OVERCOMING CORPORATE LAW AND ADMINISTRATIVE LAW ALIKE: HOW DO CORPORATIONS MANIPULATE THE EXISTING LAWS FOR THEIR PROFIT?

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ABSTRACT

Living in a country where industrialization is on rise, issues related to companies and their law has become popular in courts and media. So, in this paper I will be analysing the concept of corporate personality and corporate veil extending it the case of downfall of big companies or industrialist like of kingfisher and Vijay Mallya, showing the nexus of different laws from different aspects which starts from company law. The law of extradition will also be addressed and how the two principles together have been used to evade law.

INTRODUCTION

Although the company and its members were protected by the veil of incorporation, it has its limitations too. It means that, the veil of incorporation sometimes can lead to injustice where the principle is misused. In order to prevent injustice, the court decided to lift the corporate veil. Below are main instances of lifting the corporate veil.

Such lifting of corporate veil is an exception to the rule of corporate liability since company executives, who are insulated from liability due to the limited liability nature of the company, are held to be liable.

This research will focus on its effectiveness, which would require an understanding of corporate personality of a company along with studying provisions of the corporate law of certain countries wherein this field has majorly developed such as India, United Kingdom and United States of America. We would also focus on specific provisions which provide the courts of law with powers to pierce this corporate veil.

Lifting of Corporate Veil is a grey area when there is an absence of specified laws which allows the courts of law to take specified action in this field. This absence is present in the form of statutes as well as judicial pronouncements on the special circumstances in which this doctrine could be applied. The corporate veil is said to be lifted when the court ignores the company and directly confronts with its respective members and specified managers. This matter of breaking down the corporate insulation which is created through such a veil is largely the discretion of the courts and will depend upon the underlying social, economic, and moral factors as they confront the corporation. Further, in order to highlight the discrepancies in not just laws specific to the corporate world and the scope of them being misused but also laws from other areas that can be manipulated by corporations, it is of use to look at the current extradition law and how it is being applied.

Lastly, it is a matter of substantial legal interest to find out how the courts in India, UK, and USA have been exercising this discretion, and whether there is any general agreement or major differences in exercising their discretion while applying this doctrine of lifting the corporate veil. This is the main research problem.

The scope of this research involves in depth study of how the Corporate Veil has been allowed to be lifted by both the Legislature as well as the Judiciary in the three countries of study namely

India, UK and USA. In order to arrive at a conclusion, we will be focusing on the following questions which will provide a structure to this research.

The objectives are as following:

1) How wide is the scope for corporations to use the law to their advantage?
2) Whether the two laws have been effective in achieving their goal?
3) Whether this doctrine has been applied in the three countries in a uniform method by their respective legislatures and judiciaries?
4) Through analysis of present state of the judicial approach, is there ample opportunity for enforcement of more comprehensive measures in order to improve in its future application?

THE APPLICATION OF LIFTING THE CORPORATE VEIL AND ITS JUDICIAL INTERPRETATION

In UK, the courts have often been presented with the question of whether a company is an independent legal entity in cases where litigants are trying to recover from opponents and it is discovered that the contracting party is nearly a brass plate company with no assets but is a part of a larger, profitable group. The very principle of independent corporate existence has been evolved and established in UK itself by the House of Lords in Salomon case and has been generally applied by the courts in cases relating to corporates by treating companies as separate from its members and generally the veil will not be pierced. But in a number of cases mentioned below, the Courts in UK have come out with certain circumstances and evolved some criteria which will determine whether the corporate veil could be lifted. The English law also provides some statutory support for lifting of corporate veil, which has also been briefly discussed below.

CASES

1) *Salomon v. A Salomon & Co. Ltd*[i]

This is a landmark UK Company law case. The effect of the Lords' unanimous ruling was to uphold firmly the doctrine of corporate personality, as set out in the Companies Act 1862, so that creditors of an insolvent company could not sue the company's shareholders to pay up outstanding debts. In this case the main issue is mentioned as follows-

The liquidator, on behalf of the company, counter-claimed wanting the amounts paid to Salomon to be paid back, and his debentures cancelled. He argued that Salomon had breached his fiduciary duty for selling his business for an excessive price. He also argued the formation of the company in this was fraud against its unsecured creditors.

High Court-

At the first instance the case entitled Broderip v. Salomon[ii], Williams J said Mr. Broderip's claim was valid. It was undisputed that the 200 shares were fully paid up. He said the company had a right of indemnity against Mr. Salomon. He said the signatories of the memorandum were mere dummies, the company was just Mr. Salomon in another form, an alias, his agent. Therefore, it was entitled to indemnity from th0e principal. The liquidator amended the counter claim, and an award was made for indemnity.

Court of Appeal-

The Court of Appeal confirmed Vaughan Williams J's decision against Mr. Salomon, though on the grounds that Mr. Salomon had abused the privileges of incorporation and limited liability, which Parliament had intended to confer on "independent bona fide shareholders, who had a mind and will of their own and were not mere puppets". Lindley LJ (an expert on partnership law) held that the company was a trustee for Mr. Salomon, and as such was bound to indemnify the company's debts.

Lopes LJ and Kay LJ variously described the company as a myth and a fiction and said that the incorporation of the business by Mr. Salomon had been a mere scheme to enable him carry on as before but with limited liability.

House of Lords-

The House of Lords unanimously overturned this decision, rejecting the arguments from agency and fraud. They held that there was nothing in the act about whether the subscribers (i.e. shareholders) should be independent of the majority shareholder. The company was fully constituted in law and it was not the function of judges to read into the statute limitations they themselves considered expedient. Lord Halsbury LC stated that the statute "enacts nothing as to the extent or degree of interest which may be held by each of the seven [shareholders] or as to the proportion of interest or influence possessed by one or the majority over the others."

2) ***Lee v. Lee's Air Farming Ltd***[iii]

This is a company law case concerning the corporate veil and separate legal personality. The Judicial Committee of the Privy Council reasserted that a company is a separate legal entity, so that a director could still be under a contract of employment with the company he solely owned. In this case the privy council advised that Mrs. Lee was entitled to compensation, since it was perfectly possible for Mr. Lee to have a contract with the company he owned. The company was a separate legal person. Lord Morris said "*It was never suggested (nor in their lordships' view could it reasonably have been suggested) that the company was a sham or a mere simulacrum. It is well established that the mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company. If, then, it be accepted that the respondent company was a legal entity, their lordships see no reason to challenge the validity of any contractual obligations which were created between the company and the deceased……"* It was also held by Lord Morris that *"There appears to be no greater difficulty in holding that a man acting in one capacity can make a contract with himself in another capacity. The company and the deceased were separate legal entities".*

3) ***Jones v. Lipman***[iv]

A UK company law case concerning piercing the corporate veil which exemplifies the principal case in which the veil will be lifted, that is, when a company is used as a "mere façade concealing true facts", which essentially means it, is formed to avoid a pre-existing obligation. Lipman contracted with jones to sell him a house. But for some

reason he later changed his mind. To avoid being sued by Jones he quickly set up a Company named Alamed Ltd. and transferred the title of the house to the Company. Jones sued him but Lipman claimed that the house was already sold to Alamed Ltd. and therefore he was no more legal owner of the house.

The judge who heard the care was Russell L. After hearing Lipman's story of the Corporate Veil, the judge rejected it. He stated, "Alamed Ltd. is a creature of Lipman's device and a sham, a mask which he holds before his face in an attempt to avoid the eyes of equity." Mr. Lipman was thereby ordered to sell the house to Mr. Jones.

4) ***Gilford Motor Co Ltd v. Horne***[v]

This is a UK company Law case concerning piercing the corporate veil. It gives an example of when courts will treat shareholders and a company as one, in a situation where a company is used as an instrument of fraud. In this case Horne claimed that it was not him doing the business but the Company and under Company Law they were 2 different people. However, the Court was not convinced and lifted the veil of incorporation. In this instance, Mr. Horne was just trying to hide behind a Corporate Veil to steal business from his former employer. Where a fraud is perpetrated, the Court will lift the Corporate Veil.

COMPARING JURISDICTIONS: THE AMERICAN PERSPECTIVE

In the United States as well, the principle of piercing the corporate veil exists. However, it also suffers from vagueness and the doctrine is a victim of not having been put down explicitly, which has led the courts to exercise their discretion widely in order to determine when the veil is to be lifted. Like most corporate laws that have been established elsewhere, the American Company law is also a firm believer of limited liability and has provided corporations with a separate identity, and therefore lifting of the corporate veil occurs in exceptional circumstances. Due to the shortfall in determining these exceptions, "the boundaries of this exception are usually stated in broad terms that offer little guidance to judges or litigants in subsequent cases."[vi] Legal writers have described judicial decisions to pierce the veil as "irreconcilable and

not entirely comprehensible,"[vii] "defying any attempt at rational explanation,"[viii] and occurring 'freakishly'.[ix]

A common term that is recurrent in American judicial interpretations with regards to the corporate veil is 'alter ego', that refers to the corporation as a separate entity. However, jurists and scholars alike have claimed that use of such terms have further resulted in the courts' in ability to formulate the doctrine well, and further, that decisions vary from case to case even if they share a similar fact pattern, insinuating that the doctrine of lifting the corporate veil is merely dependent on the judges' arbitrary interpretation of the doctrine. Even still, jurisprudence and legal interpretations have managed to lay down certain pointers, for example, it was laid down that corporations with individuals as shareholders will be treated differently in a piercing context than corporations with other corporations as their shareholders.[x]

An empirical study based on statistics has been ongoing, and has come up with certain trends in deciding cases of corporate veil. For example, courts pierce less often in tort than in contract contexts, and a piercing decision is not less but more likely when the shareholder behind the veil is an individual rather than another corporation. Other results confirm prior predictions. For example, the likelihood of piercing increases as the number of shareholders decreases. Factors frequently cited by commentators, such as misrepresentation and undercapitalization, do make a difference, but this difference is more pronounced in contract settings than in tort or statutory settings.[xi] Most significantly, piercing occurs only in close corporations or within corporate groups; it does not occur in public corporations. When piercing does occur, the courts' reasoning varies with the context, and decisions reflect the differing impact of various statutory policies affecting limited liability.[xii]

Most significantly, piercing occurs only in close corporations or within corporate groups; it does not occur in public corporations. When piercing does occur, the courts' reasoning varies with the context, and decisions reflect the differing impact of various statutory policies affecting limited liability. Piercing of the corporate veil is limited to close corporations and corporate groups (parent/subsidiary or sibling corporations). In the entire data set, piercing did not occur in a publicly held corporation.[xiii] This universal respect for the separateness of the corporate entity in publicly held corporations reflects the different role that limited liability plays in larger corporations. All corporations can use the corporate form to allocate risk.[xiv]

Going over various cases, it would be useful to produce a few of them here in order for to understand the evolution and the current application of the doctrine. In *Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.*[xv], it was stated that "The fact that limited liability might yield results that seem "unfair" to jurors unfamiliar with the function of the corporate form cannot provide a basis for piercing the veil."[xvi] Further, in *Lowendahl v. Baltimore & Or*[xvii], a three part test was established for deciding on cases of when to lift the corporate veil. This test includes: (1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and (2) Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and (3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.[xviii] In *Kinney Shoe Corp v Polan*[xix], the judge held that, "When nothing is invested in the corporation, the corporation provides no protection to its owner; nothing in, nothing out, no protection. If Polan wishes the protection of a corporation to limit his liability, he must follow the simple formalities of maintaining the corporation. This he failed to do, and he may not relieve his circumstances by saying Kinney should have known better.[xx]

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The continuing reliance on case instead of statutory law, and a parallel judicial reliance on case-by-case resolution in lieu of far reaching standards, reflects the nature of the conduct being regulated.

LIFTING OF THE VEIL: HOW AND WHEN CAN IT OCCUR

The first main instance of lifting the veil is number of members below two. When the company membership is less than two, the sole member left in the company is assumed to be a sole owner. By right, the single member can only operate the business in sole proprietorships. He or she can still continue to operate their business within six-month period. After the said six months' period, the member would be personally liable for any debts incurred from that point

onward. If the company still continues to operate after six months, the corporate veil will be lifted and the company and members would be guilty under Section 36 of Companies Act 1965 (Lee, 2005).

The second is doing fraudulent trading. The court may be willing to pierce the corporate veil if it is found that the owners are plotting fraudulent scheme behind the veil of incorporation. By carrying on a business with the intention to cheat others, the company are said to be doing fraud where the veil will be lifted. When this happens, all members of the company with knowledge of this action are guilty of the crime and may be put responsible for the debts and other liabilities of the company without any limitation. By referring to the case of Re William C. Leitch Brs Ltd, the company was insolvent but one of its director still run the business normally by purchasing goods from its suppliers on credit. Since there is element of fraud existed, the court disclosed that particular director to be personally liable for the debts (McGee, 1992).

The third is evasion of legal obligations. The court will not hesitate to lift the corporate veil if its members used the veil as a way to avoid an existing legal obligation. These normally occur when individuals used the doctrine of separate legal entity to do some forbidden act. In law, an individual is not permitted to use the company's name with the power in his hand to do something that is prohibited from doing as illustrated in Jones v Lipman. In this case, the defendant entered into a contract to sell land to the plaintiff but he transferred the land to a company under his control. The court ordered the corporate veil to be lifted as the defendant used the company as a device to avoid his contractual obligations."[xxi]

The fourth is holding and subsidiary company. A holding company dominates other companies by owning some or all of their shares. Those other companies were known as subsidiary companies. According to Lee 2005, a holding company and its subsidiary companies are generally two separate legal entities. In other words, each of them had their own corporate veil. The corporate veil will usually be lifted when a holding company produces group accounts known as consolidated financial statement together with all its subsidiaries. In the event that something happens to the subsidiary company, the holding company would be responsible for it and can be sued as if they were a single entity. This is shown in the case of Hotel Jaya Puri Bhd. v National Union of Hotel, Bar & Restaurant Workers & Anor (1980) where the court held that the hotel and its restaurant are one group enterprise.[xxii]

In the 20th Century, a resolution to make gateways through such restricted boundaries (Veil) has been attempted in the following ways:

1) Further enactment and enforcement of legal provisions which enable the courts to pierce the veil of various suspicious corporate personalities which thereafter can be done in certain situations.
2) Due to the increased influx of corporate fraud cases in courts, the particular common law and civil courts have pierced the veil using the legislative provisions to hold responsible people and enforce appropriate liability upon them. Strengthening the legal provisions through case laws.

EXTRADITION: ITS CHANGING NATURE AND ITS ABILITY TO SAFEGUARD CRIMINALS

The law of extradition has been recorded to exist from as an ancient time as the thirteenth century, where the first form of an extradition 'treaty' was communicated to Hattusili III from an Egyptian Pharaoh, Ramesses II.[xxiii] The law essentially lays down the mechanism by which one sovereign requests and obtains custody of a fugitive located within the jurisdiction and control of another sovereign.[xxiv] The law can be said to find its backing in the legal maxim *aut dedere aut judicare*, which simply translates to prescribing on states the principle that they must either surrender a criminal within their jurisdiction to a state that wishes to prosecute the criminal or prosecute the offender in its own courts.[xxv] A

Jurisprudence, and subsequently the law itself on the matter of extradition has evolved through the years. The earlier stance on the nature of the law and its purpose can be derived from this quote from seventeenth-century jurist Hugo Gratius, "A general obligation to extradite or punish exists with respect to all offenses by which another state is particularly injured." Moreover, a state that had been so particularly injured obtained a natural right to punish the offender, and any state holding the offender should not interfere with that right. Thus, such a holding state should be considered bound to either extradite or punish; there was no third alternative."[xxvi]

Over the course of time, with a shifting focus to human rights, especially in International Law, a considerable change in terms of the law's application has taken place. There have come into existence various grounds on which a country can deny extradition. These grounds include:

a) The concept of dual criminality or the mandate on the presence of the crime as a punishable one in not just the country requesting extradition but also the country holding the accused. A a a b) An accused that commits an offence of a political character is saved from being handed over to the requesting party

c) In a limited number of cases Article 8 of the European Convention on Human Rights has been invoked to stop extradition from proceeding. Article 8 states that everyone has the right to the respect of their private and family life. This is achieved by way of balancing the potential harm to private life against the public interest in upholding the extradition arrangement.[xxvii] A

On the aspect of the practical application of this law, there exists a mechanism that requires for countries to have extradition treaties amongst each other. Without, the presence of such a treaty, no country can even initiate the process of deliverance of the criminal back to its jurisdiction. Keeping this in mind, one would think that the number of such treaties in existence would be quite high so as to ensure speedy conviction of criminals all over the world. However, this is clearly not the case as no country has extradition treaties with every other country. On shifting the focus specifically to India, it only has such treaties with 39 countries. Between India and UK, and the 1993 extradition treaty between them, India has requested the extradition of 131 accused, but has managed to get only one 'fugitive' - Samirbhai Vinubyhai Patel to actually be extradited.[xxviii] A

As a result of the above-discussed principles, the extradition doctrine has largely been evaded by criminals all over the world. It is contended that the shift in this ideology is not only a result of the increasing need of safeguarding state sovereignty and establishing its supremacy over the other states in a largely-politicized contemporary globe, but also to safeguard the interests of criminals committing offences of a corporate nature—specifically high-end businessmen who can easily evade the jurisdiction of their country by moving to another one.

This can be achieved successfully if the shift is to a country with a strong human rights doctrine, which would especially make the deliverance of the criminal difficult.

CONNIVANCE OF THE CORPORATE VEIL AND EXTRADITION: HOW VIJAY MALLYA EVADED THE LAW THROUGH THE TWO DOCTRINES

As discussed above, extradition—specifically the bars on it can be a handy tool for wealthy businessmen in dodging punishment. Such a situation was witnessed by India, in the case of Vijay Mallya—the owner of the Kingfisher Airline, otherwise known as 'The King of Good Times.'

A highly-publicized case, it was a great example of how the lifting of corporate veil principle and its restrictive nature in doing so can be misused by the owners and shareholders of a company, especially if its spiralling in debt. A common case of misuse of this doctrine can be highlighted through the case of *In Re. Dinshaw Manekji Petit v Unknown*, where essentially the Defendant, through his avenue of being associated with various companies either as a shareholder or even a trustee and thereby securing loans through them, he was successfully evading the tax authorities. He was levied a super-tax on those loans, which the Commissioner of Income-Tax contended to be his private income. The appellant claimed that the tax was levied on the interest and dividends owned by the company, and he was being guarded by the Corporate Veil. However, the Court in this case allowed lifting it and he was liable to pay the tax levied.[xxix]

The method adopted in this case often seems to occur, and can also be seen to have been adopted by Vijay Mallya. Mallya allegedly 'escaped' or 'ran away' from India owing Rs 9,000 crores to various banks, and has been declared a 'wilful defaulter' by several, including the State Bank of India (SBI).[xxx]

The key question to ask is why such reckless lending took place at all. Answering this question requires us to 'lift the corporate veil' hanging over the entire NPA phenomenon, digging deep to see what was happening behind the scenes. Companies owned, run, or controlled by him received loans from various banks. Over time, these companies did not or were not able to repay the instalments that came due. At that point, banks should have initiated steps to recover the money, as UBI tried to do, but many either did not do so at all, or did not go far enough. Possibly, some of them 'restructured' or rescheduled their loans, while others extended fresh credit, enabling Mallya's companies to make part payments on the earlier loans.[xxxi] Following

this, a consortium of banks led by SBI demanded for lifting the corporate veil against the various subsidiaries including Kingfisher Finvest, United Breweries Holdings Limited and Kingfisher Airlines Limited. This petition was filed with the Debt Recovery Tribunal. The counsel for the Bank claimed that Kingfisher Finvest is fully owned by Vijay Mallya and indulged in fraud and should be made liable for the entire debt.[xxxii] Although the Tribunal passed the order for lifting the veil, the administration of justice was further frustrated due to Mallya's shift to the UK sometime prior. Herein enters again the extradition treaty, and its potential of being misused.

In addition to the lifting of corporate veil petition filed by some of the banks who provided for loans to Mallya and his enterprise, there arose several other charges including fraud and further for contempt of court due to him misleading the Supreme Court on his wealth.[xxxiii] In amidst of all these charges being levied, India had already filed for extradition with UK, following which, Mallya was briefly arrested in London however was released on Bail. The case in the Supreme Court of India could also not be proceeded with as the Court stated that it could only happen if Mallya were to be present for the hearing himself.[xxxiv]

The UK has strong human rights laws, which make extradition of a person very difficult. India is among Category II countries under the UK's extradition laws. Category II cases take much more time to complete than Category I cases.[xxxv] A similar case of yet another wealthy Indian businessman having indulged in corporate malpractices, fled and taking shelter in London, has continued to evade the law authorities ever since. Taking in context here the case of Lalit Modi, the former chairman and commissioner the Indian Premier League, who was accused of money laundering among other offences, and has been unable to be either extradited or be captured by the British police itself. Finally, the case of Nirav Modi, who was the main culprit behind the $2 billion fraud case of Punjab National Bank has also found a haven in Britain after initially having fled to Hong Kong, quite possibly due to its increasing adherence to guaranteeing human rights to its civilians. A

A common way that the above-mentioned fugitives have adopted in order to continually remain free from facing punishment is to hide behind the curtain of 'political persecution.' Vijay Mallya labelled the charges and the subsequent extradition as a 'witch hunt', while Nirav Modi was reported to have arrived to the UK where he applied for political asylum with Britain's Home Office stating he was a victim of political persecution and denied any wrongdoing.[xxxvi]

Very recently, during the third Indo-UK home affairs dialogue, India sought the help of the authorities in the UK in extradition of these three wanted persons[xxxvii], and have managed to secure a court hearing in the UK itself for Vijay Mallya.

In contrast to the constant injection of public money into Kingfisher, most Indian citizens are struggling with spiraling cost of living and poor public provision of healthcare and education.[xxxviii] They do not have the luxury of defaulting like Vijay Mallya does. There is further collateral destruction of a Public Asset as Air India, being Kingfisher's profligacy is not only at the cost of India's nationalized banks but also the national carrier—Air India. "It could be on the diktat of the regulatory authorities involving various ministries of the Government of India that an unviable airline which is competing against the incumbent state carrier and siphoning away its passengers on both the domestic and international routes, is being supported via taxpayer-funded financial institutions."[xxxix]

However, The Indian Companies Act has several provisions under which the Government can actively intervene to force companies to behave or effect a change in management, which is what seems like the only current viable option in terms of the Company itself.

CONCLUSION

The modern world has become increasingly Capitalist, and as a result many of the laws that constitute within the framework of the countries can be seen as corporation-oriented. Multi-national corporations are now at the forefront of maintaining international relations, and are as important as political institutions in ensuring a country's hold on global power. Various doctrines have been developed to safeguard the interests of corporations, the Corporate Veil being one of them. It has been developed in various jurisdictions across the globe, including the Capitalist giants US and UK. Through carving out the judicial decisions in both the nations under corporate law, a comparative perspective was drawn wherein it was seen that much of the American application and understanding of the doctrine arises from the judges' and their interpretation at every case since even previously laid down precedents are rarely followed, whereas in UK, there is a much more well established mechanism in place. Both countries have added by laying down principles and guidelines from time to time, which only goes to show

that this doctrine much like many others are continuously being updated by lawmakers and courts alike.

However, there are multiple ways in which it can be misused in order for the Corporation to look after itself and its profits. Various outcomes of such a misuse including Bank fraud, tax evasion, etc. have come into existence over the years of the application of this doctrine. Such furtherance of interests by wealthy corporations comes at the cost of the general welfare of not just the economy but of individual citizens as well. Committing fraud and failing to return the loans taken from banks is essentially the money invested by various accountholders—which in majority is the common man.

Further, the extradition law has also in recent years been used by the corporate world as a tool to maintain its supremacy over the law governing it. Talking specifically in terms of Corporate Law, heads of huge corporations have used loopholes in the law to their advantage and have been successful in avoiding to being made accountable for their wrongdoings. Since in no shape or form do such individuals have a lack of resources, fleeing to countries that would make it nearly impossible to extradite them has been the getaway method of these individuals.

Thus, on analysis of the two laws, it is evident how they are blatantly being exploited by members of the corporate world, resulting in a system where accountability, justice, and the common welfare of the people are being compromised by hands of the corporate machinery and various safeguards in law present to achieve the same.

ENDNOTES

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