Term Paper On “Lifting of Corporate Veil under Judicial Interpretation”.

Company Law

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1. Background

Halsbury’s Laws of England, defines the term “company” as a collection of many individuals united into one body under special domination, having perpetual succession under an artificial form and vested by the policies of law with the capacity of acting in several respect as an individual, particularly for taking and granting of property, for contracting obligation and for suing and being sued, for enjoying privileges and immunities in common and exercising a variety of political rights, more or less extensive, according to the design of its institution or the powers upon it, either at the time of its creation or at any subsequent period of its existence 1

2. Research Question:

What is the basic concept of lifting of corporate veil and what are the instances in which court can lift the corporate veil.

3. Rationale

The paper aims to study and analyze the concept of lifting the corporate veil and the instances in which court can lift it.

4. Limitation

The paper only deals about lifting of corporate veil in general and the instances in which court can life it. The paper does not cover the Statutory provisions for lifting of corporate veil. The translation of case and provision is unofficial translation, done by the writer himself. The paper has certain word limitations.

5. Methodology

This paper has applied the doctrinal method of research.

1 Ashish Adhikari and Sudeep Gautam, Business Law in Nepal pp.241, 242
Findings and analysis

Chapter-II

Lifting the corporate veil

A company is a legal person or legal entity separate from and capable of surviving beyond the lives of its member. The principle is that, there is a fictional veil and not a wall between the company and its members. The members of the company may misuse the corporation veil under its shelter. In order to prevent the misuse of corporation veil from unjust and fraudulent acts, it is necessary to lift the veil or disregard corporate personality. The corporate veil is said to be lifted when the court ignores the company and ascertain the factors which operate to break down the corporate insulation. The matter is largely in the discretion of the courts and will depend upon “the understanding social, economic and moral factors as they operate in and through the corporation”.

The veil doctrine is invoked when the shareholders blur the distinction between the corporation and the shareholders. Although a company is a separate legal entity, it acts only through human agents. Hence there are two ways by which a company becomes liable in company of corporate law: through direct liability (for direct infringement) and through secondary liability (for acts of human agents acting in course of their employment).

Although the company has separate and distinct feature in ultimately, some human beings are the real beneficiaries of the corporate advantages, hence as stated “for while by fiction of law, a corporation is a distinct entity, yet in reality it is an association of persons who are in fact the beneficial owners off all the corporate property.”

As noted by Lord Denning in Littlewoods Mail Order Stores Ltd. v. IRC incorporation does not fully: "cast a veil over the personality of a limited company through which the courts cannot see. The courts can, and often do, pull off the mask. They look to see what really lies behind."

Company has separate personality. It is an artificial person as legal person. The legal personality of company is called Corporate personality. The Company does not have its physical existence. So, it called the Legal person or Legal entity. Being an artificial person it needs natural person to run the business. Thus, piercing the corporate veil essentially means disregarding the separation between entities organized in corporate form with limited liability of shareholders. As artificial person cannot do fraudulent activities. Natural persons have fiduciary duty towards company. They must act with good faith, honesty and due diligence. They cannot get personal benefit and cannot claim company's property until company's liquidation. If any person does the harmful acts towards company such person will be personally liable.

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2 Salomon v Salomon and co, 1895-99, All ER Rep. 33,66 LJ Ch 35.
6 Littlewoods Mail Order Stores Ltd. v. IRC [1969] 1 W.L.R. 1241, 1254
7 Durgabahadur v Government of His majesty, Ne.Ka.Pa. 031 P 195
In the American case of Milwaukee Refrigerator company case, it was held that "A corporation will be looked upon as a legal entity as a general rule but when the motion of legal entity is used to defeat the public convenience, justify wrong, protect fraud or defend crime; the law will regard the corporation as an association of persons."\(^9\) In order to promote justice and to prevent inequity, courts will sometimes ignore the separateness of a corporation and its shareholders by piercing the corporate veil. The primary consequence of piercing the corporate veil is that a corporation’s shareholders may lose their limited liability.

1. **Under Statutory Provision:**

The veil of corporate personality may be lifted as per the provision of the company law of the country. In the case of Nepal, the statutory provisions that guide it are found under Nepalese Company Act 2063. The NCA has several provisions that enables corporate veil to be lifted and makes the people liable for such conduct. Most of the provisions are related with misconduct done in the name of the company. Some of the provisions are:

Following are the provisions which provide the ground for lifting of corporate veil.

a) Transaction not done in the name of company according to section 10(1) of Company Act 2063 every company must carry on their business only in the name of the company. If any person carries the business of company other than in the name of the company, the individual would be held liable not the company\(^10\).

b) In the case of fraudulent or wrongful transaction done in the name of company, such person would be held responsible\(^11\) as per section 163.

c) In the case of causing loss or damage to the company or any person inserting false particulars in the documents of company, such person would be held responsible\(^12\) as per section 160 (a).

d) In the case of failing to maintain account or cause to maintain false account deliberately by any director or officials having responsibilities such person would be held responsible\(^13\) according to section 109, 90 160(b)(m).

e) In the case of failing to handover the documents, accounts cash good in kind to the successor or failing to take over from the predecessor such person would be held responsible\(^14\) as per section 160(e).

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\(^9\) United States v. Milwaukee Refrigerator co. (1905) 142 Fed. 247

\(^10\) section 10(1) of Company Act 2063

\(^11\) section 163 of Company Act 2063

\(^12\) section 160 (a) of Company Act 2063

\(^13\) section 109, 90 160(b)(m) of Company Act 2063

\(^14\) section 160(e) of Company Act 2063
f) In the case of maintaining any particulars in the prospectus knowingly which is not true and if caused any harm or damages to all the directors who signed in the prospectus\(^{15}\) as per section 24.

g) In the case of issuing prospectus without prior approval of the Security Board and office as required under section 23(3) of NCO such director or official would be held responsible\(^{16}\) as per section 160 (f).

h) Any shareholder providing false information or not providing as required to be provided as per Company Act 2063 such person would be held liable\(^{17}\) as per section 160 (h).

i) In the case if any person committing misappropriation or embezzlement of property such person would be held responsible\(^{18}\) as per section 161(a).

j) In the case of in any officials of company allot the share of the company contravene to the Act such officials would be held responsible as per section 161(a).

k) In the case of purchasing or assisting to purchase of its own share or its principal companies share or debenture from company’s frauds, every such director or officials\(^{19}\) as per section 61, 161(b)

l) In the case of BOD had done something beyond its authority or working scope of company every such director\(^{20}\) as per section 95(4), 160(g), and (l).

m) In the case of non convene of General Meetings every such person who has duty to convene\(^{21}\) as per section 161(w).

n) In the case of failure to supply to summary financial report, annual financial description or report to shareholders, every such directors who has duty to supply to summary financial report, annual financial description or report to shareholders, every such directors who has duty to supply\(^{22}\) as per section 80, 81, 160(n). (h).

o) In the case of failure to submit required documents as mentioned in section 78 and 79 in the General Meeting every such persons who has duty to submit will be punished\(^{23}\) as per section 80.

p) In the case of accounts were not given or shown to auditor when demanded every person who has responsibility to give or show\(^{24}\) as per section 47, 160(x), (z).

q) In the case a company does not provide information to the company register’s the person who has responsibility as per section 47,160(x) (z).

\(^{15}\) section 24 of Company Act 2063
\(^{16}\) section 160 (f) of Company Act 2063
\(^{17}\) section 160 (h) of Company Act 2063
\(^{18}\) section 161(a) of Company Act 2063
\(^{19}\) section 61, 161(b) of Company Act 2063
\(^{20}\) section 95(4), 160(g), and (l) of Company Act 2063.
\(^{21}\) section 161(w) of Company Act 2063.
\(^{22}\) section 80, 81, 160(n). (h) of Company Act 2063.
\(^{23}\) section 80 of Company Act 2063.
\(^{24}\) section 47, 160(x), (z) of Company Act 2063.
r) In the case any director or officials not providing information to the company, office, court or other institution as required by this ordinance such person would be held responsible as per section 50, 141, 175, 160(j) (w).

s) In a case company director, shareholder or company who obtain loans or remunerated contrary to Company Act 2063 such person or company would be held responsible as per section 160(a).

t) In case any company, director, officials or person who hides or provides false information about credit of company at the time seeking permission to reduce the share capital as per section 160(p).

u) In case of selling shares or debentures contrary to this Company Act 2063 such private company, their director and share holder as per section 160(q).

v) In case foreign company transacting within Nepal, contrary to the Company Act 2063 such company, their director, officials or representatives as per section 160(r).

w) In case any person maintain false record of shareholders Register Book or Debenture Holders Record Book such person would be held responsible as per section 160(t).

2. Situations where the corporate veil will be lifted by courts

   a) Determination of Enemy Character
   b) For the Benefit of Revenue or Evasion of the tax
   c) Fraud or Improper Conduct
   d) Company used as mere Cloak or Sham
   e) Government Companies

   This veil has been described as being opaque and impassable as an iron curtain and yet from time to time the legislature and the courts have disregarded the separate personality of the company by lifting the veil, that is, by introducing inroads to this doctrine. It has been considered that the limited liability of the shareholders is usually the reason why the courts or the law cater for this piercing of the veil thus ignoring the existence of the company as a separate person and looking beyond it to see who is responsible for any wrongdoing.  

25 section 50, 141, 175, 160(j) (w) of Company Act 2063.
26 section 160(a) of Company Act 2063.
27 section 160(p) of Company Act 2063.
28 section 160(q) of Company Act 2063.
29 section 160(r) of Company Act 2063.
30 section 160(t) of Company Act, 2063.
31 Dr. Rega Surya Rao, Lectures on Company Law, Asia law house publication (2008), P 48-51.
Two requirements must exist for a court to pierce the corporate veil:\(^{33}\):

a) Domination of a corporation by its shareholders.

b) Use of that domination for an improper purpose.

2. Corporate veil will be lifted by courts

A) Determination of Real Character of a Company

The court is required to lift the veil of corporate personality to examine the realities that lie behind the company. The character of company can not be determined without lifting the corporate veil.

**Case of Daimler Co. Ltd. v. Continental Tyre and Rubber Co. (1916)2ac307**

This case observed that in a company incorporated in England for the purpose of selling tyres manufactured in Germany by a German company, all the shares except one were held by the German subjects residing in Germany. The remaining one share was held by a British subject who was the secretary of the company. Thus the real control of the English company was in German hands. During the First World War, the company commenced an action to recover trade debts. The question therefore was whether company had become an enemy company consequent to world war first. The house of Lords, inter alia observed:

A company incorporated in United Kingdom is a legal entity, a creation of law with the status and capacity which the law confers. It is not the natural person with mind or conscience. It can be neither friend nor enemy. But it can assume enemy character when persons in de facto control of its affairs are residents in any enemy country or, wherever resident, are acting under the control of enemies.

**B. Prevention of Fraud or improper conduct**

**Gilford Motor Co Ltd v Horne**\(^{34}\) H was employed by the plaintiffs as their managing director. In contract included a restrictive covenant, that, after his employment had ended, he would not solicit the customers of the plaintiff. The case arose because Horne breached the contract. H solicited forming company of which he was an employee and all the shares had been issued to his wife and another employee, who were the only directors. The Court of Appeal regarded this company as a ‘cloak or sham’, formed merely as a ‘device or stratagem’ in order to ‘mask the solicitation’. An injunction was granted against both H and the company from acting in breach of the covenant.

**Jones v Lipman**\(^{35}\) Here, L entered into a contract to convey a parcel of land to J. Subsequently, he changed his mind and, in an attempt to avoid being compelled to convey the land, he formed a company, A Co, of

\(^{33}\)Business Law The Ethical, Global, and E-Commerce Environment FIFTEENTH EDITION Jane P. Mallor A. James Barnes Thomas Bowers Arlen W. Langvardt all of Indiana University

\(^{34}\)[1933] Ch 935.

\(^{35}\)[1962] 1 WLR 832
which he and a clerk employed by his solicitors were the only shareholders and directors. L then conveyed the land to A Co. Russell J granted an order for specific performance against both L and A Co. to convey the land to J for two reasons, both of which amount to lifting the veil, in the accepted sense.

First, because L, by his absolute ownership and control of A Co, could cause the contract to be completed, the equitable remedy could be granted against him. Secondly, the order could be made against the company because it was a creation of L and ‘a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity’.

The meaning of a ‘sham’ was defined by Diplock LJ in *Snook v London and West Riding Investments Ltd*, thus: ‘…it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligation (if any) which the parties intend to create….but … for acts or documents to be a ‘sham’, with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating…’

‘Façade’ has been understood to mean ‘a mask to conceal the true facts’.13 However, Lord Sumption considered in Petrodel that the words ‘sham’ or ‘façade’ beg too many questions and do not give satisfactory answers to finding what is a relevant wrongdoing.

C. Alter ego

The court will view the ego of the company’s board member on following basis.

*Tide Line Inc v Eastrade Commodities 2006 WL 4459297, 2007 A.M.C. 252, 265*

1. The absence of corporate formalities;

2. Inadequate capitalization;

3. Personal use of corporate funds;

4. Overlapping personnel and ownership;

5. Common office space, address, telephone numbers;

6. The amount of business discretion displayed by the allegedly dominated corporation;

7. Whether the related corporations deal with the dominated corporation at arms’ length;

8. Whether the corporations are treated as independent profit centers;

9. The payment of or guarantee for debts of the dominated corporation by other corporations in the group;
10. Whether the corporation in question had property that was used by the other corporations, as if it were its own.

To determine group of companies: It was held that, In the case of Re. Hellenic & General Trust Ltd. the company was a mere cloak or sham for the purpose of enabling the defendant to commit a breach of his covenant against solicitation, evidence as to the formation of the company and as to the position of its shareholders and directors leads to that inference. The courts refused to uphold the separate existence of the company where it is formed to defeat or circumvent, to defraud creditors or to avoid legal obligations.36

D. To Prevent Evasion of Taxation

In the case of Re Sir Dinshaw ManeckjeecePetit, AIR 1927 Bom, 371, the assessed was a wealthy man enjoying huge income from dividends and interests. He formed four private companies and agreed with each to hold a block of investment as an agent for it. He credited the income received by him in the accounts of the companies and took it back in the form of a pretended loan. The whole idea was to split his income into four parts with a view to evade taxes dismissing the petition. The Supreme Court, inter alia, observed.37

The company was formed by the assesses purely and simply as a means to avoiding super – tax and the company was nothing more than the assesses himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over to the assessed as pretended loan.

E. Working as an Agency

The doctrine of separate legal entity that the company is a legal entity with a different identity from that of its members means that a company does not exist to become an agent for its shareholders. Where this is the case, Anglo-Saxon courts would not hesitate to pierce the corporate veil. In Rowland J, in Barrow v CSR Ltd38 where the court found out that a parent company was responsible for the actions of a subsidiary in relation to an employee, it did not hesitate to lift the veil. The court stated:

"Now, whether one defines all of the above in terms of agency, and in my view it is, or control, or whether one says that there was a proximity between CSR and the employees of ABA, or whether one talks in terms of lifting the corporate veil, the effect is, in my respectful submission, the same."

The corporate veil of the company may be lifted where its a corporate façade is in reality only an agency. For instance, in Re R.G. Films Ltd39 an American company produced film in India technically in the name of a British Company, 90% of whose capital was held by the President of American Company which financed the production of the film. The Board of Trade refused to register the film as a British film and stated that English company acted merely as the nominee of the American company.

36 Re. Hellenic & General Trust Ltd. [1975] 3 All ER 382
39 (1953) 1 All ER 615.
Chapter-III
Conclusion
Company is fiction of law, a corporation is clothed with a distinct personality, but in real it is an association of persons who are in fact, the beneficial owners of the property of the body corporate. A company, being an artificial person, cannot act on its owns but need the Board to regulate being abstract body, it can act only through natural person. Although a company is a corporate body but still having a distinct feature but still there are instances in which the court can lift up the veil looking inside actual functioning of the company. A company is supposed to be formed for the benefit of human society. But when the company acts in a different manner against the law or public policy then the court is bound to disregard its distinct feature and lift up the veil. Thus Lifting of corporate veil is issued when there could be an abuse of corporate device in course of incorporation of company where Company refers to a legal entity formed which has a separate legal identity from its members and is ordinarily incorporated to undertake commercial business. Although some jurisdiction refer to unincorporated entities as companies, in most jurisdiction the term refers only to incorporated entities, it has been judicially remarked that “the word company has no strict legal meaning”, but is taken to mean specific form of entity created under the laws of relevant jurisdiction because of limited liability of members of company, it has become the most popular form of business vehicle in most countries in the world.

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