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# Unraveling the Corporate Veil: Examining Tort Liabilities

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ARPAN CHADHA<sup>1</sup>

## ABSTRACT

*This paper critically analyzes the Doctrine of Corporate Personality and its nuanced implications within the realm of tort obligations, with a specific focus on the seminal case of Salomon v. Salomon & Co. Ltd. The author endeavors to dissect the intricate interplay between the concept of corporate personality, limited liability, and the judicious application of the doctrine of piercing the corporate veil.*

*Encompassing an Indian perspective, the study delves into the dynamic evolution of corporate veil piercing, particularly its role in addressing tortious liabilities. By navigating through complex jurisprudential landscapes and scrutinizing key judicial decisions, the author illuminates the contours of veil piercing.*

*The study emphasizes the imperative of striking a delicate equilibrium between preserving corporate integrity and ensuring accountability. Drawing from the recommendations and conclusions, it underscores the significance of a refined statutory framework and limited judicial grounds for effective and equitable veil piercing.*

**Keywords:** Tort Obligations, Corporate Veil, Piercing of Corporate Veil, Salomon Case.

## I. INTRODUCTION

The **Doctrine of Corporate Personality** is often regarded as the cornerstone of company law. It serves as the foundation upon which the company is regarded as a distinct entity from the subscribers to its memorandum. Upon incorporation, a company, is regarded as a *separate legal entity* independent of its shareholders, promoters, directors, members, and employees, and it cannot be held liable for the wrongdoings of its members and proprietors.

The bedrock principle of corporate personality through the lens of limited liability concept emerged from the decision of House of Lords in *Saloman vs. Saloman*<sup>2</sup> where boundaries of a company as a 'juridical entity' separate from its members were clearly defined. This corporate artifice was created to allow a network of individuals to pursue an economic objective as a singular entity, without being exposed to risks or liabilities in their own capacities. In addition, companies could sue and be sued in their own name, as well as conduct activities in their own

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<sup>2</sup> Salomon v Salomon & Co. Ltd. [1897] AC 22

name. Consequently, a company could also endure the passing of its members.

The Salomon case set an unwavering precedent that has been used in various subsequent hearings. The concept introduced in Solomon's was first recognized in the *Kondoli Tea Co., Ltd., Re*.<sup>3</sup> Furthermore, in *Lee v. Lee's Air Farming Ltd.*<sup>4</sup>, the court ruled that Lee's partner was entitled to restitution under the Workmen's Compensation Act because Lee was an entity distinct from the organization that he operated and was considered to be an employee of the company.

Subsequently, the Doctrine of Corporate Personality came to be recognized in the Indian domain through various decisions and was consequently inculcated in **Companies Act, 2013**.<sup>5</sup> A company is defined in **Section 2(20)**<sup>6</sup> and is a legal person with a separate legal personality under the Act.

### **(A) Literature Review**

#### **1. Revisiting the Inhibited Doctrine of Piercing the Corporate Veil in English Company Law<sup>7</sup> Reem Kabour**

In light of the need of preserving the corporate veil for continued economic progress, this article analyzes the conservative attitude taken by English courts in the wake of Salomon. It emphasizes the necessity for a conceptual reconstitution of penetrating the corporate veil in order to create a more consistent and well-established framework for the effective application of the doctrine.

#### **2. Piercing of the Corporate Veil for Evasion of Tort Obligations<sup>8</sup> Stefan HC Lo**

This article examines the piercing of the corporate veil common law theory in the context of a company's tort liability. Where shareholders are abusing the Doctrine of Corporate Personality to avoid personal tort liability deriving from their actions, the article explores the necessity to employ traversing the corporate veil concept.

#### **3. Salomon v. Salomon – It's Impact on Modern Laws on Corporations<sup>9</sup> Rajib Dahal**

This study examines the Salomon case as a significant and robust basis for contemporary

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<sup>3</sup> Re The Kondoli Tea Estate (1886) ILR 13 Cal. 43

<sup>4</sup> Lee v Lee's Air Farming Ltd [1960] UKPC 33

<sup>5</sup> Companies Act, 2013, No. 18, Acts of Parliament, 2013

<sup>6</sup> Companies Act, 2013, § 2(20), No. 18, Acts of Parliament, 2013

<sup>7</sup> Reem Kbour, Revisiting the Inhibited Doctrine of Piercing the Corporate Veil in English Company Law, The King's Student Law Review, Vol 9 Issue 2, 59-73 (2019)

<sup>8</sup> Stefan HC Lo, Piercing of the Corporate Veil for Evasion of Tort Obligations, 46 COMM. L. WORLD REV. 42 (2017)

<sup>9</sup> Rajib Dahal, Soloman v. Soloman – It's Impact on Modern Laws on Corporations, 5 INDIAN J.L. & LEGAL Rsch. 6 (2018).

legislation pertaining to corporate governance. This paper undertakes a critical examination of the idea of distinct corporate identity and limited responsibility as articulated in the landmark case *Salomon*. Additionally, it seeks to justify the subsequent deviation of courts from this theory in post-*Salomon* jurisprudence.

#### 4. Critical Analysis on Lifting of the Corporate Veil by Judicial Interpretation<sup>10</sup>

*Siddhartha Sethi*

Cases in which the corporate veil has been broken by the courts are extensively discussed, with the focus being on Public Policy, Single Economic Entity, and Fraudulent or Improper Conduct. The paper emphasizes the importance of clarifying the rules for piercing the corporate veil in order to reduce the room for misunderstanding.

##### (B) Research Gap

The literature cited above thoroughly investigates cases in which courts have deviated from the *Salomon* judgment and invoked the doctrine of piercing the corporate veil as a result of fraudulent conduct. However, *there is a notable deficiency in research that thoroughly examines the escape of tort responsibilities through the improper utilization of the corporate veil.*

##### (C) Methodology

This research paper has utilized the methodology of *qualitative doctrinal legal research*. **Primary sources** of research include **Statutes** and **Legal Precedents** in the sphere of Company Law. Established **International Jurisprudence** is analyzed and applied in the context of the Indian legal arena.

The author has additionally utilized **secondary data** to comprehend the past research on the topic and develop solutions and strategies regarding corporate veil. This includes research publications, opinion pieces, articles, and other relevant material.

Popular **research tools** shall be used, such as Google Scholar, Hein Online, JSTOR, SCC OnLine, and WestLaw.

## II. CORPORATE PERSONALITY: A CRITICAL ANALYSIS

The decision in *Salomon* birthed the two principles, *separate legal personality* and *limited liability*, which came to be recognized as the twin pillars of Company Law. The concept of the **Corporate Veil**, as a legal fiction, asserts that a corporation is distinct from its shareholders, so

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<sup>10</sup> Siddhartha Sethi, Critical Analysis on Lifting of the Corporate Veil by Judicial Interpretation, 4 INDIAN J.L. & LEGAL Rsch. 1 (2022-2023).

that any privileges, responsibilities, or duties of the shareholders are limited to the level of their capital investments.

The landmark case of *Prest v Petrodel Resources Ltd & Others*<sup>11</sup> exemplifies a legal scrutiny on the corporate veil doctrine. Addressing the parameters of piercing the veil, the case explored situations allowing disregard for a company's separate legal identity. The Court's judgment highlighted a confined application of the doctrine, with *limited scope*. The Supreme Court also questioned the principle's existence due to *inadequate reasoning*, casting *uncertainty on its applicability*.

The juridical personality of a company renders it reliant on human agents, hence creating opportunities for both advantages and potential abuse. The presence of human agents acting on behalf of the corporation without assuming any personal obligations has resulted in dubious behavior by individuals taking advantage of the organization's distinct legal status. Therefore, the notion of **Lifting/Piercing the Corporate Veil** emerged as an exception to the Salomon principle shortly after it was established. Under this, courts *extend their scrutiny beyond the distinct legal personality* of an organization in order to safeguard it against potential fraudulent exploitation by its shareholders.

In the case of *Life Insurance Corporation of India v. Escorts Ltd.*<sup>12</sup>, the Supreme Court opined that the determination of situations in which the corporate veil may be pierced should not be exhaustively enumerated, as it is contingent upon relevant statutory or other provisions, the primary objective being pursued, the contested conduct, the presence of a public interest component, and the potential impact on affected parties, among other factors.

### III. RETHINKING SALOMON: AN INDIAN PERSPECTIVE

Several provisions of the Companies Act 2013 have been modified with the objective of ascertaining the culpable individual responsible for engaging in inappropriate or unlawful activities under the guise of the corporate entity. The persons in question are often designated as **officers in default** according to **section 2(60)**<sup>13</sup> of the Companies Act, and they occupy positions of high management.

In *VTB Capital PLC v. Nutritek International Corporation*<sup>14</sup>, the court examined that the corporate veil can be pierced when the corporate structure is used as a *sham* or *facade* to conceal

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<sup>11</sup> *Prest v Petrodel Resources Ltd & Others* [2013] UKSC 34

<sup>12</sup> *Life Insurance Corporation of India v. Escorts Ltd.* (1986) 1 SCC 264

<sup>13</sup> Companies Act, 2013, § 2(60), No. 18, Acts of Parliament, 2013

<sup>14</sup> *VTB Capital PLC v. Nutritek International Corporation* (2013 2 AC 337)

malfeasance by its members. **Section 339<sup>15</sup>** elaborates on the liability resulting from such *fraudulent* and *unlawful* behavior.

In the matter of *Sir Dinshaw Maneckjee Petit, Re*<sup>16</sup>, an individual established four new companies using dividends received from a prior company, aiming to evade tax obligations. The court ruled that in instances of *tax evasion*, the corporate veil could be pierced, allowing the true nature of the entities to be exposed.

In the case of *State of Rajasthan & Ors. v. Gotan Lime Stone Pvt. Ltd*<sup>17</sup>, the Supreme Court ruled that the concept of unveiling the corporate facade could be applied when there was a breach of law and public interest was at risk. In the present instance, the actual essence of a transaction was concealed through the implementation of two distinct transactions.

#### IV. TORT OBLIGATIONS: NAVIGATING LEGAL COMPLEXITIES

The analogy between a company and its members' economic realities resembles the *principal-agent relationship*, where the principal assumes accountability for agents' actions serving the principal's benefit. A company's pursuits serve its members, who reap profits from activities culminating in tortious liabilities. In such scenarios, when a company lacks assets to satisfy tort claims, piercing the corporate veil is warranted, attributing the company's obligations to its controlling shareholder, particularly when sufficient assets are absent to meet tort victims' claims.

From an interactive or corrective justice standpoint, ensuring accountability for wrongful conduct causing harm or loss is imperative. However, an excessive focus on corporate law doctrines of separate legal existence and limited liability permits wrongdoers to evade accountability for tortious acts facilitated through corporate entities. This not only contradicts moral principles but also hampers economic efficiency.

In summary, the economic analogy between a company and its members aligns with the principal-agent concept, warranting accountability akin to that of a principal. The propensity to evade liability through corporate structures necessitates a balanced approach, while the prevailing limitation on future liabilities warrants reconsideration. **The application of the veil piercing doctrine should extend to situations where future tortious liabilities loom, ensuring justice and fairness in the realm of corporate liability.**

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<sup>15</sup> Companies Act, 2013, § 339, No. 18, Acts of Parliament, 2013

<sup>16</sup> Sir Dinshaw Maneckjee Petit, Re (AIR 1927 Bom. 371)

<sup>17</sup> State of Rajasthan & Ors. v. Gotan Lime Stone Pvt. Ltd *CIVIL APPEAL No. 434 OF 2016*

## V. CONCLUSION & RECOMMENDATIONS

The doctrine of piercing the corporate veil in Indian law ventures beyond conventional boundaries, revealing both opportunities and complexities. It encompasses various grounds beyond the commonly recognized ones including contempt of court, avoidance of welfare legislations and cases of economic offenses. The judiciary holds broad discretion over this principle, having the potential to inconsistent interpretations and possible misuse of the doctrine.

To ensure consistency and clarity, the legislation should be updated and refined, as exemplified by the *Adams v Cape Industries Plc*<sup>18</sup> case, which narrowed the scope of veil piercing. Further, a more comprehensive examination of the law is essential, exemplified by the *Chiranjit Lal Chaudhary v. Union of India*<sup>19</sup> case. Here, the Court extended fundamental rights, including Article 21, to corporate entities. Yet, a paradox arises when the company's entity is overlooked for wrongs committed by its members.

However, the necessity of veil piercing remains evident due to evolving cases and inherent gaps in standard rules. To prevent abuse and ensure fairness, judicial interpretation is crucial. In clear instances of deception, lifting the corporate veil is essential. **Therefore, a well-defined statutory framework, coupled with limited judicial grounds, would enhance the doctrine's effectiveness.**

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<sup>18</sup> *Adams v Cape Industries plc* [1990] Ch 433

<sup>19</sup> *Chiranjit Lal Chaudhary v. Union of India* 1950 SCR 869

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