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Piercing corporate veil- moving towards a principled approach



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A company being a juridical entity is run by its agents being its directors or shareholders. As much as directors are supposed to discharge duties only in their fiduciary capacity, yet quite often it is seen that a company is used as a front to shield fraudulent activities. Thus, the concept of *piercing of corporate veil* emerged. The earliest case of lifting of the corporate veil was in *Salomon v. Salomon*, where the House of Lords affirmed the separate legal personality of company from a shareholder. The real idea behind piercing the corporate veil is to determine the people who are in actual control of the company to pin down the real cause for any illegal activity carried on by the company. Ironically, this very phrase finds no mention in any legislation and resultantly, we have to look to judgements to understand the true meaning and purpose of “piercing of corporate veil”.

Over the years, the concept of “piercing the corporate veil” has undergone a change and the jury is still not out as to when can this actually be done. Over the years “piercing of corporate veil” seemed more like a “smell test” i.e. it was upto the courts entirely to decide on the same based on subjectivity and facts of the case alone. However, when the identity of a company is widely acknowledged as a *separate* legal entity, the lifting of its veil tantamounts to temporarily destroying the corporate façade which is fatal to the corporate structure. Thus, to take such an important step which may have serious repercussions, subjective approach in itself is not sufficient. Thus, the need for a principled approach is necessary whereby definite reasons can be penned down rather than only relying on the principles of justice.

We discuss below the case of *VTB Capital Plc v. Nutritek International Corp & Others*¹, whereby the English Court of Appeal has clarified the principles upon which the corporate veil can be pierced. What sets this case apart is the fact that the judgement in this case came out in the year 2012 and proved that courts are now moving towards a principled approach for “lifting of corporate veil” whereby mere notion or belief of injustice shall not comprise enough reason to “lift the corporate veil”.

When can corporate veil be pierced according to English Law subsequent to the judgement in VTB Capital Plc v. Nutritek International Corp & Others?

Brief background of the case

The case pertained to VTB lending money to Russagroprom LLC (“LLC”) to fund the acquisition of six Russian dairy plants and associated companies from Nutriek. The LLC defaulted on its loan and VTB was left with a considerable shortfall after

¹ <http://www.bailii.org/ew/cases/EWCA/Civ/2012/808.html>



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realising its securities. VTB contended that it had entered into an agreement for grant of loan to LLC based on the fraudulent representation that Nutriek and LLC were under the same management and faulty valuation report of dairy companies.

Among the many claims sought by VTB, one such was to amend the Particulars of Claim to allege that once the “corporate veil” of the LLC is pierced, those who controlled it and Nutriek, in this case being Marcap BVI, Marcap Moscow and Mr Malofeev, shall also become the parties to the facility agreement.

The House of Lords discussed *obiter dicta* in reference to the case of *Salomon v. A. Salomon and Company, Limited* that the corporate veil can be pierced to identify the company with those in control of it. In cases in which that is done, the authorities show that it will or may lead to the granting of remedies against the company which, veil piercing apart, might appear in principle to be available only against those controlling it; and, equally, against the controllers when they might appear in principle to be available only against the company.

The House of Lords passed its judgements based on the following grounds:

1. Analogy with law relating to undisclosed principals – this contention raised by the counsel for VTB was rejected on the basis that no undisclosed principal can be sued or sue unless it has granted express or implied authority to its agent to enter into a contract. Considering the facts of the present case, the House of Lords could not draw any parallel with this principle of law. It was also stated that, to consider a stranger as a part of a contract, would be possible only in some exceptional cases, the present case being not one of them.
2. Although courts can in any appropriate case pierce the corporate veil, however, this can be done only in consequence to a holding either that the puppet company was a party to the puppeteer’s contract, or vice versa.
3. The House of Lords also reasoned that there is no logic requiring the corporate veil to be pierced only because consequently, the revelation of the true facts will show Marcap BVI, Marcap Moscow or Mr Malofeev to be parties to either of the relevant contracts. It was opined that such a step would at most prove that VTB was induced by them to enter into contracts by mis-representation. It was viewed that the suggestion to pierce the corporate veil in the present case was only an appeal to decide that the three defendants were original, additional parties to the contract and would require the court to determine the same based on pure fiction.
4. The House of Lords referred to the “veil piercing” principle as a limited one which provided a practical solution in certain factual cases. The House of Lords



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stated that in certain cases corporate veil was pierced, only because the same was just and convenient. But none of these cases treated the company's identity as other than a legal person which is separate and distinct from its puppeteers. This would have been in direct contrast to the principles laid down in Solomon vs. Solomon. Thus, there was no precedence to treat the puppeteer as a party to the contract to which he was never a party.

The House of Lords on the basis of the discussion above did not allow amendment to the Particulars of Claim and rejected to pierce the corporate veil of LLC.

The position after VTB ruling

Being a recent verdict, the VTB ruling stands out as the House of Lords refused to pierce the corporate veil only on the basis that the three defendants were indirectly the parties to the facility agreements entered into. On the grounds of just and equitable alone, the corporate veil cannot be pierced. Thus, the doctrine of privity of contract was upheld. However, the House of Lords fell short of ruling when can the corporate veil actually be pierced.

Indian scenario

Unlike English courts, the Indian scenario is based on statutory requirements to pierce the corporate veil. One of the oft referred case in Indian history is that of Life Insurance Corporation of India v Escorts Limited², whereby the Supreme Court stated that:

“the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be in reality, part of one concern.”

Thus, the Apex Court opined that lifting of corporate veil is permissible only to the extent of findings required under a particular statute.

This case was referred to in Walnut Packaging Private Limited vs The Sirpur Paper Mills Limited And Another³, whereby the Andhra High Court referred to cases of Kapila Hingorani v State of Bihar⁴ and Singer India Limited vs Chander Mohan Chadha & Ors⁵, whereby, it can be established that for courts to pierce the corporate

² 1986 AIR 1370

³ <http://indiankanoon.org/doc/1524768/>

⁴ <http://indiankanoon.org/doc/1255780/>

⁵ <http://indiankanoon.org/doc/1134266/>



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veil of any corporate it has to be established that doing the same will be in the larger interest of public good.⁶ The quantum of public good was taken to be “*an iota*”. In the same case, the Hon’ble Court also held that the principle of corporate veil piercing of a holding company shall not be required or available when its subsidiary company is ordered to be wound up.

Another facet of piercing of corporate veil was discussed in *Krishi Foundry Employees Union vs Krishi Engines Ltd*⁷, whereby the Andhra High Court stated that if the company uses other concern; a firm, society or association, only to facilitate evasion of legal obligation like payment of direct or indirect taxes or denial of statutory benefits to workmen, the Court has to disregard the separate legal entity of the company. In such an event the question before the Court is one of company law, and the corporate personality of the company is of secondary importance.

Our viewpoint

The viewpoints in the case of piercing the corporate veil is different in English and Indian courts. While English courts are moving towards a principled approach whereby mere apprehension of deceit or mis-representation shall not suffice, Indian courts are still emphasizing on larger public interest. The VTB case proves there should be a definite link or involvement in the contract or agreement on the basis of which sham has been alleged. Thus, the principle of privity of contract is still a vital point of consideration. Whereas, in Indian cases, if the case so demands, corporate veil could be pierced. As dynamic that the principle of piercing the corporate veil is, it is still a wait and watch game for all corporate law followers to pen down an exhaustible list of circumstances, when the corporate veil can be pierced.

⁶ See also *Krishi Foundry Employees Union vs Krishi Engines Ltd* at <http://indiankanoon.org/doc/293842/>

⁷ <http://indiankanoon.org/doc/293842/> . See also *M/S.Yella Constructions Limited vs The East Coast Railway, Rail Vihar* at <http://indiankanoon.org/doc/1332213/>