



The emerging theory of reverse piercing of corporate veil: Its implication and impact

Monalisa Chandra

Research Scholar, Department of Law, NLUJAA, Assam, India

Abstract

A company has its own separate legal identity which is quite different and distinct from its members i.e. Directors, shareholders, etc. It is the stepping stone of any kind of corporate governance. There could be arising of various legal or financial issues that cannot be handled individually i.e. in case of limited liability of any individual a corporate body is required to be in existence. It is because whenever there is an abuse of limited liability of any individual within the corporate entity there is always a hidden selfish motive or goal involved. So to find out the real character behind this selfish motive the "doctrine of corporate veil" comes into existence. It is a common immunity or shield that has been provided to a corporate entity which protects it from such selfish natural entities within the corporation. This concept is widely used and accepted. But the separate entity is a corporate rule and its veil must not be usually lifted, rather it must be generally lifted to find out the culprit. It is reinforced by Legal Authorities, practitioners, and jurists. This concept is called "lifting of the corporate veil". Generally, lifting of the veil is a one-way process and is very common in India as well as abroad since the probability of various conditions. But sometimes the veil of corporation needed to be reviewed and reversed under special conditions. Such a reversal of piercing is called "Reverse piercing of corporate veil". It is an exact opposite of the forward piercing of the veil. Just like general piercing of the veil, reverse piercing has its values, ethics, importance and process of implementation. In this project, the author will discuss the reverse piercing concept and its limitations and approach in Indian Scenario. It is a new concept and is unemplyed in India judicial system and being rejected by the Indian Judiciary.

Keywords: corporate veil, reverse veil, corporate personality

Introduction

To achieve perfect fairness of justice in corporate governance "the doctrine of corporate veil piercing" may be forward or reverse came into eyes of jurisdiction. Any corporate body i.e. the company itself has the status of legal entity that has a separate identity and has access to corporal justice, in case of torts or nuisances done by any natural person. The real person can be held liable for offenses within the corporation. However, it was not so easy to find out the real offender so to achieve real justice was not feasible. Thus to achieve real justice the courts adopted many doctrines within a period as measures to prevent corruption from the corporation and misuse of any kind of protection for unethical usage. The separation of legal entity in form of the corporation has always protected the economic growth of that governance and if any natural entity is found liable and tries to escape from his liabilities, the court either helps the corporation or the individual whoever is liable by piercing either in the Traditional way or the reverse way.

In a traditional way of piercing, the creditors of any corporation will try to hold the shareholders as liable for any debt that has occurred in the corporation. But in reverse piercing, the shareholders will attempt to hold the corporate liable of the debts that have occurred. The traditional way of piercing is very common in practice and is well established but on the other hand the reverse piercing is not very common and has generally been rejected by the Indian judiciary. But it is very common in outside of India, mostly used by governments, e.g.

GM leasing Corporation Vs US.

As seen the piercing of corporate veil is the most confusing and illustrative concept witnessed by the courts. There has been no codification of such laws in any book of law rather it is merely a common law that has been framed and written to avoid any frauds in the corporate world. To use such theories the judges usually rely on the various theories and must be privileged and not to be abused. There is a basic creditor, corporate and shareholder relationship arrangement in the form of Contract. There must not be a "Breach of Contract" otherwise the veil of incorporation will come into play.

Given Below are the conditions when the courts will supervise and justify if the veil needed to be removed partially or completely

- If there is a common partnership of stakeholders, shareholder and the directors.
- Does a Holding or its Subsidiary own maximum stock or if any individual exists who holds the stock of both the companies?

- Does a Holding corporate is financing its subsidiary or if the subsidiary is allowed to take credit from its parent company?
- Is the Capital of Corporation adequate?
- Does the Holding Corporation pay a salary to its subsidiary corporation daily?
- Does any company have employees or if it is just used as merchandise to buy or sell goods and earn a profit?
- Does the company have assets or it uses it to pay income and bear expenses of the company?
- Is the corporation running as a personal gain and profit mechanism?
- Does the corporation maintain books of records?
- Are there meeting at regular intervals taking place i.e. Board of directors meetings, corporate meetings, minutes of meetings, etc.
- Is the corporation insolvent?
- Is there any particular individual who is having special powers and control over a corporation?
- Is a particular corporation is maintaining other corporations?

It is most often seen that the holder or the parent company usually dominates its subsidiary company and controls overall operations as if the subsidiary does not exist. It is rather a part of its parent company. The natural person who runs the holder company i.e. the directors or shareholders usually tries to commit fraud in the domination against the creditors. This is an injury to the creditors hence it forms an essential element of "Piercing of veil".

Corporate Veil and Its Lifting

The Doctrine of piercing of corporate Veil was first seen in the landmark judgement case of Solomon v Solomon and Co. From 1907 till 1966 the courts started implementing the idea and concept of piercing of corporate veil. This concept was used in the case where some economic benefits were involved along with the finding out of the fraudulent entity and actions within the corporation. To apply this concept corporate needed to be declared as a "Separate Entity" which means any company should be considered as a separate legal identity or an artificial person. Since the corporation has been formed by a set of rule, regulations and obligations thus it is not a natural person, hence it cannot be held liable for any kind of liability that has been done by the natural person within the corporation by the conductance of fraud. The fraudulent person will try to conduct torts for his gains and will try to take advantage of the separate legal identity of the corporation and enjoy the liabilities of the company. So to avoid such an act, the concept of "Corporate Veil" was introduced. It was enshrined in the law that any shareholder, director or stakeholder and the company to which he belongs are two different personalities in the eyes of law. A shareholder is considered a natural person whereas the company as the artificial person who had its rights and liabilities. Thus to separate both the artificial and natural entity within the corporation "the veil of the corporation" came into existence. Whenever there is a witness of liability the court can partly or completely disregard this veil of incorporation which is termed as "lifting of the corporate veil".

Terms Related to Corporal Veil

- **Separate Legal Entity:** A company has been derived from various sets of rules regulations laws and procedures and has been given a status of separate personality that is not natural but that has been brought up by natural persons. Hence the status of a company does not exist in reality rather is an artificial person. But some rights and liabilities are enjoyed by the corporation with the person in contract as:
 - a. A corporation can sue and be sued.
 - b. There is a contract between the company and the shareholders and there must not be any "breach of contract".
 - c. There must be some liabilities of shareholders.
- **Holding and subsidiary company:** Any Company which is holding 80% or 100% of total shares is called a holding company. It is also referred to as "Parent Company". Any corporation that holds less than 5% of total shares is called a Subsidiary Company. The directors of the holding company usually try to control and dominate the subsidiary company.
- **One Person Company:** It is the type of company where there is only one shareholder in maximum. It is defined under sec-2(62) of the Indian Company Act 2013.
- **Corporate Personality:** After the company has been incorporated then it becomes a separate legal entity and is distinct from its members.
- **Mens Rea:** A company is an artificial person whenever there will be an act of crime there will be always a directing mind the will of the company. Thus the directing mind has a criminal intension and the company may be found guilty of a criminal offense. But since the company is an artificial person company cannot be charged with criminal cases and be sentenced to imprisonment. Only fine can be imposed.

Principles of Veil of Corporation

- There is a partition between the members and the corporation. If a company is registered under the Companies Act 2013, then all of the dealings of the company with other companies will have to be done in the name of the company or else the members of the company will be disregarded. Whenever business debts are occurring in company owners are not liable for it i.e. if a corporation runs short of funds, then creditors cannot claim their assets from the company to fulfil their debts. Also, nobody in a corporation can be sued personally i.e. an employee or a shareholder cannot be sued personally. This concept of personal limited liability is called a veil.
- In the year 1857, in case of *Salomon Vs Salomon & Co Ltd.* it was held by the House of Lords unanimously that a company is a separate legal person and is different from its shareholders. In case of solvency and liquidation of assets, the unsecured creditors were left with insufficient debentures and so on the claim the court said that the company's existence was valid and the business of the company belongs to the company itself and not to Salomon.

In India, the first case was observed in Calcutta High Court In *Re., Kondli Tea Co. Ltd* where the court rejected the plea of the shareholders in terms of “ad valorem” duty. It was held that a tea estate is a separate person and it did not belong to the shareholders even though all shares belonged to them. The company will be treated as the agent of the shareholder.

- Another case was witnessed in case of *Macaura v Northern Assurance Ltd*

Why Lifting of Veil?

- To find out and determine the actual character of the company.
- In order of protection of the company if there are tax-related issues.
- When a company is trying to avoid legal obligations.
- When the subsidiary companies act as an agent of the holding companies.
- Whenever it is found that there is a conduction of improper conduct or fraud.

Various Approaches to Lift Veil.

There are four types of the approach used by the courts to use the concept of the veil and its lifting in general and each of this method has been used and imposed in different situations and methods.

- **Peeping behind the veil of incorporation:** This kind of lifting of veil, in general, is done to find out the reach character or identity of the company i.e. to identify the shareholder of the company who is liable and to what extent he holds the company. He might be the controlling Authority of the company and so the court may require finding out the information of that controlling Authority and on receiving of the information the veil can be drawn and the separate identity of the corporation is revealed.
- In case of, *Daimler Company Ltd. Vs Continental tyre and rubber company*, it was asked by the English Based Company that if a certain amount was required to be paid by them to the plaintiff company. Here the Court found out using the veil that weather the company was of Enemy Character.
- **Penetration of the veil of incorporation:** Whenever the court tries to find out the Controlling Authority or the shareholder and impose the responsibilities on them for the acts they have undergone in the name of the company.
- **R.V London County Council case:** here the cinematographer was not allowed to possess the license since the majority of the Authority had business relations with the stakeholders of the enemy state of Germany and its transaction was of the enemy character.
- **Extending of the veil of incorporation:** When two or more companies are acting as a one, i.e. Single Entity and the court will look for the acts they have done unanimously then this kind of piercing of veil comes into role. Here the parent or holding company holds maximum or complete shares its subsidiary company.
- **DHN foods distributors Ltd. Vs London Borough Tower Hamlets:** here the plaintiff complained that there was disturbance caused due to use of land by some other company. In this case the concept of the holding and its subsidiary came into the extent of the piercing of veil.
- **Ignoring the veil of incorporation:** Whenever there is a case of corporate fraud conductance then the piercing of the veil comes into its extreme level and is mandatory to be lifted. If the court finds out that any company is just made to do Frauds and is working for a dishonest approach then the court will ignore the veil.

Gilford Motor Co Ltd v Horne is a famous case of fraud where an employee was held liable of fraud since he had incorporated a company in the name of his wife and the sole purpose was to attract the customers of his previous employer which was against his employment contract.

Despite, all of the above courts have contributed lesser in developing the principle that can help in the governing of the piercing corporate veil. There arises a lot of confusion concerning various factors that even the lawyers, legal jurists, and writers fail to accept and agree that there is a single definition of any corporate entity. Here there arises the plaguing concept of the piercing of veil jurisprudence. In Reality, there is no actual theory that can determine the existence of veil piercing. Several different theories mostly emerged about corporate veil piercing like an alter-ego, corporate entity, inequitable use of corporate firm.

But there are theories just a metaphor and are just on a process of declining as per Justice Cardozo who had already warned so henceforth arises a lot of criticism over such matters. There are various evidential inadequacies upon the use and implementation of these theories. Courts will often advance equitable and public policies concerning applying the corporate veil piercing. There are different types of problems that has different ways of application but only a few sets of rules have been made and implemented to almost every case i.e. applying the corporate entity principle and regarding a corporation as an entity or not. And in this concept, there lies a great confusion because many different cases have different situation and are often treated singly. This approach creates a lot of confusion. And this confusion is creating plague in the courts and its multiplying with issues if any owner wants to seek actual justice or real benefit of his own. The courts have different views on the disregarding of the corporate entity. Usually, it is in a view of "an alter-ego" i.e. any corporation that has been used instrumentally just in case of transaction but without regarding as a separate entity. The main approach of the veil of incorporation is just to get an "equitable result". But with a new era and bigger problem and confusing states of corporal issues, the concept of Reverse Piercing of the veil has emerged.

In this concept, the corporate parties who are the "insider" as well as the third party or the "outsider" have similar opportunities to claim their liabilities from the corporation. In the outsider concept, the third-party creditor can claim his liabilities from the corporation or allow recovering of all the debts occurred from the corporation or its subsidiaries. This concept has been rejected on many occasions but it has its benefit since it gives importance to the interest of the plaintiff, or the innocent shareholder and corporate creditors. There is a growing trend in this new concept of Reverse Corporate Veil Piercing. Since, it will balance all the needs of every involved parties those who require Corporal Justice.

Here, we shall discuss this new trend and learn how it is different from the general veil piercing. Also, we will analyze the emergence of this concept concerning Indian Scenario and why is it least used in India.

1. Reverse Piercing of Corporate Veil.

The Doctrine of "Reverse Piercing of Corporate Veil" is relatively a new but controversial concept in the area of corporate law. It was considered problematic owing to the situations where a corporation which has multiple shareholders. The Reverse Piercing of Corporate veil refers to the concept when any creditor or the shareholder of the corporation usually attempts the corporation liable for debts of the shareholders. Unlike general Piercing, the reverse piercing requires only two analyses i.e. the domination analysis (the concept of alter-ego) and promotion of fraud or injustice. Also, some states refer to the third type of analysis i.e. the concept of revenue corporate veil. The third-party plaintiff tries to seek payments or debts owed to him by the corporation.

Domination is when any owner uses a corporation to achieve his personal goals. This concept is also considered as Alter-Ego which means that the domination of a parent corporation over its wholly-owned subsidiary is not the issue rather the action of the Corporation. Most of the cases of the Reverse Piercing of the Veil are due to such closely held companies. Certain fact resulting in Veil piercing in such closely held companies is:

- There is the absence of corporal formalities
- There is an issue of inadequate capitalization
- Extensive communication of funds
- Overlapping of ownership and directorship along with shared office address

For Domination there must be an element of Fraud too.

The Concept of Reverse Piercing of Corporate veil emphasizes the relationship between the corporate owner and the corporation, especially for the holding and subsidiary company. While the Traditional piercing of Corporate Veil draws a line between the two and this line always exists. This line brings in the concept of "Artificial Personality" of any corporation which is always different from its stakeholders. On the other hand, the reverse piercing of corporate veil strikes this concept and identifies both the corporation and its members as "Single Legal Entity" thus the legal separation of entity vanishes.

Thus there lays a conflict in the judiciary that whether this line which virtually exists must exist or not.

Outside Reverse Piercing is the concept in which the plaintiff or the third party who is an outsider can seek the claim after the piercing takes place and can impose required liabilities upon the corporation and can satisfy the debts that have occurred. This concept is used when there is a liability by the subsidiary company due to the debts caused to its parent company. It has been witnessed in the famous Landmark Case in *Kingston Dry Co v Lake Champlain Transportation Co*, the plaintiff here is the Kingston Dry Dock who had repaired the ship that was owned by the subsidiary of the defendant company i.e. Champlain. It was Champlain, not its subsidiary that has requested for repair and thus agreed with Champlain. Both the parent and it is a Subsidiary company that had the same board but they took decisions independently. After a Default occurred Kingston attached the boats to its Subsidiary overcome the debts by Champlain.

"The court on trial initially accepted the plaintiff's verdict but later on the judgment was reversed stating that any subsidiary company can never be held liable for the debts that have occurred for by its holding company if it is possible then it is very rare. Thus limiting the scope of Reverse veil Piercing. This Decision remained for 30 years.

Again another case was seen in *W.G Platt's Inc. V Platt's*, in which the plaintiff who was the wife of the respondent imposed liabilities on her husband's Company to satisfy her assets as per the "decree of divorce".

Reverse Piercing of Veil Evolution Indian Scenario

This Concept of Reverse Piercing of Veil was not universally accepted by the judiciary as in practice unlike in the other countries. While, other countries have accepted this concept based on the theories as proposed and interpreted by international courts. But in India, this kind of jurisprudence was virtually unheard and mostly the

courts were reluctant in using this concept and bluntly rejected it. It was not implemented until the year 2005 when the courts have witnessed a large number of cases where the corporation was charged to be liable by the stakeholders or the third party and they demanded justice under criminal prosecution.

It was first witnessed in the Case of *A.K Khosla v T.S. Venkatesan* in which as per criminal law two prerequisites would be helpful in the prosecution of a person. First is men's rea, as it's merely a juristic person, not a natural person and it has been made by a set of laws and procedures hence have no body or mind of its own and so it cannot be imprisoned. Secondly, the act of mens-rea by the corporation and that cannot be generated by a company. This same view was implemented in the case of *MV Javanli v Mahajan Borewell Co.* but with slight modification by the Supreme Court, which stated that if there is a criminal act by the company then the company cannot be imprisoned or sentenced but fine can be imposed on the corporation. Finally, there was a Landmark Judgment that was taken in the case of *Standard Chartered Bank v. Directorate of Enforcement* the Apex court finally held the corporation liable and can be prosecuted and punished for the act and offenses with some imposition of fines, regardless of the mandatory punishments. Here, the Standard Chartered Bank was prosecuted for violating the rules and regulations of FERA Act 1973. This Judgment marked the stepping stone of Reverse piercing of Veil in Indian Courts.

Reluctance of Indian Courts and Vicarious Liability:

The concept of Alter-Ego, in general, is that when individual controls and acts as directing the mind of a corporation then the directing mind will be accused if there is a hidden profit involved. A corporation can also be considered as an accused person. But this concept has been considered unacceptable in Indian Courts stating that a company cannot be liable but a director's or officer's act making them liable. On this basis of "principle-agent" principle there is no need of forming a separate doctrine, therefore, this principle was of vicarious liability.

1. The Approach by Courts and Application of Reverse Corporate Veil Since it is a whole new concept in the judiciary so it is just a concept based process to see the "legal reality" and provide the most accurate judgments accordingly. Three basic approaches have been followed by the courts to apply the concept of Reverse Piercing of Veil are

The doctrine of Strict Adherence of Separate Legal Entity: As per the application of such an approach it was stated by the court that there will be no exception for this doctrine. The basic concept of this approach is that the courts suggested that no individual in any corporation can enjoy the rights of the corporate veil and can use it for his benefit

Application: The application of such case has been witnessed in the famous Landmark case of

Boggs v Blue Diamond Coal co in which the plaintiff had filed a suit against the Holder company negligence of maintenance coal mine by its subsidiary company. The concept of reverse piercing was strongly opposed by the courts and was also criticized strongly.

As per the analysis: Facts that were not taken into consideration, firstly 100% stocks of the subsidiary company was owned by its parent company. Secondly, the subsidiary sold all the resources (coal) to its parent company. Thirdly, all funds were provided by the parent company to its subsidiary to meet the daily expenses. Final and the most important fact that was not considered was that the parent company had taken all the responsibilities of its subsidiary to ensure the safety of its mines.

This case is still under approach.

- **Traditional way of lifting the corporate veil:** As a matter of facts courts are negligent to apply this concept in the reverse lifting of veil and this approach is mostly criticized as well as appreciated. The courts believe that new corporations require modern principles and approach to move a step ahead in right direction. It was a matter of consideration that they took this concept that it is not a one sided or unfair way to provide justice. But since there are now definite standards available so no decisions can be made on definite factors

Analysis: In *Crum v Krol*, case the personal damage claim was asked by the company owner to his wholly owned subsidiary company. But the court held that the corporation since was wholly owned so essentially the alter-ego to the owner.

The approach is unpredictable and is random. Since this concept is confusion in itself then application of this theory here is inappropriate.

- **The Balancing of Equitable and Public Policy:** Whenever there is requirement of equity and public policy for the benefit of the corporate owner the courts will always pierce the corporate veil. If this approach is accepted then there will be a transformation of the general veil piercing into a complete different equitable doctrine. This approach is merely based upon the balancing of relevant interest. It is always necessary to have a public policy to inculcate such approach.

Analysis: Barium Steel Corporation v Wiley here the owner of the corporation agreed upon entering into the agreement of the corporation to purchase all of the stocks of the defendant. There was a breach of agreement on the side of the defendant causing the injury to the company's subsidiary. The defendant defended that the owner did not suffer any damage. The court initially made judgement on the basis of Separate legal entity but later on held that the corporate and its legal shareholders are same.

There is complete refusal of applying the Reversal of corporate veil under this concept. A better approach is needed.

Why Reverse Corporate Veil?

If we consider the fact as stated and the analysis, it is observed that there are pros as well as cons relate to the application of reverse corporate veil. If we compare the con with the pros then it is the con that outclasses the pros. There has been a considerable amount of injury to the creditors, debtors, and stakeholders when it comes to the application of the reverse lifting. There are about thousands of shareholders who are greedy for money and will try to lift the veil and take money out of the corporation thus proving this doctrine as problematic. Whenever a third party is involved there is always harm that is caused to the third party. It was unanimously agreed by the courts all the required inputs and outputs are met to apply this concept, but it is irrelevant to find out the direction of lifting.

The main objective is to find out the frauds in the company and get fairness by judging both directions, so the reverse lifting is as much as important as the forward lifting of the veil. Still, none of the courts have given a positive response over the employability of the doctrine because it is still in a nascent stage. This doctrine can be implemented when all the possibilities come to an end. With the advent of time the courts will develop all kinds of tests to find out the applicability of the doctrine.

HYBRID Approach

To find out the resolution of this problem associated with reverse lifting of the veil as a new "hybrid" approach has been proposed. According to this approach there will be a certain degree of identity between the corporation and the owner who will try to claim an application under this doctrine.

For Example, A runs a medical store. He incorporates another private company AA Co. Pvt Ltd. The Directors of that company is his wife and relatives and all of the shares are divided among them. Now if A claims his money under this principle from the company then A will be declared insolvent.

Establishment of the degree of identity-

A is the gives funds to the company for all the expenses and use as a personal item The Directors had no corporal dealings or meetings and also did not get any dividend from the company as shareholders Assumption: AA Co. Pvt Ltd. is an "alter ego" of A. The concept of reverse lifting can be awarded.

Conclusion and Suggestion

The concept of "reverse piercing" in India is not guided by the principle of vicarious liability and is diluting the constructions of the Company's Act 2013. The Separate legal concept is an exception and is based on the interest of public policy. Thus this doctrine is at a nascent stage but has percolated in the Indian jurisprudence. The hurdles that arise due to the corporate criminal liabilities can only be fixed if the provisions are made mandatory. But this doctrine of reverse piercing cannot be applicable in all circumstances. The concept of Separate legal entity does not address the problem.

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