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ABSTRACT

A company, once incorporated, acquires a separate legal personality. The basic understanding is that there is a veil or a screen in between the company and its members. Therefore, a company is a legal person or a juristic person. Although, in certain situations, the authority of the company can be questioned. In case of fraud or evasion, the veil that makes the distinction between the company and its member can be lifted by the Court. This is called Piercing of the Corporate Veil. The veil protects the rights of the members. The Court does not lift the veil until and unless they find it absolutely necessary to do so. The opposite of piercing corporate veil is the reverse piercing of corporate veil. Although it is not acknowledged in India as much, this concept is when the shareholders shift the liability entirely on the company.

In this paper, the researcher aims to point out the flaws in the concept of corporate veil, the situations where it would not be lifted and the growing concept of reverse piercing.

Keywords: Corporate Veil, Lifting, Company, Liability, Reverse Piercing

INTRODUCTION

The concept of a company, being a corporate entity is based on various concepts including the existence of a 'separate legal entity' being the most relevant one. In the eyes of law, the company is considered as a juristic person. This feature differentiates between the company and its member. Therefore, acts done by the company would hold the company accountable and not its members. The company acquires various powers such as to sue and be sued. Therefore, this creates a veil that protects the management of the company. In rare cases, when it is clear that there has been mismanagement on purpose for personal benefit, the veil may be lifted and the members would be held accountable for the actions.

There are various provisions in The Companies Act, which hold the management of the company liable for their actions- Section 2(60) of the Act holds the officer-in-default liable for his actions; Section 7(6) makes suppression of material facts as punishable; section 34 makes them liable for misstatement in prospectus; Section 36 makes directors liable for inducing a person to invest money in the company; Section 339 holds the directors liable for fraudulent trading, and Section 447 includes other kinds of fraudulent activities.

The company as a separate entity was established in the landmark case of Salomon v. Salomon & Co. Ltd.¹ It was held that- “The company is at law a different person altogether from the subscribers to the memorandum, and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them.”

Although it seems like a fairly easy provision, there are underlying flaws in this concept. The Judiciary believes that veil must only be lifted in rare cases and when it can be proved that there is a civil or criminal activity committed by the company. The Courts have contradicted their own belief several times and lifted the veil when it was not necessary. Apart from this, the Courts have laid down various grounds under which the corporate veil can and cannot be lifted and these grounds have been vague in nature. Various High Courts have passed contradicting judgments on the same grounds and therefore, this creates ambiguity.

The concept of reverse piercing has been growing in India. Reverse Piercing is when the shareholders of the company entirely shift their liabilities on to the company. The researcher would delve into the above mentioned concepts in this paper.

¹ Salomon v. Salomon & Co. Ltd. [1897] A.C. 22

RESEARCH PROBLEM

There are certain flaws in the concept of piercing the corporate veil. The Judiciary believes that veil must only be lifted in rare cases and when it can be proved that there is a civil or criminal activity committed by the company. The Courts have contradicted their own belief several times and lifted the veil when it was not necessary. Apart from this, the Courts have laid down various grounds under which the corporate veil can and cannot be lifted and these grounds have been vague in nature. Various High Courts have passed contradicting judgments on the same grounds and therefore, this creates ambiguity. The researcher would look into these flaws and the contradictory methods of the court as well as the growing concept of Reverse Piercing.

RESEARCH QUESTIONS

1. What are the grounds covered as per law for lifting the corporate veil?
2. Does the Arbitral Tribunal have the power to lift the corporate veil?
3. Is Public Interest a ground for piercing the corporate veil?
4. Would the concept of Sham be considered as a separate ground from fraud?
5. What is the concept of Reverse Piercing? Is it relevant in the current scenario?

RESEARCH OBJECTIVES

1. To analyse the various grounds accepted by the Courts for piercing the corporate veil.
2. To examine various case laws to validate the grounds accepted by the Court.
3. To study the concept of Reverse Piercing in the Indian scenario.

STATEMENT OF HYPOTHESIS

The researcher hypothesizes the meaning of corporate veil and reverse piercing and the variety of judgments delivered by the Courts based on the same concept. Additionally, the researcher highlights the flaws in the concept based on the case studies.

REVIEW OF LITERATURE:-

1. C.A. Sandeepkanoi: Lifting of Corporate Veil (2017)- In this paper, the researcher establishes the separate legal personality of a corporation. The researcher points out certain cases where the courts fail to recognise the corporate personality and hold the members liable for the actions of the company.

2. Bello & Nrichel: Piercing the Veil of Business Incorporation (2015)- In this paper, the researcher covers the judgments given in favour of piercing the corporate veil, over the past two decades. It covers the history of corporate veil and the rights of third parties in such a case. The researcher aims to cover every aspect of separate legal personality of a corporation.

3. Vasundhara Majithia, Yamini Rojora: Lifting of Corporate Veil (2015)- In this paper, the researcher aims to cover the basics of a company and how it obtains a separate legal personality. The researcher explains in-depth the meaning of corporate veil and the obligations and liabilities of the stakeholders in such a case.

4. R. Judith Priya, S. Susmitha: A Descriptive Study of the Doctrine of Lifting of Corporate Veil (2018)- The researcher aims to highlight the juristic personality of a company and the rationale behind the concept of corporate veil. The researcher analyses the various provisions related to the concept.

5. S. Manish Kumar: Analysis of lifting the corporate veil (2020)- The researcher analyses the concept of piercing the corporate veil through the provisions. The researcher examines various landmark case laws that laid down the principles and grounds for the concept of lifting of corporate veil.

6. P. Shanthini, MS. Arya. R: A study on the lifting of corporate veil with reference to case laws (2018)- In this paper, the researcher analyses the doctrine of piercing the corporate veil and the separate legal personality of a company. The researcher looks into various case laws. The researcher does a comparative analysis between the 1956 and 2013 laws as well.

7. M. Ashwin, C. Sathvik: Sham as a ground for lifting the corporate veil (2018)- In this paper, the researcher looks various case laws and identifies the various contradicting judgments. The researcher points out the flaws in the concept. The researcher studies the two possible meanings of sham in this paper.

8. K. Naman, S. Akash: Is Reverse Piercing the Solution? (2019)- In this paper, the researcher highlights various aspects where the concept of reverse piercing would be beneficial in India. The researcher after analysing case laws provides suggestions that would be helpful in recovery of the economy by way of reverse piercing of corporate veil.

9. C. Bharat: Arbitral Tribunal Piercing the Corporate Veil (2020)- In this paper, the researcher studies various case laws with respect to the question of corporate veil being pierced in an arbitral tribunal. The researcher highlights the powers and the rights of a tribunal and why the corporate veil cannot be lifted in an arbitration.

10. Chauhan: Piercing the Corporate Veil to impose criminal liability on corporations (2019)- In this paper, the researcher aims to highlight the liability of a parent company over the wrongful actions of its subsidiary company. The researcher concludes the paper with their own suggestions with respect to companies being held accountable for the actions and liabilities of the shareholders.

CHAPTER I: ARBITRATION AND CORPORATE VEIL

It is established that the corporate veil can only be lifted in certain cases where it is absolutely necessary. Only under certain circumstances can the corporate veil be lifted. In recent times, the Court has held that an arbitrator cannot pass a judgment for a company to lift their corporate veil in their arbitration proceedings.

1. In the case of *Balmer Lawrie & Company Ltd vs Saraswathi Chemicals*², the Court first laid down that an arbitrator cannot order to lift the corporate veil.

Facts of the case:-

In this case, the Decree Holder (DH) executed proceedings against the Judgment Debtor (JD). The DH alleged that the JD had certain obligations to fulfil towards the arbitral award. The DC alleged that the JD in question has previously siphoned off the assets and therefore, he must be held responsible for his actions.

Issue raised:-

Whether the Court had the necessary grounds under which the corporate veil of the respondent company could have been lifted while executing the arbitral award too?

Arguments raised:-

The petitioner showcased certain documents where the respondent's identity was different. The petitioners believed that the reason behind the inconsistency and inconvenience were the actual people making the decisions on behalf of the respondent firm. The belief arises from the fact that the judgment debtor had signed and certified every document in regards to the business where the firm was portrayed as a company.

Judgment and Reasoning:-

It is pertinent to keep in mind that an arbitral tribunal's jurisdiction arises from the two parties in dispute. The decision of an arbitral tribunal concerns the two parties in question and not a third party. Therefore, giving a decision to lift the corporate veil of the respondent company where the Judgment Debtor, as a third party, is held accountable is beyond the scope and jurisdiction of the arbitral tribunal and beyond the powers of the arbitrator. There are exceptions to expanding the scope of an arbitral tribunal, but lifting of corporate veil proceedings cannot

² 239 (2017) DLT 217

be initiated only on the basis of the consensus amongst the two parties in the proceedings. It is also important to note that even though an ordinary Court can initiate lifting of veil proceedings, it is only performed in rare cases. The grounds covered by the petitioner in the present case are not grounds under which the corporate veil of a company can be lifted. There has been no fraud proved and based on mere allegations of improper conduct of the respondent company, the court cannot lift the corporate veil. The Court further held in this case that family members of the board of directors managing the affairs of the company cannot be considered as a ground for lifting the corporate veil until and unless fraud has been proved.

2. *Sudhir Gopi v. Indira Gandhi National Open University*³ was another case where the rights of an arbitral tribunal regarding lifting of corporate veil have been established.

Parties:-

In this case, the petitioner is the Chairman was UEIT (Universal Empire Institute of Technology) which has been incorporated in UAE as a limited liability company. The Respondent in this case is a university that was established under the Indira Gandhi National Open University, 1985.

Facts of the case:-

UEIT and IGNOU agreed to collaborate for various distance learning courses and the criteria would be decided as laid down by IGNOU. The agreement was for a period of 3 years, after which it would have been extended. It was decided that the parties would be accepting fees from the students.

The issue arose when UEIT defaulted on the payments as claimed by IGNOU. UEIT held that students were enrolled through IGNOU from institutions that were operating unlawfully outside Trade Free Zones and due to that, UEIT suffered losses. Therefore, IGNOU revoked the agreement between the two parties and claimed that they suffered losses for which the Chairman and Managing Director of IGNOU must be held responsible. UEIT claimed that the Chairman was not a part of the agreement and that including him would lead to a mis-joinder of parties.

³ 2017 SCC OnLine Del 8345

Judgment and Reasoning:-

The Arbitral tribunal gave the judgment in favour of IGNOU and lifted the corporate veil. The judgment was given against Mr. Gopi and UEIT, joint and severally. Aggrieved by the decision of the Tribunal, the respondents approached the Bombay High Court. The Court held that an arbitral tribunal cannot pierce the corporate veil as it is against the Indian Laws which recognise a company as a juristic person and give them a separate legal identity.

The situation in India as per powers of an arbitral tribunal in regard to lifting of corporate veil is currently unclear and confusing. It can be seen that the judgments delivered by High Courts cannot be binding on one another and therefore, this subject lacks clarity.

CHAPTER II: PUBLIC INTEREST:-

Public Interest is also considered as a ground for invoking the lifting of corporate veil and therefore, this chapter focusses on the case- State of Rajasthan & Ors. v Gotan Lime Stone Khanji Udyog Pvt. Ltd. & Ors⁴.

Facts of the case:-

The Rajasthan Government had granted a mining lease for extraction of lime stone to the Respondent firm. The Respondents filed an application to transfer the mining lease to a private company instead. The application was allowed since it involved no extra expenses and the Board of Directors would remain the same. Eventually, the respondent company sold all their shares to Ultra Tech Cement Limited and became a wholly owned subsidiary. The government alleged that the share price which was approximately Rs. 160 crores was only a consideration that was given for sale of the mining lease. The case was put forth in the Rajasthan High Court where the Court held that there would be no interference from the judiciary as a company is a juristic person. The High Court believed that mere transfer of shares would not affect the mining lease agreement between the petitioners and the respondents. The judgment delivered was further appealed in the Supreme Court.

Judgment and Reasoning:-

The bench set aside the judgment given by the High Court. They took no notice of the lifting of corporate veil by going through the transactions. It was established that there were two transactions. These transactions in isolation seem legal and fairly executed whereas seen as a whole, they would be considered unlawful. The Court held that the respondent had clearly and smartly transferred the mining lease to Ultra Tech by changing the price of shares. Therefore, the transaction should be declared void as the mining lease was transferred without prior permission from the government.

The Court further believed the ground of public interest to lift the corporate veil. The ownership mining rights was a subject matter of the state which concerns the public of the state as well. Therefore, it must regulate in accordance with the public trust doctrine.

⁴ CIVIL APPEAL No. 434 OF 2016, Arising out of SLP (Civil) NO. 23311 OF 2015

The Indian Jurisprudence and the English Jurisprudence:-

In the landmark case of *Prest v. Petrodel*⁵, the Supreme Court held that the doctrine of lifting of corporate veil has often been applied incorrectly, for vague reasons. In the case of *Ben Hashem v. Ali Shayif*⁶, the judge held the opinion that lifting of corporate veil must be rare and only when it is absolutely necessary. Judges believed that unless an evasion principle is clear in the case and there are no other remedies, only then the corporate veil must be lifted. Eventually, it must be lifted when “a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control”⁷

Therefore, in England, public interest is not considered as a ground to lift the corporate veil. The Courts have laid down certain grounds under which a company’s corporate veil can be lifted. This has been done to protect the rights of a company.

In India, the laws are more focussed on balancing the rights and interests of the shareholders and other third parties that would have invested in the companies. This is in consideration with the fact that the decision of the court to lift the corporate veil would affect the third parties as well. Therefore, In India, public interest can be considered as a ground under which the corporate veil can be lifted. Although it may be evident that the application of public interest has been evoked on different explanations while citing various English case laws without the proper application. Hence, when considered, there is no precedent for the case of public interest.

In the current case, the Court held that the respondent company was established with the intent to avoid any statutory requirement and obtain the consent of the government for the mining lease to be transferred to a third party. The hidden motive here was to get private benefits at the cost of the interests of the public. After a look at the judgement delivered by the Court, it becomes clear that the bench lifted the corporate veil rather immethodically. When there was evident violation of rules, the bench did not have to indulge in the question of public interest.

⁵ [2013] UKSC 34

⁶ [2008] EWHC 2380 (FAM)

⁷ Lord Sumpton’s opinion

Since there is no fixed precedent that defines public interest, the concept can be used in different ways as per the convenience of the judges. Considering public interest as a ground for lifting the corporate veil goes against the separate identity of a company which prevents the corporate veil being lifted from time and again. This case has laid down a harmful precedent that can be used to deter the status of an independent personality in the near future.

Therefore, the ambiguity of the concept of public interest makes it difficult ground for lifting the veil since there are many factors that must be considered, but have not been laid down anywhere in the Indian courts. This would eventually hamper the growth of businesses as investors would be uncertain to invest their money into new ventures.

Thus, public interest must only be applicable as a ground for lifting the corporate veil when it can be proved that the company has participated in fraud. Other than that, it must be not considered as a ground unless the judiciary lays down the concept in detail.

CHAPTER III: SHAM AS A GROUND

In the landmark case of *Balwant Rai Saluja v. Air India*⁸, the Court recognised the piercing of corporate veil after relying on the case of *Prest v. Petrodel*⁹ which recognised the ambit of the doctrine. In the judgment of *Balwant Rai*, the Court held that the corporate veil can be pierced only when “it is evident that the company was a mere camouflage or sham deliberately created by the persons exercising control over the said company for the purpose of avoiding liability”. This is similar to the concept of sham that has been mentioned in the *Prest* judgment.

The issue here lies as to the concept of sham and what it constitutes. It is argued that there can be two meanings of sham. It can either mean the ‘economic reality’ or the ‘impropriety’. Sham transactions are considered separate from fraud and evasion transactions. In the case of ***Snook v. London & West Riding Investments***¹⁰, the Court held that sham were actions which gave third parties rights on the face of it. Therefore, it is a false notion of rights given to third parties; rights that are non-existent.

Therefore, the Indians Court must identify the ambit of a sham transaction. In the case of ***Vodafone International Holdings v. Union of India***¹¹, sham was discussed in relation to tax evasion. The Court held that- “Once the transaction is shown to be fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also for tax evasion, the Court can always lift the corporate veil and examine the substance of the transaction.”

Therefore, through the judgment, it could be inferred that when a transaction is made to avoid tax at the cost of the interests of third parties such as the shareholders then such a transaction would be known as a sham transaction. Although, the Court further referred to sham as an entity other than a transaction, while explaining the actions of a wholly owned subsidiary on its holding company. Therefore, this judgment cannot be relied upon as it constitutes two meanings of sham.

⁸ 2014 LLR 1009

⁹ Supra Note

¹⁰ [1967] 2 Q.B. 786

¹¹ (2010) 235 CTR (BOM) 15

In the case of *Juggilala Kamalapat vs Commissioner of Income Tax*¹², the Supreme Court held that the Court could pierce the corporate veil if and when the company is being used to commit fraud, tax evasion or any other form of fraud.

Understanding the landmark cases, it can be believed that Supreme Court has often not considered the *Balwant Rai* case and thus, despite the limited grounds mentioned in the judgment, Indian Courts have failed to follow the same. Seeing the wave of ignorance regarding the *Balwant Rai* case, it could be safe to assume that the concept of sham has been lost, and therefore, cannot be considered as a ground for lifting the corporate veil.

Unfortunately, there has been no clarity on the topic and therefore, the confusion seems to prevail.

¹² 1970 AIR 529

CHAPTER IV: REVERSE PIERCING OF CORPORATE VEIL

Reverse piercing shifts the liability of the shareholders and holds the company liable for their individual actions. This is used as a way to pay off the debts by the creditors. This doctrine was established in the United States¹³.

Reverse piercing can be distinguished into Inside piercing and Outside Piercing. This depends on which party wishes to lift the veil. Inside piercing is performed when the members or directors of the company receive a benefit or a liability of the company. Inside piercing is for the benefit of the company.

Outside piercing is adopted by third parties or outsiders to satisfy their debts. Here, the third parties pray for relief against the actions of the debtors by holding the company's assets.

This theory can be seen in the case of *W.G. Platts Inc. vs Platts*¹⁴, where there was an issue of marital dispute over property. The Court held that the plaintiff could impose liability on her husband's company to satisfy the debts as mentioned in the divorce decree. The Court gave this judgment since the company was an "alter ego" of the respondent. A company can be called an alter ego of a dominant shareholder. This is because the shareholder controls the management of the company and partly owns the company as well, although not wholly. This was also mentioned in the case of *Trossman v. Philipsborn*¹⁵.

In another case, *GM Leasing Corporate vs The United States*¹⁶, it was held that the company was an alter ego of the taxpayer and therefore if he failed to pay taxes, the company would hold that liability. Here, the reverse piercing was applied.

In India, the courts were of the opinion that the liability of a shareholder must not be imposed on their company. The Courts did not completely accept the concept of alter ego. In the case of *A.K.Khosla v. T.S. Venkatesan*¹⁷, the Court held that a company being a juristic person could not have mens rea since it has no mind of its own. Therefore, it cannot be punished for

¹³ Evan Zhang, Debtor, 463 B.R. 66 (S.D. Ohio)

¹⁴ 73 Wn.2d 434 (1968)

¹⁵ 373 Ill.App.3d 1020

¹⁶ 429 U.S. 338 (1977)

¹⁷ 1991 (2) CHN 321

the acts of its shareholders. The view of this court was confirmed in the case of *MV Javali v. Mahajan Borewell Co*¹⁸ by the Supreme Court, but with slight change. Eventually, it was laid down by the Court that mandatory sentence of imprisonment and fine cannot be imposed on a corporation. In such a case, fine would be the only punishment. However, the courts were against the concept to hold a corporation liable for the debts or fraudulent acts of the shareholders.

Their stance eventually changed in the case of *Standard Chartered Bank v. Directorate of Enforcement*¹⁹. In this case, the Supreme Court applied the principle of reverse piercing by holding the company accountable for the debts and liability of the owners of the company. In the famous case of *Iridium vs Motorola*²⁰, the courts acknowledged the concept of alter ego.

Due to the hike in the number of white collar crime cases, it is essential for the Courts to understand this concept of reverse piercing of a corporate.

The doctrine of the lifting of the corporate veil is an exception that achieves the ends of justice and fairness. Companies were given the benefit of separate legal entities for their protection and growth, but have been often misused the benefit for deceptive practices. In these situations, the courts should adopt to reverse piercing of the veil for greater good and justice.

In the case of *Shamrock Oil & Gas v. Ethridge*²¹, the Court was of the opinion that, “the mere abstraction of the corporate entity should never be allowed to bar out and pervert the real and obvious truth.”

¹⁸ (1998) 230 ITR 0001

¹⁹ AIR 2005 SC 2622

²⁰ (2011) 1 SCC 74

²¹ 159 F. Supp. 693

FINDINGS

Analysing the case laws mentioned above and the various research papers and articles, it is evident that there are certain flaws in the system. There are many High Court judgments that contradict each other on the same set of principles and rules. This makes it evident that there is no uniformity regarding the concept of corporate veil being lifted in India. Although the practice has been prominent for many years, the application in certain cases have failed the principle of separate legal personality of a company entirely.

The ground of public interest has not been defined properly in any case and therefore, it leaves room for ambiguity. The courts have referred to foreign judgments as persuasive value, but have failed to recognise the concepts in entirety.

“Sham” has not been defined either, and the definition laid down has often clashed with the concept of fraud and evasion.

This level of clarity appears to be lacking at the Supreme Court when dealing with issues of corporate legal personality. An approach with careful consideration of the language used would prevent confusion from arising as to whether a special meaning was purported by the usage of specific words or phrases by the Court.

CONCLUSION

The doctrine of corporate veil is not subjected to any rule per se. It depends on the material facts of the matter. It is important that while deciding the cases, the Courts keep in mind, the legal personality of a company.

There are various grounds such as fraud, facade or sham, group enterprises, and unfairness, which are considered by the Indian Courts for piercing the corporate veil. These grounds can be exhausted at times and do not cover the grounds alone. The ambit is huge, yet limited and flawed.

The Judiciary believes that veil must only be lifted in rare cases and when it can be proved that there is a civil or criminal activity committed by the company. The Courts have contradicted their own belief several times and lifted the veil when it was not necessary. Apart from this, the Courts have laid down various grounds under which the corporate veil can and cannot be lifted and these grounds have been vague in nature.

The ambiguity of the concept of public interest makes it difficult ground for lifting the veil since there are many factors that must be considered, but have not been laid down anywhere in the Indian courts. This would eventually hamper the growth of businesses as investors would be uncertain to invest their money into new ventures.

SUGGESTIONS

1. The legislation must create a more reformed system where it is for corporations to have their headquarters outside the country.
2. Further, there must be provision where it is necessary for companies to report to the Ministry so that the activities of the company are under surveillance.
3. There must be a principle laid down by the Judiciary where it can be calculated on what basis the corporate veil can be lifted.
4. The grounds under which the corporate veil can be pierced must be explained in entirety so that the application of the same is not contradictory.