

CORPORATE VEIL AND LIMITED LIABILITY COMPANY: AN ANALYSIS

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Abstract

Nowadays, company is considered as separate legal entity. The concept was initiated to fund big projects as they require more finance, but in present time the term is used in it's widest sense. One such type of company which protects shareholders risks is Limited Liability Company, or company limited by shares. In limited liability Company, the creditors can only look to company's assets for their claim and personal assets of members of the company cannot be claimed against credit. If the company has committed any fraud or other illegal acts, the same cannot be then seen as corporate personality, and members are examined personally in order to identify the person liable. This act is called lifting of corporate veil. There are many provisions in the Companies Act, 2013.

The paper will examine different theories of corporate veil, position in United States and United Kingdom, and will also reply on some case laws. The paper will also discuss convergence in concept of companies and laws dealing with such concepts which have been seen since the emergence of the concept of companies.

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INTRODUCTION

A company having the liability of its members limited by the memorandum or article of association, to the amount if any, unpaid on the shares respectively held by them is termed 'a company limited by shares'. Such a company is called Limited Liability Company. The liability of members can be enforced at any time during the existence and also during the winding up of the company. The rule of limited liability is generally understood to concern the scope of shareholder's liability. If shareholders can be found personally liable as a general rule, the principal can be extended to contract creditors or employees.

A company is a separate legal entity, the most important ingredient that flows from the separate legal personality clause is that of limited liability. The concept was invented in the 17th century. As the capital needed to finance the largest projects grew, and along with it the necessity of raising money, investors were reluctant to invest because of the risk involved in essentially guaranteeing the entire debt of the business entity. The main importance of the limited liability concept is that it protects the company and its members, as well as to facilitate commercial ventures in which the company may be interested. Thus, creditors who have claims against the company may look only to the corporate assets for the satisfaction of their claims as creditors and generally cannot proceed against the personal or separate assets of the members. This has the potential effect of capping the investors' risk whilst, consequently, their potential for gain is unlimited¹.

Nevertheless, there is a major exception to the general concept of limited liability. There are certain circumstances in which courts will have to look through the corporation, that is, lift the veil of incorporation, otherwise known as piercing the veil, and hold the shareholders of the company directly and personally liable for the obligations of the corporation.

LIFTING THE CORPORATE VEIL

In the event of fraud, illegal or improper acts committed by the company the facade of corporate personality have to be removed to identify the person guilty and such is known as lifting of corporate veil. The court may lift the corporate veil only under Statutory Provisions or Judicial Interpretations.

¹ Gower and Davies Principles of Modern Company Law (7Ed) London Sweet and Maxwell (2003) at 176.

The veil may be lifted as per express provision of the Act. The Companies Act, 2013 provides for the following cases under which the director or the member of the company may be held personally liable:

- Section 34 & 35 – Mis statement in the prospectus.
- Section 39 – Failure to return application money.
- Section 12 – Misrepresentation of name
- Section 219 – For facilitating the task of an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company.
- Section 216 – For investigation of ownership of the company.
- Section 339 – Fraudulent Conduct.

Legal Doctrines Which Constrain Limited Liability

A. PRODUCTS LIABILITY

Products liability extends beyond the corporate group to reach all the enterprises involved in manufacturing, distributing and selling products that harm consumers. The doctrine seeks to ensure compensation for victims and to allocate losses to the economic activity that caused them². It was developed by the courts for this reason, in response to the needs of modern consumer society, with little thought given to any broader consideration of enterprise principles. Within the corporate group, the cases are clear in holding that a parent who distributes a defective product manufactured by its subsidiary will be liable in products liability. The doctrinal basis for these cases is products liability, without any inquiry into limited shareholder liability and traditional veil piercing analysis.

B. DIRECT PARENT COMPANY LIABILITY

Direct parent company liability in tort for claims that are also brought against the subsidiary. On the surface these are not derivative liability cases at all, for in these the parent is held directly liable for its own torts which pertained to the subsidiary's affairs. However, the tort doctrines developed such as "assumption of duty" or "non-delegable duty" have been widely expanded to provide relief in cases involving corporate groups.

² Restatement (Third) of Torts: Products Liability §1 et seq (1995).

C. 'SINGLE BUSINESS' THEORIES

Several cases have based liability on the operation of a single business by a multi-corporate enterprise operates as a single business, as the modern large business typically does. By looking to the whole business, rather than its constituent separate corporate entities, "single business enterprise" avoids completely a direct discussion of the policies of limited liability. Jurisprudentially, the doctrine could serve as a vehicle to supplant all veil piercing law for corporate groups

D. AGENCY AND 'QUASI AGENCY'

A number of cases using the language of agency to find parent company liability for subsidiary conduct in these agency cases the courts purport to use traditional theories of agency to attribute liability of one corporate entity to another. However, this is a misapplication of traditional common law agency which, at its core, turns on consensual agreement for one party to act in the interest of another and, in the right circumstances, to have the legal capacity to take legal actions and incur liability for the other. When courts speak of "agency" in attributing subsidiary liability to a parent corporation, they are usually not applying common law agency doctrine, but rather a variant of veil piercing that is perhaps better called "quasi-agency".

CURRENT POSITION IN OTHER COUNTRIES

UNITED KINGDOM

The doctrine of piercing the corporate veil is apparently in a transitory state in many common law jurisdictions. Current practice by Her Majesty's courts demonstrates that the courts are increasingly becoming as interested with legal and equitable principles as they are with the traditional fraud requirement. In other words, what the Common law courts typically consider is injustice and impropriety. Where this is the case, the only motive of the courts in lifting the veil is the restoration of equity.

UNITED STATES OF AMERICA

The U.S. courts lift the company's immunity in a variety of situations. The piercing concept does not come from the laws of the states or federal government but it is a judicial creation which varies from state to state. The scope of abuses relating to groups of companies is the

most popular reason for which the courts disregard the separate entity principle. If a controlled company is organized as a mere tool in the hands of a parent enterprise and the separateness of the two corporations has ceased, one can assume that holding only the subsidiary corporation liable for any damages resulting from fraud or dishonesty of the parent company would result in injustice.

CASE LAWS

*DELHI DEVELOPMENT AUTHORITY V. SKIPPER CONSTRUCTION COMPANY(P.) LTD.*³

The court held that the corporate bodies were mere cloaks and that the devise of incorporation was really a ploy adopted for committing illegalities and/or to defraud people.

*WORKMEN OF ASSOCIATION RUBBER INDUSTRY LTD. V. ASSOCIATION RUBBER INDUSTRY LTD.*⁴

Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the SC upheld the piercing of the veil to look at the real transaction.

*SANTANU RAY V. UNION OF INDIA*⁵

In case of economic offences a court is entitled to lift the veil of corporate entity and pay regards to the economic realities behind the legal facade.

*CIT V. SRI MEENAKSHI MILLS LTD.*⁶

Where the veil had been used for evasion of taxes and duties, the court upheld the piercing of the veil to look at the real transaction.

*JOHNSON V. ABBE ENGINEERING CO*⁷

³ (1996) 4 SCALE 202(SC)

⁴ (1986) 59 Comp. Cas.134 (SC)

⁵ (1985) 65 Comp. Cas. 196 (Delhi)

⁶ AIR 1967 SC 819

⁷ 749 F. 2d 1131 (5th cir, 1984)

The parent inspected the subsidiary's plant for conformity to the parent's recommended safety requirements and this was enough involvement to support a finding that the parent was directly liable to the employee injured by a violation of those requirements.

*SOLAR INTERNATIONAL SHIPPING AGENCY V. EASTERN PROTEINS EXPORT, INC*⁸

It was held that a corporation was liable for its commonly owned sibling's shipping contracts because it had acted as the sibling's undisclosed principal. Yet the facts show clearly that this was not really an agency case, but one concerned with piercing the veil to prevent an abuse of limited liability. Both corporations were owned by the same family, and both had identical boards of directors. They operated out of the same address, used the same telex and telephone numbers, the same stationary and sales forms, and the same sales agents. The corporation which had entered the contract had never issued its own checks or had its own employees. In this situation, the court concluded that this was "not just a shell corporation but a shell game". Yet these fairly typical veil piercing facts were here held to justify a finding of agency, with liability based on it, and the case offered no discussion of veil piercing. Such a "quasi agency" doctrine is, of course, not true common law agency at all, but rather another doctrinal tool to fashion specific results when an exception to limited liability is appropriate.

CONCLUSION

The act of piercing the corporate veil until now remains one of the most controversial subjects in corporate law, and it would continue to remain so, even for the years to come. By and large, as discussed in the paper, the doctrine of piercing the corporate veil remains only an exceptional act orchestrated by courts of law. Courts are most prepared to respect the rule of corporate personality, that a company is a separate legal entity from its shareholders, having its own rights and duties, and can sue and be sued in its own name.

As we move from jurisdiction to jurisdiction across the globe, its application narrows down to how that system of the law appreciates the subject. Common law jurisdictions are examples par excellence where the piercing of the corporate veil has gained notoriety, and as the various cases indicate, courts under this system of the law generally appreciate every case by its merits.

⁸ 778 F. 2d 922 (2d Cir 1985)

The above notwithstanding, there are general categories such as fraud, agency, sham or façade, unfairness and group enterprises; which are believed to be the most peculiar basis under which the common law courts would pierce the corporate veil. But these categories are just a guideline and by no means far from being exhaustive.

Also, from the results and discussion on the law limited liability in a company limited by shares it has been clear that there has been a convergence in the application of these laws. Earlier when because of the law of limited liability the managerial personnel escaped liability from the company gradually with the evolution of law there has been a shift and the law as read in books is different from its applicability.

Secondly, because of the incorporation of the company, the company has been considered as an artificial person having a separate legal entity, though the company never had brain or thoughts it was made liable for the acts done by its members, here arose the concept of lifting of the corporate veil which was again a convergence and with it came into picture the vicarious liability of the company.

Therefore the convergence made is essential for today's corporate affairs as the big organizations could have easily fooled the innocent shareholders and escaped their liabilities.