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Corporate Reverse Piercing: A New Edge to the Corporate Governance in India

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Introduction: In India, there has been a huge development in the commercial law. It is hard to believe that concepts such as partnership and incorporation of company have such stringent laws presently. The well-established concept of limited partnership and general partnership is easily traceable from the Roman era whereby the Romans *societas* (partnership) permitted the Roman *socius* (partner) to add to the capital and labour in order to promote the development of an enterprise. The increasing bad debt crisis and huge losses faced by banking sector have led to various amendments in the Company Law as well as the enactment of the Insolvency and Bankruptcy Code, 2016 in India.

A corporation is a separate, independent legal entity which can sue and be sued in its own name. But the question is whether a corporation can operate without directors/ shareholders? It's the directors and shareholders who are the brain and heart of a corporation. The concept of separate legal entity can be rooted as early as in the year of

1897, in the case of *Salomon v Salomon*[1] and even before that, in India, in the case of *Re., Kondoli Tea Co. Ltd*[2] wherein the Hon'ble Court observed that a company is a separate legal entity from its shareholders. But time and again, corporation has been used as an instrument to fulfill the hidden selfish motives of its shareholders. Very often, the concept of Limited Liability is inappropriately utilized by the individual shareholders of a company. Shareholders of a corporation, in order to avoid their own personal liability started using the corporation as an "alter ego" and an "instrumentality". There is a thin line protecting a corporation and its members also known as 'Corporate Veil'. Therefore, in order to protect the investors, it is necessary to pierce the corporate veil and catch the main person operating under the guise of a corporation and catch hold of the real assets of those shareholders.

Need for Reverse Corporate Piercing: The individual shareholders started misusing the power of the limited liability in order to hide their own expenses in the name of the company. Therefore, there was a need to regulate the acts of individual shareholders through an equitable doctrine known as 'Corporate Piercing'. This principle has been adopted in the Common Law and Civil Law countries.

There were *Benami* transactions, scams and money was transferred in the account of the company in order to avoid the liability. Due to these fraudulent transfers of shareholders, there was a need to regulate such malpractices amongst the shareholders and protect the hard earned money invested by the creditors which gave rise to the concept of 'Reverse Corporate Veil Piercing' also known as reverse piercing. This concept is derived from the traditional veil piercing and is a development by the American Courts in order to meet the more equitable needs of investors and creditors of a corporation. The concept of reverse piercing is unaccepted in India as no cases have been registered in the country wherein the Court has substantially inflicted the personal liability of a shareholder upon the corporation by reverse piercing. In *United Spirits Ltd. & Ors. Vs IDBI Bank Ltd. &*

[1] 1987 AC 22
[2] (1886) ILR 13 CAC 43

Ors[3], though the contentions were raised by the counsel to invoke the principle of reverse piercing but no parlance was placed on the same by the Hon'ble High Court.

Reverse Corporate Veil Piercing - Meaning: Reverse Corporate Veil Piercing is the liability to pay the debts of individual shareholders upon the corporation or upon the subsidiary for the act of the parent corporation. There are basically two types of reverse corporate piercing:

- ***Insider Reverse Corporate Piercing****:* It is carried by the corporation owners or insiders to take advantage of the corporation claims that they could not take in their individual capacity.

- ***Outside Reverse Corporate Piercing****:* Under this a third party imposes liability upon the corporation for the debts of the individual shareholders.

Further, many courts have rejected the insider reverse piercing concept as corporation owners take advantage.

In order to invoke the concept of Corporate Reverse Piercing, the court has to consider the following ingredients:

1. Fraudulent transfer made by a shareholder of the corporation

2. Domination by a shareholder over the corporation: the individual exercises such a control over a corporation that the corporation is an alter ego or instrumentality of an individual person.

3. No other remedy is available with the creditor to recover the amount.

[3] 2019 (5) KarLJ775

The traditional approach has always been such that a corporation has so far been protected from the debt of the shareholders (entity shielding) and the shareholder is probably protected from the debts of the corporation (owner shielding).

International Jurisprudence: This doctrine witnessed its emergence in the US through the judgment delivered by Judge Hand where he did not specifically used the word "reverse piercing" but to some extent limited the scope of the concept of the reverse piercing. In *Kingston Dry Dock Co. V Lake Champlain Transportation Co.*[4], where the plaintiff repaired the ship owned by the Champlion's subsidiary and there was default in the payment by the defendant then the trial court attached the ship in order to clear the debts of the creditors.

Notably in US, the doctrine seems to primarily emerge from the marital dispute as discussed in the case of *WG Platts Inc V Platts*[5], whereby the plaintiff sought to impose liability upon the husband corporation in order to satisfy her share of assets as per the divorce decree. The court allowed the claim of the plaintiff and the corporation was considered an alter ego of the husband. Later on for almost 30 years, the courts of US refused to entertain the doctrine of the reverse corporate piercing but with the necessity of time, the doctrine of reverse corporate veil piercing started revolving.

The corporate reverse veil piercing has emerged an important principle recently in corporate governance in the States of Florida, California, etc. in the USA. It is categorically mentioned by the courts that the same test is applied in the reverse piercing as that in the traditional corporate piercing. Even in the year 1992 the New York Court held that piercing the corporate veil in reverse is permissible.

Indian Scenario: Though this doctrine is not accepted by the Indian Court but there are various situations where the application furthers the cause of justice and provides equitable

[4] 31 F.2d 265 (1929)
[5] 49 Wn. 2d 203 (1956)

outcomes in the corporate governance. Like the traditional veil piercing, the court in India can apply these principles in the following cases:

1. The court is satisfied that degree of identity between the owner and company is highly subjective.
2. If not applied then it will affect the innocent third party adversely.
3. Being an equitable principle, it is the last resort available with the court in order to provide justice to the creditors.

Though, reverse corporate veil piercing is not invoked by the Indian Courts but a similar approach has been taken up by the Courts also known as ‘Corporate Criminal Liability’ which is an interesting analogy where the body corporate is held liable for the acts of its owners. Though reverse piercing is a last resort but it must be allowed by the Indian Courts. The concept of reverse corporate piercing may shape the Indian corporate governance which is still at a budding stage in order to cater justice to creditors.

Conclusion: The question which hinders the court is that how a corporation would protect itself from the application of reverse piercing concept. Is it even justifiable that the corporation made liable for the sins of the shareholders? This is still a matter of concern. Reverse piercing, though to a certain extent may impact the capital structure or the financial planning of a corporation, an important factor to be considered herewith is that it is the last remedy to be resorted by the courts. Reverse piercing has been, since its emergence, an equitable doctrine aiming to protect the rights of innocent creditors who have exhausted all the available remedies with them and left with no other option but invoking the doctrine of corporate reverse piercing.

Corporate Reverse Piercing is an evolving doctrine which might lead to attachment of corporation assets with the third party but an equitable doctrine to protect the rights of the innocent creditors. Though corporate reverse piercing is a very debatable topic in India with existing confusion about the application of the doctrine but adopting one such approach might lead the corporate governance to a new level.