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**HUMAN RIGHTS VIOLATION AS A GROUNDS FOR PIERCING THE
CORPORATE VIEL**

Abstract

The article attempts to study the criteria for the applicability of the doctrine of piercing the corporate veil for civil liability claims by the sufferers of Human Rights violations, especially to the employees of the company by defeating the limited liability. The main precedent to be studied will be that of the one set in the 2003 case against the State of Bihar and various human rights provisions available nationally and internationally for a right to a life with dignity in accordance with the UNGP practices. This shall also be applied to the present Covid-19 pandemic.

Introduction

“The company is at law a different person altogether from the subscribers to the Memorandum and, although it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or the trustee for them. Nor are subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.”

-Lord McNaughten

1844 saw the first of incorporated companies. By the year 1885 the Doctrine of Limited Liability was introduced along with the inclusion of limited liability companies. The incorporation of a company gives it the status of a separate legal entity which means it is treated separately from its directors, employees, board members and promoters. The duties and liabilities of the company along with its commitments are individualistic to the organisation and not to its shareholders or owners. If one views it from purely a legal standpoint a limited liability company is a legal person and this separate individualism is known as the “*Veil of Incorporation*” which was stated in the case of *Salomon v. Salomon*¹. The House of Lords in this case stated that the limited corporate liability is adjacent to the limited liability of a corporate and its veil which forms the base principle.

A business entity or organisation has one key goal that stands to be- profit. An entity is set out to create a profit that is incrementing in nature. Further the core receiver of this profit is the founder or head of the organisation.

*“For a 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 of all the corporate property.”*²

This means that as there is a person behind the company who is reaping off the benefit and profit, there is a limit to be placed on the principle of limited liability that forms the corporate veil. The co-dependence of the limited liability along with a separate legal entity is called the ‘twin concept’. The lifting of this ‘twin concept’ is the piercing of the corporate veil.

The violation of Human Rights in by a corporate, especially of its employees is a criterion for piercing the corporate veil. This was first stated in India in the case of *Kapila Devi Hingorani v. The State of Bihar*.³ In this particular case the human rights violation was due to non-payment of salaries or wages to the employees for work or according to what the court deems fit. However in the present ‘pandemic times’ many corporates have fallen victim to tumultuous economies due to which this criterion (non-payment) comes into question.

¹ *Salomon v. Salomon and Co. Ltd.*, [1897] A.C. 22

² All Answers Ltd. November 2018. Lifting of the Corporate Veil. [online]. Available from: <https://www.lawteacher.net/free-law-essays/business-law/article-on-lifting-of-the-law-essays.php?vref=1>

³ *Kapila Devi Hingorani v. The State of Bihar*, Writ Petition (C) No. 488 of 2002

Literature Review

The case of *United States v. Milwaukee Refrigeration Transit Company*⁴ saw the shift in the concept of a legal entity. This American case stated that in every case a corporation will act as a legal entity by general principle, however in any situation where this principle is misused as a shield to go against public policy, or 'defeat public convenience' the persons behind the entity will be held liable.

*"A corporation will be looked upon as a legal entity as a general rule but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime the law will regard the corporation as an association of persons."*⁵

Piercing of the corporate veil is an act that is to determine the personal with the mal-intentions at the top brass. This is the end of the line spectrum for the wrongdoings acting as a key exception to the general principle of limited liability. Lord Denning in the case of *Littlewoods Mail Order Stores Ltd. v. IRC*⁶ stated that:

"To 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."

This 'mask' is peeled away to ensure the members of the company- the board of directors, promoters and shareholders- are performing the activities of the company with due diligence.

It has been observed by precedents set by courts that the piercing of the corporate veil is conducted for the investigation of members of the limited liability company to prevent fraud via the establishment with the view of public policy.

A decision by corporate law to allow shareholders limited liability is a decision to allow them, as investors, to allocate some of the risks of doing business to third parties.⁷ This method is a key method via which the courts have been able to regulate the risk aspect of the limited liability company via the process of lifting the corporate veil.

⁴ *United States v. Milwaukee Refrigeration Transit Company*, 142 F.247 (1906)

⁵ id

⁶ *Littlewoods Mail Order Stores Ltd. v. IRC*, [1969] 1 W.L.R. 1241, 1254

⁷ Robert B. Thompson, *Piercing the Corporate Veil: Is the Common Law the Problem?* 37 CONN. L. REV. 619, 622 (2005).

There have been established certain grounds on which a corporate veil can be pierced via legislatures and judgments in the interest of justice, equity and good conscience. There lacks an air tight formula via which the lifting of the corporate veil can be justified due the necessity of corporate operations.⁸ The solution is the decision taken by the courts in determining the same to examine the “*underlying social, economic and moral factors as they operate in and through the corporation.*”⁹ Hence the principle established in *Solomon v. Solomon* cannot be tenaciously followed but must be adjusted in accordance with the facts and scenarios.¹⁰

The Indian Judicial System has seen a massive shift in the principle and application of piercing of corporate veil over the last few years. The concept of corporate veil was initially used for the prevention of tax evasion and fraud however in case there is a lack of compliance with the Companies Act, there has been as broadening of the horizons by the court amongst other reasons.¹¹

- The criteria include fraud or illegality as stated in the case of *Delhi Development Authority v. Skipper Construction*.¹²

- The case of *Formosa Plastic Corporation Ltd. v. Ashok Chauhan*¹³ stated that in case of the initiation of execution proceedings, the court will have the authority to pierce the corporate veil especially in cases where the veil is used as a garb to fictitiously acquire properties in the name of other persons for the purpose of committing illegalities or for defrauding others, so as to enable it to pass appropriate orders to do justice between the concerned parties.

-In cases where the subsidiaries of a company are liable of the wrong, the veil of the parent company can be lifted if there was knowledge of the same as stated in the case of *DHN Food Distributors v. Tower Hamlets London Borough Council*.¹⁴

- The landmark judgements in *Kapila Hingorani v. State of Bihar*.¹⁵ And *Husainara Khatoon v. State of Bihar*¹⁶ stated that in circumstances where there is a requirement for justice in due

⁸ Warner Fuller, *The Incorporated Individual: A Study of One-man Company*, (1938) 51 Harv LR 1373, 1377

⁹ *Tata Engineering Locomotive Co v. State of Bihar* AIR 1965 SC 40

¹⁰ *Odyssey (London) Ltd. v. OIC Run Off Ltd.* (2000) TLR 201 CA

¹¹ *Bhatia Industries & Infrastructure Limited vs. Asian Natural Resources (India) Limited and Ors.* [2016(6)ABR132]

¹² *Delhi Development Authority v. Skipper Construction*, (2000) 10 SCC 130

¹³ *Formosa Plastic Corporation Ltd. v. Ashok Chauhan* 1999 (1) AD (Delhi)

¹⁴ *DHN Food Distributors v. Tower Hamlets London Borough Council* 5 (1976) 1 WLR 852

¹⁵ *Supra* 3

to human rights violations towards the employees of the corporation, it acted as a valid criterion for piercing the corporate veil.

This research article follows the UNGP¹⁷ guidelines and works towards establishing a just form of jurisdiction to hold liable the corporates for negligent acts by based on due and reasonable diligence. These obligations state that if the members of a company are seen to violate basic human rights by refusing to provide means for the principle life of dignity to the employees and rather benefit themselves it will lead to personal liability of these members. This due diligence should adhere to human rights guidelines.

This paper further follows papers that work about lifting the corporate veil within subsidiaries that is more relevant than ever with respect to the current pandemic times as seen with the high rates of unemployment as well as following certain landmark judgements. This brings us to the research gap. There is a massive lack of research due to the topic being extremely new. However with the current state of unemployment and the cut in salaries as well as a certain degradation in the quality of life for corporate employees the question of whether the benefit the board of directors still receive rather than the employees is a question for human rights violation and whether it's enough to lift the corporate veil.

Research Objective

The research objective is to study the doctrine of piercing the corporate veil, its correlation with human rights and how the present pandemic situation plays into this matter.

The issue here hence is whether in the present pandemic situation does a cut in salaries or furloughing at a short notice act as a violation of human rights and whether it should qualify as a clause to pierce the corporate veil or act as an exception.

Methodology

This research paper has been written via two methods. First the empirical data that has been collected through the medium of a form and primary data collected from a diaspora and sample set of 50. This sample set consisted mainly of an unbiased population of students and

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¹⁷ United Nations Guiding Principles in Business and Human Rights

individuals across the country of India. These citizens were not ones who have experienced any disparities or ones who caused any disparities as that would lead the data to be biased.

The secondary data collected is via referring to research papers written by the European Business law Review, Articles written by legal associates at tier one law firms in India and Research papers by the University of Cambridge. The secondary data has also been collected by the judgments passed in cases such as Kapila Hingorani v State of Bihar, Husainara Kahtoon v. State of Bihar and In Chairman, Railway Board and Ors. v. Mrs. Chandrima Das and Ors.

Analysis

Doctrine of piercing the corporate veil

There hasn't been any established or lock grid methods by which there can be a determination of the lifting of the corporate veil. There has been a proven difficulty faced by the courts in determining any fixed criteria for the same. This principle has however had one fixed logic behind it and is applicable to all the various scenarios where mal-practice has been done behind the veil of a separate legal entity, this test is if the control over the committing of the act, the knowledge of the act and lack of due diligence is the causation for the act. These are the factors upon which the determination of the lifting of the corporate veil will be placed.

Various scenarios can be placed under the sphere of judicial interpretation with respect to the piercing of the corporate veil as follows:

1. The actions of the members and decision makers of a company if not in compliance with the laws of the land or moral principality, can via legislative and judicial interpretation of statutes be brought under administrative compliance via the lifting of the corporate veil. Sometimes the corporate form will be ignored in order to accomplish the specific legislative goal of a government benefit program that distinguishes between owners and employees. And of course, sometimes the corporate form will be respected where doing so is necessary to reach a result that is consistent with a particular state or federal statutory scheme.
2. The failure to follow any formalities, under-capitalizations, alter egos, ownership of all of the stock in the company, payment of dividends etc. under a corporate are all

sub categories under the three main criteria of fraud, bankruptcy and preventing limited liability where not needed which includes Human Rights violations as proven by the case of Kapila Hingorani v. State of Bihar in India. Unless the directors or core of the corporate have wrongly benefitted by the acts mentioned above, it won't be a clause for the piercing of the corporate veil.

Statutory Provisions In Support Of Lifting the Veil

The provisions for lifting the corporate veil are provided for in the Companies Act 2013. These provisions provide for criteria under which the veil can be lifted so individual directors/members can be made liable. Section 45 of the Act that covers the reduction of members of a company below the stipulated number in the statute is a criterion for the same as it leads to extra benefits to the members. Section 147 of the Act states that an improper use of the name or entity of the company to sign a fraudulent bill of exchange or negotiable instrument also stands as grounds for piercing of the veil.

Section 542 of the Act further provides for the liability imposed in cases of fraudulent conduct of business. During the process of winding up of a company, if any business of the company is conducted with any intention to defraud the creditors or any other third party with intention of doing so, all involved persons with the knowledge of doing so, will be held liable for the same without any restrictions on the liability and must pay in the manner prescribes by the court be it fine or criminally via imprisonment.

Comparative Analysis with the Laws of U.K. and U.S.

Veil-piercing jurisprudence in the U.K. and the U.S. is largely based on facts and circumstances and defies neat categorizations.¹⁸

United States of America

In the United States of America the concept of corporate veil piercing is exercised in case where parent companies have control over the subsidiaries and the practice is carried out with fraud, illegal activities or improper conduct that creates injustice. It is always associated with intentional and misleading acts lead to veil piercing.¹⁹ The creation of the reasonable belief

¹⁸CarstonAlting, Piercing The Corporate Veil in American and German Law-Liability of Individuals and Entities: A Comparative View, 2 TULSA J. COMP. & INT'L L. 187, 199 (1984).

¹⁹ Anderson v. Kennebec River Pulp & Paper Co., 433 A.2d 752 (Me. 1981); African Metals Corp. v. Bullowa, 41 N.E.2d 466 (N.Y. 1942); Bucyrus-Erie Co. v. Gen. Prod. Corp., 643 F.2d 413 (Ohio App. 1981); Truckweld Equip. Co. v. Olson, 618 P.2d 1017, 1021(Wash. App. 1980); Sprecher v. Weston's Bar, 253 N.W.2d 493, 498 (Wis. 1977).

that the parent and subsidiary are one company can support veil-piercing, and factors such as non-observance of formalities, gross undercapitalization, and commingling of assets have been cited as veil-piercing triggers.²⁰ Where the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will disregard the corporate entity and treat it as an association of persons.²¹

United Kingdom

In U.K., the corporate veil is pierced if it is necessary to achieve justice.²² Even similar terms such as "alter ego" can be found in some U.K. cases.²³ As in the U.S., veil-piercing occurs in the U.K. where there is a high degree of control by the shareholder.²⁴ However, a number of U.K. decisions reflect a general reluctance to pierce the corporate veil.²⁵ Nevertheless, piercing has occurred in some cases involving intentional acts of deception or efforts to avoid a legal duty.²⁶

Corporate Veil Piercing and Human Rights

The violation of human rights by corporates, their subsidiaries and contracting partners of multinational companies is a topic that is rampantly being discussed within the research community and if violating principles of the UNGP is a criteria for the lifting of corporate veil is valid. These queries mainly stem from acts such as land related relocation and uprootment of people and labour laws and labour conditions such as mining activities. This stems from the principles of Corporate Social Responsibility (CSR) "An appropriately modest set of duties ties to relationships with stakeholders in the organization"²⁷

Most difficulties in analysis along with research on the veil piercing lie on the corporate liabilities that are hindered by jurisdictional questions.²⁸ The law instead should focus on the

²⁰ Brunswick Corp. v. Waxman, 459 F.Supp. 1222 (E.D.N.Y. 1978); DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681 (4th Cir.1976).

²¹ United States v. Milwaukee Refrigerator Transit Company (1905) 142 F, edn. 247.

²² Creasy v. Breachwood Motors, Ltd., [1993] BCLC 480, [1992] BCC 638 (Q.B.)

²³ Security Exchange Ltd. v. Gordon, Transcript of Hearing, Oct. 7, 1988 (C.A.)

²⁴ Wallersteiner v. Moir, 2 All E.R. 217, 1 W.L.R. 991 (C.A. 1974)

²⁵ Littlewoods Mail Order Stores, Ltd. v. I.R.C., 1 W.L.R. 1241 (C.A.1969).

²⁶ Wallerstein v. Moir, 2 All E.R. 217 (1974); Creasy v. Breachwood Motors, Ltd. [1992] BCC 638 (Q.B. 1993); Re A Company Ltd. v. Vwagh, [1985] BCLC 333.

²⁷ Denis G Arnold, Global Justice and International Business 23 Business Ethics Quarterly 125 (2013).

²⁸ Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law, Gwynne Skinner, 72 Washington & Lee Law Review 1769–1864 (2015)

behavioural factors of such corporates particularly to the duty of care when it comes to employee lifestyle and dignified lives.²⁹

The issue that lies with multinational companies at the present is that their subsidiaries are held responsible for the violation of human rights and not them.³⁰ This is a criterion that must be created via a corporate criminal liability to be placed on them for being vicariously liable as was seen in the disastrous Bhopal Gas tragedy and Union Carbide.

Further comes in question the applicability of the UNGP (principle 26) highlight that judicial mechanisms grant effective access to justice when they accord due process before impartial, independent and non-corrupt courts, and provide means to effectively enforce judgments. These criteria are the same as the ones mentioned in the human rights literature in general³¹ and in the business and human rights literature in particular³² The UNGP further refers to legal barriers directly related to civil tort and criminal claims and transnational litigation and to the practical barriers already mentioned such as jurisdiction.

Further in the case of *Chairman, Railway Board and Ors. v. Mrs. Chandrima Das and Ors*³³, the court held that as a signatory to the International Covenants and Declarations as adopted by the United Nation must be followed. By the declaration of Human rights anything against the liberty and basic dignity of a human being done by the corporate must be severally be punished and act as a criteria for the piercing of the corporate veil. This is a principle that must be engrained within domestic jurisprudence.

Further the case of *Kapila Hingorani v. The state of Bihar* that was a reference point to *Husainara Khatoon v. State of Bihar* who was a widowed victim of a Human rights violation by a corporate subsidiary of the State government led to the decision that preventing any employee from a decent life of dignity that is hindered by the causation of accidents, violations of labour laws or desertion and prevention of salary payment all falls under a cause for lifting of the Corporate Veil in India and allowed it to be a criterion as a fraud and malpractice against human rights under Indian Laws.

²⁹ Infringe Human Rights, 169, 192 (The UN guiding principles on business and human rights: foundations)

³⁰ Human Rights violations of subsidiaries and the liability of the Parent companies, Rolph .f. Weber and Rainer Baisch, *European Business Law Review EBLR* (27 5) 669 2016.

³¹ (ICJ 2006:158;ECtHR and CJEU 2016)

³² (FRA 2017;Zerk 2014;Skinner et.al 2013;Van Der Plancke et al 2016;Enneking et al. 2015;Pigrau Solé et al.2016;Alvarez and Yannibas: 2016;Skinner 2015;Weber and Baisch 2016).

³³ *Chairman, Railway Board and Ors. v. Mrs. Chandrima Das and Ors*, AIR (2000) SC 988

The Present Pandemic Situation

The present day scenario before corporates is one of extreme unexpectedness. The present pandemic situation of Covid 19 has led to numerous corporates lying in a complete loss due to the collapse of the global economies. In the primary survey conducted for this article the basic question of whether furloughing in times of need and cutting of salaries is valid. Within the responses while 60% of the sample set were in association with a person who has been furloughed or rendered unemployed. However the situation called for the question with reference to the fundamental principle of life of liberty if the cut in salaries was one that was a valid cause for piercing the corporate veil. As seen via the research mentioned above, the insufficient payment of wages is a violation of Human Rights under regular circumstances.

However the Present situation saw a drastic turn of events. There was a 50-50 opinion that stated that these exceptional circumstances should act as an exemption from the above. The reason for this logically applied files within the above mentioned data of application of the already existing laws i.e. the presence of intent. There is mostly a complete lack of intent in the present situation as it is a matter of survival for most of these corporates. However if there is a malpractice by hiding behind this exception it should be treated as criteria for dropping or piercing the veil.

Conclusion and Suggestions

The article at its core comes to the conclusion that the exception to the principle in a limited liability company with a separate entity is that where there is an intention for malpractice observed for the personal gain of the members of the company. The prevention of providing and depriving the constitutes of the company with wages, salaries and a decent work environment (such as health and medical care in countries like the USA) it acts as a violation of Article 21 of the Constitution of India and basic worker's rights principles. The same is followed as criteria for lifting the corporate veil and suing the ones who benefit behind the company while the employees suffer. This has been observed as a Human Rights violation in multiple cases in the Indian Judicial system as well as grounds for piercing of the corporate veil. However in cases of exceptional nature as observed in the years 2020 and 2021 due to the economy being brought to a standstill where there has been furloughing and a reduction in salaries, there is a lack of ability to follow the same. The courts have hence proven by the revocation of the MHA Circular in May of 2020 for payment of full salaries that the same

must not be followed. This being said, in cases and companies where the profits have surged such as the FMCG or agricultural sectors as well as e-commerce intermediaries, there lies no justification for the deprivation of full salaries or furloughing due to the present economic situation for the employees as well. Further the improvement in the economy post 2021 is also grounds for the same. In case the deprivation continues in these circumstances where the members of the corporate deem benefits to its umpteenth amount, it should be considered a mal-practice and Human Rights violation as per the precedents set and the veil must be pierced.



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