



## DISREGARDING THE SEPARATE ENTITY RULE PROMULGATED IN SALOMON'S CASE: AN EMPIRICAL STUDY

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### Abstract

Separate Legal entity of a corporation has proved to be a double edged sword as it promotes capitalism and evasion of legal obligations. Corporate veil may sometimes amount to injustice and incorporator's limited liability may be a lenient way out leading to further frauds, problems in trading and revenues. There is no consensus on the type of category while disregarding the separate legal entity principle whether it depends on policy or justice. It seeks as to how director's liability may adversely affect incentives for intellectual property. It analyses an empirical study of corporate veil piercing of Westlaw countries with an attempt to find the manner in which the separate entity is disregarded and then looks at a similar study done in China. It also gives an international and Indian perspective of ways of disregarding the principle with relevant compilation of judgements.

Keywords- corporation, disregard, principle, entity, veil etc.

### Introduction

The separate legal entity principle can shield parties unnecessarily and the good reason behind such rationale may be defeated.<sup>1</sup> Professor Kahn-Freund called the decision upheld in *Salomon v Salomon & Co Ltd*<sup>2</sup> as

calamitous. While giving the benefit of limited liability to incorporators to carry on their business, it also allows promoters to abuse the advantage of see-through incorporation of an undercapitalised company. Trade creditors and employees of a company bear a huge part of the risk of corporate insolvency where the latter has to involuntarily deal with it due to lack of information about the employer's financial standing. The tort creditors bear an unprecedented risk during company's insolvency unlike the contract creditors who at least entered the contract at their own will. The flexibility and facility for shielding the directors and members against the claims of the creditors has resulted in fraudulent and anti-social activity.

The '\$2 company' case shows how the burden of large debts incurred has been so conveniently shifted on the company for being a separate legal entity. The 'bottom of the harbour' schemes portrayed how large income tax liability was transferred to a new corporation incorporated through a series of transactions. The new corporation was merely used for the benefit of the people who have formed it like granting unsecured interest free loans, corporate capital for personal living expenses, further tax minimisation, payment of management services and astronomical fees etc. Trust structure fused with corporate form might give even a bigger leverage to the defaulters. The House of Lords has extended the principle of separate legal entity to private enterprises which has had several negative consequences. The question lies in whether the negative outweighs the positive aspect of the principle in *Salomon's case* or whether

<sup>1</sup> *Berkey v Third Avenue Rly* [244 NY 84 at 94-5,(1926)].

<sup>2</sup> AC 22[1897].



the statutory and judicial assistance can help crack open the corporate shell which has been misused.

### Literature Review

1. Henry Winthrop Ballantine<sup>3</sup>- It basically talks about the importance of history of corporations, its characteristics especially separate legal entity, citizenship and finally classification. It talks about how earlier corporations were mainly municipal, charitable and ecclesiastical which slowly paved way for guilds, educational and eleemosynary corporations, regulated companies. In Continental Europe, corporation and partnership were both named *societas*, but a distinction in the latter was marked by the adjective 'anonymus'. It also mentions the advantages of corporation over partnership. According to the definition of a corporation as a legal artificial person, it has the capacity of succession, contract, to take hold and convey property in its name as well as to sue and be sued. The right to act as a corporation has been granted by the special authority from the state which is the result of the franchise. While disregarding the corporate entity, limits on the corporate privilege, fraudulent device, individuals liability for corporate stocks, one man company, parent and subsidiary corporations, enemy character needs to be taken into account.
2. Nicholas James<sup>4</sup>- The doctrine of separate legal entity is metaphorically constructed
3. Murray A. Pickering<sup>5</sup>- The principle may encourage law to evolve in a haphazard and irrational way. It also has a pervasive effect as to whether it would keep adding another facet to the scope of corporate law subject to three exceptions, namely-extent of the company's legal competence, nature of its legal capacity and the manner in which its capacity is exercised.
4. Aris Haigian<sup>6</sup> - The Cuban uprising forced the expropriation of banking industry highlighting Banco Para el Comercio Exterior de Cuba v. First National City Bank<sup>7</sup> (Bancec), where the question arose as to whether Bancec was a mere arm of the Cuban government. Based on its instrumentality engaged in a governmental function which was also controlled by the government, the test proves that Bancec was an alter ego of the state.
5. A. John P. Mancini<sup>8</sup> - In the case of Commissioner v. Bollinger, the Tax Court

<sup>3</sup> Ballantine on Corporations, Founded on Clark and Marshall Corporations (1927).

<sup>4</sup> Separate Legal Personality: Legal Reality and Metaphor, 5 BOND L. REV. [i] (1993).

<sup>5</sup> The Company as a Separate Legal Entity, 31 MOD. L. REV. 481 (1968).

<sup>6</sup> The Separate Entity Fiction Exposed: Disregarding Self-Serving Recitals of Juridical Autonomy in

Nationalization Cases, 6 FORDHAM INT'L L.J. 288 (1982).

<sup>7</sup> 505 F. Supp. 412 (S.D.N.Y. 1980).

<sup>8</sup> The Continued Validity of the Separate Entity Doctrine: The Remaining Issues after Commissioner v. Bollinger, 42 TAX LAW. 773 (1989).



and the Sixth Circuit Court decided that the corporations were merely agents for partnerships and therefore should be disregarded for tax purposes. It analyses the separate entity doctrine's credibility after the verdict of the above mentioned case and also the Court's understanding of avoiding state usury laws.

6. William H. Clark Jr. & D. Alicia Hickok<sup>9</sup> - With changing times limited liability is made attainable to owners of any business organization which are now seen embracing entity status separate from its owners. It states the relationship among limited liability, separate entity status. It also questions the modern relevance of an old debate between contractarian and concession theories where the former sees corporation as a contractual entity governed by the corporate law which supports the contracting process enabling incorporation whereas the latter sees corporation as an authority to be delegated by the state.
7. Joshua C. Macey<sup>10</sup> - Winkler observes that the legal base of a corporate constitutional rights lie not in the Supreme Court's acknowledgement that the corporations have a 'separate personhood' but rather in the doctrine that they are simply 'associations of people'.
8. William C. Hoffman<sup>11</sup> - It mainly dealt with development and applications of the separate entity rule in US, UK and Western Europe. It also dealt with practical problems regarding separate entity immunity and alter ego liability.
9. Barry Horwitz<sup>12</sup> - Machen argued that for the sake of convenience rights and liabilities have been conferred to the corporate entity but the powerhouse behind it is the men of flesh and blood. He regards the legal entity status of corporation as a mere metaphor or fiction of law. The general concept of disregarding the corporate entity is all consistent but veil-piercing doctrine is applied inconsistently by the courts as it does not want the shareholder to suffer a liability beyond its investment.
10. Rhonda Chesmond<sup>13</sup> - Intellectual property which promotes useful and new innovations which cannot afford the negligence and avoidance of duty by the directors on account of separate legal entity. A corporation although is a juristic person can interfere with third party situations and cause considerable damage when there is personal liability of the directors or if the corporation was established for wrongful acts, abusing the corporate veil.
11. Robert B. Thompson<sup>14</sup> - The belief that shareholders will respect the general rule of separateness from the corporation has lead

<sup>9</sup> Repricing Limited Liability and Separate Entity Status, 40 Seattle U. L. REV. 497 (2017).

<sup>10</sup> What Corporate Veil, 117 MICH. L. REV. 1195 (2019).

<sup>11</sup> Separate Entity Rule in International Perspective: Should State Ownership of Corporate Shares Confer Sovereign Status for Immunity Purposes, 65 TUL. L. REV. 535 (1990-1991).

<sup>12</sup> A Fresh Look at a State Doctrine: How Public Policy and the Tenets of Piercing the Corporate Veil Dictate

the Inapplicability of the Intracorporate Conspiracy Doctrine to the Civil Rights Arena, 3 NW. J. L. & Soc. POL'y 131 (2008).

<sup>13</sup> When Legal Fictions Collide: The Primacy (or Otherwise) of the Separate Entity Principle of Corporate Law in Intellectual Property Cases, 11 DEAKIN L. REV. 69 (2006).

<sup>14</sup> Piercing the Corporate Veil: An Empirical Study, 76 CORNELL L. REV. 1036 (1990-1991).



illegitimate results. The principle is not absolute and any instance where public convenience is defeated to validate the wrong, courts should disregard it. Professor Ballantine mentions that everything narrows down to good faith and sincerity in the use of corporate privilege through legitimate means. It conducts an empirical study to evaluate certain claims such as whether piercing the veil is more likely to be in contractual cases than in tort or when the shareholder behind the veil is an individual not a corporation or in close corporations rather than a public one. The courts rely on different statutory policies affecting limited liability while lifting the veil and thus exposing the myth of separate legal entity.

12. Hui Huang<sup>15</sup> - It conducts an empirical research on China's cases based on statutory veil piercing as a part of corporate law reforms of 2005. It tries to find some rationale behind the complex and uncertain doctrine and to confirm whether China has been successful in protecting the interests of its creditors. It follows interest group theory approach to develop its veil piercing regime and tries to improve its efficacy to facilitate foreign lenders, partners or investors in the companies

13. Naman Kamdar & Akash Srinivasan<sup>16</sup> - The bad loan crisis in India has wrecked the Indian economy although several steps have been taken like the enactment of the Insolvency and Bankruptcy Code 2016 and amendments to the Banking Regulations Act 1949. It suggests the adoption of reverse veil piercing where the liability of the controllers

of the corporation is shifted to the corporation itself which leave little room for the controllers to use the separate legal entity status of the corporation for wrongful purposes.

#### *Research gaps*

There is no flow of continuity or certainty with regards to how the courts decide whether they would disregard the separate legal entity status of a corporation or not. There is no criteria mentioned on the way how or when it is done, it's variance from place to place, whether it is based on the identity of the individual or the corporation, the situation, rationale behind the decision of the courts, undercapitalization, informalities, contract versus tort etc.

#### **Objectives and Issues**

The objective is to try and encompass an empirical study as to disregarding the separate legal entity status of a corporation by focusing mainly on piercing the corporate veil while touching other relatable information. The issues presented with this study are as follows-

1. What is the general frequency distribution of courts piercing the corporate veil? Does its effectiveness vary from place to place?
2. Is there a difference based on the number and identity of shareholders?
3. Is there a difference based on whether the defendant is an individual or a corporation?
4. Is there a difference based on the identity of the plaintiff?
5. Is there a difference based on the substantive context in which the claim arose?

<sup>15</sup> Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading?, *The American Journal of Comparative Law*, SUMMER 2012, Vol. 60, No. 3 (SUMMER 2012), pp. 743-774.

<sup>16</sup> Solving the Bad Loan Crisis in the Unconventional Way: Is Reverse Piercing the Corporate Veil a Solution?, *12 NUJS L. REV.* 169 (2019).



6. Is there a variation based on procedure?
7. Is there a difference based on statutory claims?
8. Is there a difference in the reason given by the courts with respect to frequency, informalities, undercapitalization, contract versus tort?

**Methodology**

The project includes sample data analysis of a pool of 1600 Westlaw cases through 1985 concerning the issue of corporate veil piercing. The factual data is based on whether it was pierced or not, year, number and identity of the shareholders or individuals, situation of the claim, whether was procedure involved or not. The addition to the factual data, it also includes the rationale of the courts for piercing or not piercing the veil along with usage of multiple reasons listed by the court.

The results are based on decided cases and may not be a settling representative sample. Case results are specific and the fact patterns may not help clear the uncertainty. The lack in significant change in the number of cases portrays a slight touch of stagnancy. It takes inferences from all the articles referred for this study.

Data Sample

<i>Category</i>	<i>All cases</i>	<i>Pierced</i>	<i>No Pierced</i>	<i>%Piercing</i>
#	1583	636	947	40.18
<i>Category</i>	<i>Total number of cases</i>	<i>Pierced</i>	<i>Not pierced</i>	<i>% of piercing</i>

Pre-1960s	130	53	77	40.77
1960s	399	164	235	41.10
1970s	572	233	339	40.73
1980s	484	187	297	38.64
<i>Category</i>	<i>Number of cases</i>	<i>Pierced</i>	<i>No pierced</i>	<i>% Piercing</i>
State Courts	938	369	569	39.34
Federal Courts	647	268	379	41.42
Trial Courts	401	161	240	40.15
Intermediate App.	860	338	522	39.30
Supreme Courts	316	133	183	42.09
<i>Category</i>	<i>Total number of cases</i>	<i>Pierced</i>	<i>No pierced</i>	<i>% Piercing</i>
Individual Plaintiff	695	262	433	37.70
Corporate Plaintiff	652	240	412	36.81

<i>States</i>	<i>Total cases</i>	<i>Percentage Pierced</i>
New York	212	34.91
Texas	106	34.91
California	89	44.94
Illinois	78	42.31
Louisiana	67	35.82
Pennsylvania	65	30.77

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Georgia	47	38.30
Florida	46	41.30

Non Creditor	514	207	307	40.27
Government	218	126	92	57.80
Corporate	164	22	142	13.41
Shareholder	59	15	44	25.42

<i>Identity of shareholders</i>	<i>Total number of cases</i>	<i>Pierced</i>	<i>Not Pierced</i>	<i>%Piercing</i>
Individuals: -One	276	137	139	49.64
-Two or three	238	110	128	46.22
Close but -More than three	263	92	171	34.98
-Public shareholders	9	0	9	0.00
Total Individuals	786	339	447	43.13
Corporate: -Parent	386	142	244	36.79
-Subsidiary	68	19	49	27.94
-Sibling	183	76	107	41.53
Total Corporate	637	237	400	37.21

<i>Context</i>	<i>Total cases</i>	<i>Pierced</i>	<i>Not pierced</i>	<i>% Piercing</i>
Contract	779	327	452	41.98
Tort	226	70	156	30.97
Criminal	15	10	5	66.67
Statute	552	224	328	40.58

<i>Procedure</i>	<i>Total cases</i>	<i>Pierced</i>	<i>Not Pierced</i>	<i>% Piercing</i>
Jurisdiction	141	52	89	36.88
Venue	12	7	5	58.33

<i>Category of plaintiff</i>	<i>Number of cases</i>	<i>Pierced</i>	<i>Not Pierced</i>	<i>% Piercing</i>
Creditor	612	259	353	42.32

<i>Category</i>	<i>Cases</i>	<i>Pierced</i>	<i>Not Pierced</i>	<i>% Piercing</i>
Instrumentality	75	73	2	97.33
Alter ego	181	173	8	95.58
Misrepresentation	169	159	10	94.08
Agency	52	48	4	92.31
Dummy	78	70	8	89.74



Lack of substantive separation	141	120	21	85.11
Intertwining	63	54	9	85.71
Undercapitalisation	120	88	32	73.33
Informalities	151	101	50	66.89
Domination & control	551	314	237	56.99
Overlap:				
Officers	174	87	87	50.00
Directors	152	66	86	43.42
Owners	101	49	52	48.51
Office	68	40	28	58.82
Business Activity	43	35	8	81.40
Employees	52	36	16	69.23
Management	43	28	15	65.12
Other	169	118	51	69.82
Total overlap	812	459	343	56.53

more the chances. It was found that courts pierced to reach the defendants that is individuals rather than the corporation. The identity of the plaintiff did not make such a difference although government entities were most successful while corporations were the least effective. Court's preference to hold the shareholders of close corporation liable rather than the public ones maybe due to strong facilitation of public market shares. The courts pierced the veil of a corporation more often in contract rather than tort due to the trend of successor liability in product-liability taking its place. There court entertains less jurisdiction cases as it considers the subsidiary to be separate and distinct from the parent and evidence against the latter to be lacking. There is no justification for the procedural aspects but there is higher percentage in venue cases. Bargain setting and activity of insiders of the close corporations<sup>17</sup> is deeply prevalent as instrumentality topped the charts.

**Research and Analysis**

*Findings of the Westlaw Countries Sample*  
 The veil was pierced by the court in about 40% of the reported cases. The rate at which the court had pierced the veil stayed almost constant year after year. The type of court does not seem to affect the percentage of veil piercing. Individual or corporate identity of the plaintiff does not lead to different results. There is no certain conclusion for the varying results of veil pierced due to difference in regional legal framework. The number of shareholders affected the manner of piercing the veil by the courts as lesser the people

*Chinese empirical study on piercing the veil<sup>18</sup>*  
 A sample data of 99 cases in China compiled after the enforcement of Company law reform 2005 that is from 1<sup>st</sup> January, 2006 to 31<sup>st</sup> December 2010 was analysed which were all against private companies. The court pierced 63% of the cases which is a higher rate compared to United States, United Kingdom and Australia. The different provinces of China showed different regional results in lifting the veil. There is gradual increase in the number of piercing cases and is more readily taken up in primary level than higher courts. The statutory context is significant for the courts and the rate is

<sup>17</sup> Robert B. Thompson, The Limits of Liability in the New Limited Liability Entities, 32 WAKE FOREST L. REV. 1, 9 (1997).

<sup>18</sup> Hui Huang, Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading?, The American Journal of Comparative Law, SUMMER 2012, Vol. 60, No. 3 (SUMMER 2012), pp. 743-774



similar in contract as well as tort. The Chinese courts touched the corporate group setting less often and the most common reason for veil piercing was commingling.

The corporate privilege of separate legal entity status cannot be misused to infiltrate the rights of innocent parties<sup>19</sup> and both corporate acts or individual acts of shareholders will not be shielded against liability.<sup>20</sup> It should not be used as a camouflage to avoid contracts or obligations.<sup>21</sup> Using its instrumentality to obtain rebates will not save promoters or members of the corporation from answerability.<sup>22</sup> Courts also speak of disregarding the separate entity when there is fraudulent conveyance of debts from one corporation to another having similar name and same management and stockholders.<sup>23</sup> In 'one man' corporations one should differentiate between his business and individual affairs.<sup>24</sup> An informal action like the contract of the sole proprietor of the stock cannot escape liability by stating non-observance of corporate formal requirements such as resolution of directors.<sup>25</sup> Abuse of corporate franchises by joining hands in a trust agreement against the public policy disregards the separate legal entity status of

the corporation even if individual shareholders make the deal in their own individual capacity, it would be seen as a corporate act.<sup>26</sup> Individual or corporate liability should be based on circumstances of reciprocal agency between the two facilitating fraud or injustice.<sup>27</sup> In most of the cases the holding company is held liable for the debts, torts and contracts of its subsidiary<sup>28</sup> and it is excepted if the principle and agent relationship is missing.<sup>29</sup> Sometimes the assets the subsidiary can be claimed to be a part of bankrupt parent corporation.<sup>30</sup> A dominating parent corporation cannot share the assets of an insolvent subsidiary as against its creditors.<sup>31</sup> When the stock ownership is acquired not for the purpose of corporate affairs but for the dominating its subsidiary and furthering instrumentality, the two corporations will be treated as a single unit by the court.<sup>32</sup> To make prove the control of the parent corporation over the subsidiary, evidential facts like identity of stockholders, officers, the manner of conducting business and also keeping books and records comes in handy.<sup>33</sup> If the corporation engaged with the enemy of the state for commercial purpose, its rights and assets may be subject to seizure by the government.<sup>34</sup> Based on the mutual

<sup>19</sup> Brundred v. Rice, 49 Ohio St. 640, 32 N. E. 169, 34 Am. St. Rep. 589.

<sup>20</sup> Minifie v. Rowley, 187 Cal. 481, 202 Pac. 67.

<sup>21</sup> Higgins v. California Petroleum Co., 147 Cal. 363, 81 Pac. 1070.

<sup>22</sup> United States v. Milwaukee Refrigerator Transit Co., 142 Fed. 247.

<sup>23</sup> Rock v. Speedwell Motor Car Co., 24 Cal. App. 123.

<sup>24</sup> Looney v. Thorpe Bros., 277 Fed. 367, 371.

<sup>25</sup> Kentucky Coal Lands Co. v. Mineral Development Co., 295 Fed. 255.

<sup>26</sup> State v. Standard Oil Co., 49 Ohio St. 137, 30 N. E. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145.

<sup>27</sup> Donovan v. Purtell, 216 Ill. 629, 75 N. E. 234, 1 L. R. A. (N. S.) 176.

<sup>28</sup> Fourth Nat. Bank of Montgomery v. Portsmouth Cotton Oil Refining Corp., 280 Fed. 879, 284 Fed. 718.

<sup>29</sup> Marsch v. Southern New England R. Corp., 230 Mass. 483, 120 N. E. 120.

<sup>30</sup> re Eilers Music House, 270 Fed. 915, 274 Fed. 330.

<sup>31</sup> Hunter v. Baker Motor Vehicle Co., 225 Fed. 1006, 1015.

<sup>32</sup> Chicago, M. & St. P. R. Co. v. Minneapolis Civic & Commerce Ass'n, 247 U. S. 490, 62 L. Ed. 1229, 38 Sup. Ct. 553.

<sup>33</sup> Berkey v. Third Avenue Ry. Co., 387; s. c., 251 U. S. 255, 65 L. Ed. 244 N. Y. 84, 155 N. E. 58, 61.

<sup>34</sup> Continental Tyre Co. v. Daimler, 1 K.B. 833[1915].



understanding between shareholders or members, quasi-partnerships and single economic entities have tried to acquire to acquire the title of separate legal entity, which makes it even more intriguing for the courts to disregard the principle.

Adam Smith stated that the fictitious and powerful nature of corporations puts human beings to a disadvantage therefore limited liability and separate legal entity should be disregarded. Section 1603 (b) of the Foreign Sovereign Immunities Act in the US took over the separate legal entity rule in terms of instrumentality and agency by limiting foreign state owned entities to assert their sovereign immunity. The court disregarded the corporate form and turned to 'facts beneath the personality' although legal title to gold was in the corporation.<sup>35</sup> In guardian-adolescent entrepreneurial venture, the separate entity rule does not differentiate between adults and adolescents unlike rules of ownership limited by theories of capacity and contract. The adolescent's status as sole proprietor will be questioned if third parties are extensively involved.

If the corporation acted for public agency or instrumentality or its involvement with the government is not dissuaded, the corporate form can be disregarded.<sup>36</sup> Switzerland applied the restrictive theory of foreign

sovereign immunity at a rather earlier date and its federal court declined to observe the separate entity rule as it was not free from doubt.<sup>37</sup> Following the Swiss and German high courts, many French ones also disregarded the legal status of the corporation and focused entirely to solve the immunity dilemma exclusively based on the nature of the activity.<sup>38</sup>

Reverse piercing may be alternative to solve the bad loan crisis in India by removing the separate entity rule and transferring the liability back to the corporation. It is mainly divided into three parts- insider<sup>39</sup> (corporation against itself), outsider<sup>40</sup> (owners and personal creditors against the corporation) and triangular<sup>41</sup> (liability of entity to affiliate via controller) reverse piercing.

In Intellectual Property Rights cases, a person cannot escape from the personal liability of tort committed, whether he is a director, employee or a member, and the excuse of separate legal entity falls short.<sup>42</sup> In Sharman's case<sup>43</sup> it was found that all respondents were liable for infringement authorisation of applicant's copyright were liable as both individually and as joint tortfeasors. To evaluate the personal liability of the directors three tests have been devised, namely-

<sup>35</sup> United States Grain Corp. v. Phillips, 261 U.S. 106, 113 (1923).

<sup>36</sup> Bradford v. Director Gen. of R.R. of Mex., 278 S.W. 251, 252 (Tex. Civ. App. 1925)

<sup>37</sup> Banque Centrale de la R'publique de Turquie v. Weston Compagnie de Finance et d'Investissement S.A., Judgment of Nov. 15, 1978, BGE 104 Ia 367 (German)

<sup>38</sup> Banque camerounaise de d'veloppement v. Soci't'des 'tablissements Rolber, 79 I.L.R. 532 (in English).

<sup>39</sup> Prem Lata Bhatia v. Union of India, 2006 SCC OnLine Del 136

<sup>40</sup> Curci Investments v. James Baldwin, 14 Cal.App.5th 214 (2017)

<sup>41</sup> Nursing Home Consultants v. Quantum Health Services, 926 E Supp. 835 (E.D. Ark. 1996).

<sup>42</sup> C Evans & Sons Ltd v Spritebrand, 2 All ER 415,419[1985].

<sup>43</sup> Universal Music Australia Pty Ltd v Sharman License Holdings Ltd, 220 ALR 1(2005).



- ‘Direct or procure’ test

The court decides whether director agreed for the commission of the tort being aware of the consequences of a wrongful act.<sup>44</sup>

- ‘Make the tort his own’ test

This test is narrower and more stringent, where the courts decide whether the director’s imparted policies may lead to accumulating and infringing goods.<sup>45</sup>

- The rule in *Said v Butt*- the root quality approach

The court decides whether director’s best interests were involved in its preference of paying damages for breach of contract over honouring the contract.<sup>46</sup> But its extended application by a director cannot be used to infringe the rights of another behind the mask of legal entity.<sup>47</sup>

In India, statutory provisions of the Company Act, 2013 like personal liability, non-compliance with requirement of incorporation (Section 7), mis-description of company’s name (Section 12(3)), mis-statement in the prospectus (Section 34 & 35), facilitating the task of an inspector under Section 210, 211 and 213, fraudulent conduct under Section 339 while winding up and liability of ultra vires act beyond the ambit of Memorandum of Articles etc. all form grounds for scrutiny.

Condonation of delay in Section 460 of the Companies Act, 2013 was extended to Limited Liability Partnership (LLP) through an amendment in Section 67 of Limited Liability Partnership Act, 2008 which would help the Registrar of Companies to set

enquiry and inspection of doubtful companies who convert themselves into LLPs. Companies (Significant Owners) Amendment Rules, 2019 would help remove the corporate veil by catching any Significant Beneficial Owner (SBO) holding beneficial interests more than 10% and not filled the Form- BEN 1 under Section 90 of the SBO Rules.

### Suggestions

Despite the constitution of a Board for placing liability, there should be more stricter penalties. Inter-agency co-ordination in disregarding the separate entity principle would go a long way especially while dealing with myriad financial instruments. Preferential shares by invisible promoters should be monitored by the concerned authority as it would lead to dictation of terms in sensitive sectors like telecom and defence. The preferential shareholders should be given qualifying voting rights rather than complete ones. Lastly, sectoral policy changes should be sought.

### Conclusion

Disregarding separate legal entity by lifting the corporate veil has been the convenient way for the courts. Even in a tussle between contractual and tortious liability, grounds based on fraud, personal liability, instrumentality, agency etc have been constant but reverse piercing is yet to be tried extensively. China’ empirical study shows more piercing percentage than the US, UK or Australia. Intellectual property rights should not be dampened by the lack of responsibility to take up the liability by the directors of a

<sup>44</sup> *Performing Right Society Ltd v Caryl Theatrical Syndicate Ltd*, 1 KB 1[1924].

<sup>45</sup> *King v Milpurruru* 136 ALR 327 (1996).

<sup>46</sup> *Root Quality Pty Ltd and Another v Root Control Technologies Pty Ltd and Others* 177 ALR 231, 258 (2000).

<sup>47</sup> *O’Brien v Dawson* 66 CLR 18 (1942).



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company. United States disregarded the principle much later than Swiss, German and French courts who stuck to the facts of the case and spirit of justice rather than fictional personality. Indian statutory laws and amendments can help in breaking the old rule of separate legal entity. Disregarding the separate entity rule may sound good in theory but with regards to its applicability, it is quite uncertain.

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