-2014, All Companies

Year	Number of cases	Pierced	Not Pierced	Pierced (%)
2011	50	43	7	86%
2012	54	40	14	74%
2013	240	182	58	75.83%
2014	66	49	17	74.24%
2011- 2014	410	314	96	76.59%