ABSTRACT

The principle of corporate veil is one of the most controversial topics in the corporate world. This concept is based on the legal principle where the corporate’s personality is different from the personality of its members, shareholders etc., but the façade of corporate veil might be lifted by the courts to determine the liability of the persons hiding behind the veil in case the corporate is found guilty of any offence or fraudulent conduct. This leads us to the question whether the corporates can be held criminally liable or not considering the question that they have been accorded a legal personality by law. Since they are artificial persons, they are incapable of having requisite mens rea to attract criminal liability.

The paper shall discuss about the separate legal entity of a company which leads to the concept of corporate veil and subsequently the doctrine of lifting of the corporate veil. The authors shall also discuss its history and subsequent evolution and the various approaches in form of theories which the courts have adopted while deciding whether or not to pierce the corporate veil. The authors have further discussed the judicial trend followed by the Indian Courts to determine the criminal liabilities of the corporate.
INTRODUCTION

The most fundamental Principle of a company law is its corporate personality. It is on this quintessential and elemental principle that which makes a company an entity which is entirely distinct from its shareholders, promotors, directors etc.¹ Thus, when a company is incorporated, a legal entity gets created, which is separate from its members, employees, shareholders, directors, promotors etc., which has led to the concept of ‘corporate veil’.² The purpose of establishing this doctrine was to provide business efficacy and convenience. The main stimulation behind the formation of a corporation or a company is the limited liability which is offered to its shareholders and because of this limited liability, the liability of each shareholder is limited only what he or she has contributed as shares to the company.

In the doctrine of ‘Lifting the Corporate Veil’, the law goes behind the mask or veil of incorporation to determine the real person or group of people behind the company. The concept of ‘lifting the corporate veil’ has been regarded by the courts and jurists. The Courts according to Gower’s common dictum would lift the veil when the corporate personality of the company is being blatantly being used as a means to commit fraud, improper conduct or where the protection of public interest is of paramount importance or where the sole purpose of forming the company was to evade taxes. The corporation shall be regarded as an association of persons rather than a legal entity when the very same legal entity is used to defeat public convenience, justify wrong or to defend crime.

To have a clarity in the concept of ‘lifting of corporate veil’, corporate personality of a company is required to be understood. The courts before did not affix any criminal liability of the corporates on the ground that being an artificial personality, they are completely incapable of having any

mens rea but later the courts took an altogether different approach wherein through judicial pronouncements they held that the corporates can be criminally prosecuted.

SEPARATE LEGAL PERSONALITY OF A COMPANY

The consequence of attributing a legal personality to a corporation is that it is distinct entity from its members and this “legal personality” is often described as an artificial person in contrast with a human being, a natural person. This clearly indicates that a corporation is completely capable of enjoying rights and of being subject to certain duties which are not same as borne by its members.

The principle of a corporation having a separate legal entity was firmly established in the landmark cases of Solomon v. Solomon & Co. Ltd. In this case, Solomon, who was a sole trader had a flourishing business as a leather merchant, had sold his manufacturing business to Solomon & Co. Ltd., a company which he himself had incorporated) in consideration for all but six shares in the company. He received debentures worth 10 thousand pounds. The other subscribers to the memorandum were his wife and five children who each took up one share. The business subsequently collapsed and Solomon made a claim on the basis of the debentures held as a secured creditor. The liquidator on the other hand argued that Solomon could not rank ahead of other creditors on the ground that both the company and Mr. Solomon were one and the same, in other words that the company carried on business on behalf of Solomon.

The House of Lords on appeal subsequently held that Solomon & Co. Ltd. was not a sham; that the debts of the corporation were not the debts of Mr. Solomon because they were two separate

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5 Ibid
6 Ibid
7 Ibid
8 Ibid
legal entities; and that once the artificial person has been created, "it must be treated like any other independent person with its rights and liabilities appropriate to itself."9

Since, most of the provisions of Indian Law were borrowed from the English Law, it mostly resembles the English Law. Solomon’s case has been the authority ever since in the decisions of the doctrine in Indian company cases.

In the case of Macaura v. Northern Assurance Co. Ltd10, the House of Lords held that the insurers were not liable under a contract of insurance on property that was insured by the plaintiff but owned by a company in which the plaintiff held all the fully-paid shares.11 The House of Lords held that only the company as the separate legal owner of the property and not the plaintiff, had the required insurable interest.12 The plaintiff, being a shareholder, did not have any legal or beneficial interest in that property merely because of his shareholding.13

The Privy Council in a more recent case of Lee v. Lee’s Air Farming14, the doctrine of separate legal entity of a corporation was further supported wherein it held that Lee, could be an employee of the company as a separate and distinct entity from the company which he controlled, so that Lee’s wife could claim workers’ compensation following her husband’s death.15

Similarly, the Supreme Court in the case of Tata Engineering Locomotive Co. Ltd v. State of Bihar & Ors16, stated that a corporation in law is equivalent to a natural person having a legal entity of its own which is completely separate from its shareholders.17 The corporation has its own name and seal, separate assets from its members. The liability of its members extend to only the share capital invested by them, similarly, the creditors of the members would also not have no authority over the assets of the corporation.18

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9 Ibid
10 Macaura v. Northern Assurance Co. Ltd, (1925) A.C. 619
11 Ibid
12 Ibid
13 Ibid
14 Lee v. Lee’s Air Farming (1961) A.C. 12
15 Ibid
16 Tata Engineering Locomotive Co. Ltd v. State of Bihar & Ors. AIR 1965 SC 40
17 Ibid
18 Ibid
Gower has summarized the position, and according to him, the courts have only construed the statutes as “cracking open the corporate shell” when compelled to do so by the clear words of the statute.\textsuperscript{19} Thus, in India it can be observed that at present, that the courts are somewhat cautious and circumspect cracking open the veil.

**EXCEPTIONS TO THE PRINCIPLE OF SEPARATE ENTITY**

Lord Halsbury recognized the separate entity provided there was "no fraud and no agency and if the company was a real one and not a fiction or myth."\textsuperscript{20}

The reason why exceptions exist can be classified into two categories. Firstly, even though a legal personality is attributed to the corporation, it cannot really be treated as natural person as it incapable of committing a crime which requires the existence of *mens rea* unless the Courts determine the intention of the directors or the members.\textsuperscript{21} Secondly, strict recognition of the principle may lead to an unjust or misleading outcome if interested parties can "hide" behind the shield of limited liability.\textsuperscript{22}

The judicial discretion and legislative action also allows the separate entity principle to be disregarded where some injustice is intended, or would result, to a party (either internal or external to the company) with whom the company is dealing.\textsuperscript{23}

**PIERCING OF CORPORATE VEIL**

Lifting the corporate veil, in simple words means disregarding the corporate personality and looking behind the real person who are in the control of the company and where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take

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\textsuperscript{19} Supra note 6
\textsuperscript{20} Supra note 2
\textsuperscript{21} Supra note 2
\textsuperscript{22} Supra note 2
\textsuperscript{23} Supra note 2

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shelter behind the corporate personality.\textsuperscript{24} In this regards the court will break through the corporate veil. According to the definition of Black Law Dictionary, “piercing the corporate veil is the judicial act of imposing liability on otherwise immune corporate officers, Directors and shareholders for the corporation's wrongful acts”.\textsuperscript{25} In the words of Aristotle, when one talks of lifting status of an entity corporate veil, one has in mind of a process whereby the corporate is disregarded and the incorporation conferred by statute is overridden other than the corporate entity an act of the entity.\textsuperscript{26}

Corporate personality of a company, should ordinarily be respected. The whole law of corporations is still based on this basic principle of corporate entity. There are umpteen instances in which the courts have upheld this principle and resisted the temptation to break through the veil. But when the benefit is misused, the court is not powerless and it can lift the veil of corporate personality to see the realities behind the veil. In doing so, the court sub serves the important public interest, namely, to arrest misuse or abuse of benefit conferred by law.\textsuperscript{27}

Thus, it is quite evident that 'Piercing the veil' law exists as a check on the principle that, in general, investor shareholders should not be held liable for the debts of their corporation beyond the value of their investment.

**HISTORY OF THE DOCTRINE OF CORPORATE VEIL**

The doctrine of corporate veil has been originated in 1897 with the Solomon case. Since then it is being followed till the present date.\textsuperscript{28} But during the years, the way the doctrine of corporate veil is followed has taken different approaches. From 1897 to 1966, was called the period of early

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\textsuperscript{25} Black’s Law Dictionary 1168 (7th ed. 1999)
\textsuperscript{26} Supra note 27
\textsuperscript{27} Supra note 27
\textsuperscript{28} Supra note 27
experimentation where the courts experimented with different approaches of the doctrine. The different approaches were tried keeping in view the decision of house of lord in salmon’s case.

From 1966 to 1989 was period where the rules of the House of Lords in Solomon’s case were changed and the lifting of veil was encouraged. Lord Denning in *Littlewoods Mailstores v IRC* stated that "the doctrine laid down in Salman's case has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can, and often do, pull off the mask."

From 1989 to the present date, the doctrine of corporate veil lifting began to be disfavoured by the courts. The classic case which started the trend of disapproving the doctrine is *Woolfsan v. Stratheclye*, Regional Council in which Lord Keith stated that the only situation where a corporate veil could be lifted was where there are special circumstances indicating that the company is a 'mere facade concealing the true facts.' Thus the English court started to take a very narrow view of the doctrine and the judgement of the court of appeal in *Adams v Cape Industries Plc.* There were only three circumstances in which the corporate veil could be pierced. They were:

1) If the court is interpreting a statute or document and the statute itself is ambiguous, it would allow the court to treat a group as a single entity.

2) If special circumstance indicate that it is a mere facade concealing the true facts, the court may lift the veil.

It is an application of the agency principle. Parent companies and subsidiaries are unlikely have express agency agreements and it is even difficult to prove an implied agency. Evidence is required that day to day control was being exercised by the parent company over its subsidiaries.

29 Supra note 27
30 Supra note 27
31 Supra note 27
32 *Littlewoods Mailstores v IRC* (1969) 1 WLR 1241
33 Supra note 27
34 *Woolfsan v. Stratheclye* (1978) SLT 159
35 *Adams v Cape Industries Plc* (1990) Ch 433, at 539D
APPROACHES ADOPTED BY THE COURTS TO LIFT THE VEIL

The courts use the word “veil” as a metaphor but it approaches the practice of lifting the veil differently in different cases. There are four different attitudes which court takes while deciding different cases. These are 'Peeping behind the Veil', 'Penetrating the Veil', 'Extending the Veil' and 'Ignoring the Veil'. The author will discuss each of the approach in detail as in, in what circumstances which approach does the court uses.

1) Peeping behind the veil: This approach is used by court to deal with the information as to who are the shareholders, what is the proportion of their holdings, who are the controllers, and what is their inter-relationship with regard to the control of the company. After knowing the information, the veil is pulled down and the company again becomes separate legal entity. The most important case in this regard is the “Daimler case”. The question there was whether the defendant a British company, should pay the plaintiff, a British registered company, even though all the directors and shareholders of the British registered company were German residents. The lower courts ruled in favour of the plaintiff as the Proclamation against Trading with the Enemy Act 1914 stipulated that 'in the case of incorporated bodies, enemy character attaches only to those incorporated in an enemy country. The House of Lords, however, allowed the appeal on a point of fact that is to recognize the character of the company.

Further examples in which the court peeps behind the veil is one of holding company, wholly owned subsidiary, or associate company.

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37 Ibid
38 Ibid
39 Ibid
40 Ibid
41 Daimler company ltd. v Continental Tyre and Rubber Company (Great Britain), [1916] 2 AC 307
42 Ibid
43 Ibid
44 Ibid
45 Supra note 39
2) **Penetrating the veil:** In second category the courts reach through the veil and get hold of the controlling shareholders personally. The purpose of penetrating the veil is to impose responsibility upon the shareholders for the company's acts and to establish their direct interest in the company's assets. One example of the shareholder’s direct interest is taxation. Other example when veil is penetrated is when there is tendency of war.

In *R v London County Council* a local authority refused to renew a cinematograph license held by a company incorporated in England, because a substantial majority of its shares were held by German nationals and three out of its six directors were Germans. The court upheld the refusal, holding that the control or at least the influence which enemy nationals might exert over the activities of the company in exhibiting films was a relevant matter during wartime. Bray, J. said that it is ‘clearly permissible for the council to consider, when a company is the applicant, who are the persons who control the company.

The approach here is to consider the situation as if the shareholders were to obtain the license in their personal capacity and then to decide whether the company ought to obtain it in its name.

Another recent aspect which is currently in vague is the agency relationship in which court will penetrate the veil. The courts construct the direct interest of the shareholders in their controlled company's acts and property by way of imputing agency relationship between the company and its controlling shareholder, whether a private person or a holding company. Agency is a means of lifting the veil. The main idea of the court behind lifting the veil is to find the responsible person and the courts base their judgement on the

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46 Supra note 39
47 Supra note 39
48 Supra note 39
49 Supra note 39
51 Ibid
52 Ibid
53 Ibid
54 Supra note 39
55 Supra note 39
56 Supra note 39
notion that the principle has manipulated its agent to act in a specific manner, thus depriving the agent any willpower of its own.57

3) **Extending the veil:** A third technique of lifting the veil is by its extension so that it embraces a bundle of companies.58 When a group of legal entities is conducting a common activity, so that instead of referring to each one separately, one can regard them all as a single entity, under one extended veil of incorporation.59 An example of this would be *DHN Food Distributors Ltd. v London Borough of Tower Hamlets.*60 In this case, a company claimed compensation for disturbance owing to the expropriation of land though the land belonged to another company, the shareholders of which were identical to those of the two others.61 Lord Denning emphasized that: 62

“This is especially the case when a parent company owns all the shares of the subsidiaries ... These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says ... The three companies should, for present purposes, be treated as one.”

It is important to note the different approaches taken by the court as explained above. Its first step was peeping behind the veil to see the shareholdings of the three companies at stake.63 It revealed that the shareholders (and directors) of all three were identical.64 This is actually a penetration of the veil which leads to the second step by recognizing the direct interest of each of the components in the assets of the enterprise.65 Then it proceeded to penetrate the veil, by applying the partnership approach.66 The third step is the extension of the veil to cover the entire group, seeing it as one, comprehensive entity.67 It was finally

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57 Supra note 39  
58 Supra note 39  
59 Supra note 39  
60 *DHN Food Distributors Ltd. v London Borough of Tower Hamlets* [1976] 1 WLR 852  
61 Ibid  
62 Ibid  
63 Supra note 39  
64 Supra note 39  
65 Supra note 39  
66 Supra note 39  
67 Supra note 39
held that the companies as a group are entitled to compensation not only for the value of
the land but also compensation for disturbance.\textsuperscript{68}

4) **Ignoring the veil**: This is the most extreme form of lifting the veil. This approach is taken
by the court when they think that the company was not founded for commercial or other
sound grounds, but only as a means to defraud or defeat creditors or to circumvent laws.\textsuperscript{69}
Courts use this approach as a sanction.\textsuperscript{70} However, not only is it against the legal system
but it also deprives the courts of the possibility of issuing orders against the company as
such, if and when they deem fit.\textsuperscript{71}

The approach of the court to ignore the company does not always do justice, especially when other
parties are affected.\textsuperscript{72} In such cases, a remedy can be found to nullify the hurtful action.\textsuperscript{73} For
example, if a contracting party tries to avoid the execution of the contract, maintaining that a
company is the proprietor of the land, the court may order him as the controlling shareholder to
have the resolutions necessary to complete the sale passed by the company's authorities.\textsuperscript{74} By
following a different remedy, the court need not ignore the separate legal entity of the company.\textsuperscript{75}

**GROUND OF LIFTING THE CORPORATE VEIL**

As early as Solomon, judgments have shown possible inclinations to exceptions to the separate
entity concept.

The circumstances under which the Courts may lift the corporate veil may broadly be grouped
under the following two heads:

A. Under Statutory Provision:
   - When membership is reduced (Under section 45 of the Companies Act)

\textsuperscript{68} Supra note 39
\textsuperscript{69} Supra note 39
\textsuperscript{70} Supra note 39
\textsuperscript{71} Supra note 39
\textsuperscript{72} Supra note 39
\textsuperscript{73} Supra note 39
\textsuperscript{74} Supra note 39
\textsuperscript{75} Supra note 39
- Improper use of Name (Section 147(4))
- Fraudulent conduct (Section 542)
- Failure to refund application money (Section 69(5))
- Misrepresentation in prospectus (Section 62)
- Holding Subsidiary companies (Section 212)
- For facilitating the task of an inspector to investigate the affairs of the company (Section 239)
- For investigation of ownership
- Liability for ultra vires acts

B. Under judicial interpretations
- Protection of revenue
- Prevention of fraud or improper conduct
- Determination of the enemy character of a company
- Where a company acts as an agent for its shareholders
- In case of economic offences
- Where Company is a sham or cloak

CRIMINAL LIABILITY OF CORPORATIONS IN INDIA

Criminal Liability of Corporations: Pre-Standard Chartered Bank Case Law

Earlier, Indian courts were of the opinion that corporations could not be criminally prosecuted for offenses requiring *mens rea* as they were absolutely incapable of possessing it which is an essential element for majority of offenses that would result in imprisonment or other penalty.\(^76\) Indian courts held that corporations could not be prosecuted for offenses requiring a mandatory punishment of imprisonment for the simple reason that they could not be imprisoned.\(^77\)

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\(^76\) Supra note 1
\(^77\) Supra note 1
In *A. K. Khosla v. S. Venkatesan*\(^7^8\) two corporations were charged with having committed fraud under the IPC. The Magistrate issued process against the corporations. The Court in this case pointed out that there were two pre-requisites for the prosecution of corporate bodies, the first being that of *mens rea* and the other being the ability to impose the mandatory sentence of imprisonment. A corporate body could not be said to have the necessary *mens rea*, nor can it be sentenced to imprisonment as it has no physical body.

Whether a company could be convicted for an offence where the punishment prescribed by the statute is imprisonment and fine was still uncertain.\(^7^9\) This controversy was first addressed in *MV Javali v. Mahajan Borewell & Co and Ors*\(^8^0\) where the Supreme Court held that mandatory sentence of imprisonment and fine is to be imposed where it can be imposed, but where it cannot be imposed, namely on a company then fine will be the only punishment.

In *Zee Telefilms Ltd. v. Sahara India Co. Corp. Ltd*\(^8^1\), the court dismissed a complaint filed against Zee under Section 500 of the IPC wherein it was alleged that Zee had telecasted a false program whereby it defamed Sahara India. The court observed that *mens rea* was one of the essential elements for the commission of the offense of criminal defamation, it absolved the company of liability under section 500 of IPC on the ground that a company could not have the requisite *mens rea*.

**STANDARD CHARTERED BANK CASE LAW**

This was the landmark case in which the Apex court overruled all other principles which had yet been laid down wherein the company could not be criminally liable for offences. In this case, Standard Chartered Bank was being prosecuted for violation of certain provisions of the Foreign Exchange Regulation Act, 1973.\(^8^2\) The Supreme Court held that the corporation could be...

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\(^7^8\) *A. K. Khosla v. S. Venkatesan*, (1992) Cr.L.J. 1448
\(^7^9\) Supra note 1
\(^8^0\) *MV Javali v. Mahajan Borewell & Co and Ors.*, AIR 1997 SC 3964
\(^8^1\) *Zee Telefilms Ltd. v. Sahara India Co. Corp. Ltd.*, (2001) 3 Recent Criminal Reports 292
\(^8^2\) *Standard Chartered Bank and Ors. v. Directorate of Enforcement*, (2005) 4 SCC 530
prosecuted and punished, with fines, regardless of the mandatory punishment required under the respective statute.  

The Court did not go by the literal and strict interpretation rule required for the penal statutes and went on to deliver complete justice by imposing fine on the corporate. It held that the courts in case of penal statutes must only see that the thing charged as an offence is within the plain meaning of the words used and must not strain the words on any notion that there has been a slip that the thing is so clearly within the mischief that it must have been intended to be included and would have included if thought of.

The Supreme Court also pointed out that, with regards to criminal liability, the FERA statute does not make any distinction between a natural person and corporations and that according to FERA, corporations are vulnerable to criminal prosecution, and allowing corporations to escape liability based on the difficulty in sentencing would result in grave injustice to the statute. Further, the Code of Criminal Procedure, does not encompass any provision for the exemption of corporations from prosecution on the ground that it would be difficult to sentence them in accordance with the statute. The Court however, did not develop its reasoning far enough so as to specifically hold that a corporation is capable of forming mens rea and acting pursuant to it. Nevertheless, the Court held that corporations would be criminally liable for offenses and thus, could be prosecuted and punished, at least with fines. Since, many of the offenses, punishable by fines, have mens rea as a prerequisite element of the offense, thus, it can be implied that post Standard Chartered decision, corporations are capable of possessing the requisite mens rea.

CRIMINAL LIABILITY OF CORPORATIONS: POST-STANDARD CHARTERED BANK CASE LAW

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83 Ibid
84 Ibid
85 Tolaram Relumal and Anr. v. The State of Bombay, 1955 (1) SCR 158
86 Supra note 85
87 Supra note 85
88 Supra note 85
89 Supra note 85

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In *Iridium India Telecom Ltd. v. Motorola Incorporated and Ors.*, the Supreme Court held that a corporation is virtually in the same position as any individual and could very well be convicted under common law as well as statutory offences including those requiring *mens rea*. By relying on the ratio of Standard Chartered Bank Case, the court held that the criminal liability of a corporation would arise when an offence is committed in relation to the business of the corporation by a person or body of persons in control of its affairs.

The Court further held that the corporations were no longer privy to the immunity from criminal prosecution on the grounds that they are incapable of possessing the requisite *mens rea* for the commission of criminal offences.

In another judgment of *CBI v. M/s Blue-Sky Tie-up Ltd and Ors.*, the Apex Court reiterated the position of law held that companies are liable to be prosecuted for criminal offences as well as for fines.

**CONCLUSION**

Courts have struggled for years to develop and refine their analysis of these claims. However, each new action brings a different set of facts and circumstances into the equation and a separate determination must be made. Merely seeks to strike a balance between the interest of the public and the concept of a separate personality. Thus, the principle of corporate veil is essentially used as a flexible tool to ensure that justice is delivered. If the principle of lifting of corporate veil is applied rigidly with no scope at all left for judicial discretion, the whole purpose of the principle would get defeated.

Till date, the act of piercing the corporate veil remains one of the most controversial subjects in corporate law. Though certain categories such as fraud, agency, sham or facade, unfairness and group enterprises have been identified for being the basis under which the Courts would pierce the

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90 *Iridium India Telecom Ltd. v. Motorola Incorporated and Ors.*, AIR 2011 SC 20
91 Ibid
92 Ibid
93 *CBI v. M/s Blue-Sky Tie-up Ltd and Ors.*, (2011) 15 SCC 144
94 Supra note 1
95 Supra note 27
corporate veil but it is of utmost importance to note that these categories are just guidelines and by no means far from being exhaustive.\textsuperscript{96}

Although the courts have pierced the corporate veil to determine the identity of the persons behind the commission of offences such as frauds etc., the courts through judicial interpretation have also held that the corporates should not be treated differently from an individual and should be kept on the same footing while fixing criminal liability and hence they can be criminally prosecuted.

\textsuperscript{96} Supra note 1