VOLUME 2 | ISSUE 2

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

REVISITING SOLOMON'S CASE: A DECISION THAT NEEDS TO BE CRITICALLY RELOOKED, REVIEWED AND ANALYSED

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ABSTRACT

This paper revisits the decision in the Salomon case that introduced the 'Corporate veil' principle. Through a thorough review of literature, it is understood that much debate exists with regard to its validity since lifting the veil has become a common subsequent practice. The paper analyses the decision in a three-fold manner. First, a few relevant or significant aspects of the judgement are put-forth and analysed. Second, the need for lifting or piercing the corporate veil is discussed in light of our current economic developments. Third, aspects of the judgement which seem irrelevant or inconsistent in the present century are also detailed. The paper concludes by stating that several judicial, statutory and other grounds to disregard corporate personality have now evolved. This along with the method of purposive interpretation of the judiciary has made the Solomon judgement seem outdated today.

INTRODUCTION

"*A company is that which is incorporated either under the Companies Act, 2013 or any other previous Act*"[2], this is the common definition used in everyday legal parlance. Such a company is said to have its own corporate personality distinct from the members who form it, i.e. it's an artificial entity created either by legal fiction or recognition from the State. Therefore, once a company is duly incorporated under the appropriate statute, it acquires a unique juristic identity and becomes capable of exercising functions, performing duties and enforcing rights in the capacity of a company and is not a mere collection of individuals. This idea of 'Independent Corporate Existence' or 'Corporate Veil' was firmly laid down in ***Saloman v. A Saloman & Co. Ltd***[3] as a strict legal principle. This principle has come to

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[2]Companies Act, 2013, §2(20), No.18, Acts of Parliament, 2013 (India).

[3]Salomon v. A Salomon & Co. Ltd. [1896] UKHL 1.

become a basic feature of company law. Apart from the above-mentioned characteristic, a company is also featured with Limited Liability, perpetual succession, capability to sue and be sued, possess separate property etc.

LITERATURE REVIEW

A majority of the available literature on the doctrine of 'corporate veil' criticise any strict application, require a review of the principle laid down in Salomon and advocate for flexibility or exceptions to individual corporate personality on select situations.

Marc Moore in his paper titled, "**A temple built on faulty foundations: Piercing the corporate veil and the legacy of Salomon v. Salomon**"[4] focuses on the reluctance of the English Courts to impose liability on members of a company even when they were masking fraudulent acts behind veil because the judges wanted to preserve the 'corporate veil' legacy of the Salomon judgement. This doctrine was applied even in much more complex cases and this is heavily criticised by the author.

Tang-Cheng Han in his paper titled, "**Piercing the separate veil of a company: a matter of policy?**"[5] points out that a company's separate personality must be ignored if the recognition of its individuality is undesirable to public policy. He thus, stands contrary to the opinion in Salomon and revisits the judgement that solidified the 'corporate veil' theory. However, although the decision in Solomon was disagreeable to him, there was no proper judicial approach or a common, unified principle to lift the veil which bothered him heavily. This problem identified by him is easily solved today since clearer grounds, both statutory and judicial, for lifting the veil is available.

Further, authors like **Tan Zhong Xing** in "**The new era of corporate veil piercing**"[6] and **Varun Chopra** in "**Lifting the Corporate Veil on Shell and Shadow Companies: An**

[4]Marc Moore, *A temple built on faulty foundations: Piercing the corporate veil and the legacy of Salomon v. Salomon*, JOURNAL OF BUSINESS LAW, 180, 180-203 (2006).

[5]Tan-Cheng Han, *Piercing the separate personality of the company: a matter of policy?*, 40 SINGAPORE JOURNAL OF LEGAL STUDIES, 531, 533 (1999).

[6]Tan Zhong Xing, *The new era of corporate veil piercing*, (2016) 28SAcLJ 209.

Indian Overview"[7] also focus on the need to lift the Corporate veil and disregard the Solomon judgement.

A significant literature gap is that no author has discussed how parts of the Salomon judgement might still be acceptable today. This will be discussed in Part I of my analysis.

ANALYSIS

I. Current significance of the judgement

Before delving into the argument of why the judgement in the Salomon case needs to be revisited in the background of current developments or practices of companies, it is imperative for us to understand if the judgement stills holds any value.

a. The main contention of **Lord Halsbury** was that***, the sole guide of the court's decision must be the statute and that judges have no business to add or take away requirements from the statute.*** Since there wasn't any stipulation regarding the maximum or minimum extent of interest that can be held by a shareholder, the company was properly constituted under the provisions of the law.[8]To quote the words of **Lord Macnaghten**"How can a body corporate, made capable by statute lose its individuality just by issuing the bulk of its capital to one person?"[9]. They stated that even if the method of operation and actors involved in the company were same as those before incorporation, the company is in no way an agent or trustee of its members according to law.

   One could associate this as highlighting the significance of refraining from judicial overreach. Whether the circumstances of this case was contrary to the legislature's intention was still quite ambiguous since testing this proposition was not an easy feat and exhibiting excessive judicial creativity by constructing the legislature intention was not the solution. According to me, the famous saying that ***judges should not make but only interpret law*** applies perfectly to this scenario.

[7]Varun Chopra &SubonThattamparambilGovindankutty, *Lifting the Corporate veil on Shell and Shadow companies*, CNLU LJ (7) [2017-2018] 96.

[8]Salomon v. A Salomon & Co. Ltd., [1897] AC 22, 29-32.

[9]Salomon v. A Salomon & Co. Ltd., [1897] AC 22, 51-54.

b. Another very strong case for the preservation of the company's individuality was that, ***the primary motivation which induces individuals to incorporate a company is to take advantage of the limited liability feature and avoid any risks of bankruptcy***. If not for these options, not many businesses would register to be companies. Raising money through debentures is also something the law allows and members of a company could hold these debentures akin to any outside creditor. The fact that he is a member of that company is no reason for him to refrain. In ***Wheeler v. Smith***[10], the court said that although the claims of a sole director-cum-assured-creditor must be scrutinised with care, the law doesn't prohibit his claim.[11]

Therefore, the judgement ***restated the unique feature of limited liability available to those incorporating a company***.

c. Although the decision of the court was to impose no liability on Mr. Salomon, Lord Watson did indicate that courts could ignore the separate legal personality of the company. He commented that, "proceedings which are permitted by the Act may be so used by the members of a limited company to constitute fraud upon others, to whom they in consequence incur personal liability".[12] Therefore, ***when directors or employees of the company find inroads or loopholes in the law and perform fraudulent acts against others, the veil may very well be lifted.*** This comment reflects the futuristic approach of the court, who, although adjudicated favouring protection of the company's legal identity, also made indications for exceptional circumstances. The above are a few aspects of the judgement in the Salomon case which, in my perspective, still renders it relevant in today's societal and judicial developments.

II. Need or rationale behind lifting the corporate veil introduced in Salomon

With time, the popular and routine application of the veil became controversial. Owing to criticisms from several spheres and varied judicial opinion, certain exemptions were carved

[10]Wheeler v. Smith, 30 F 2d 59 61 (9th Cir 1929).

[11]Parth Dixit & Ramya Katti, *Disrobing OPC's: the battle with the cloak of limited liability*, (2017) 3 HNLU SBJ 22.

[12]Supra 4

out to make the principle more consistent with the realities of modern economic life. In such exceptional circumstances, the veil shielding the corporate from liability can be lifted or pierced and liability can be imposed on its members.This initially was a result of judicial technique and not legislative amendment or parliamentary will.[13]

Any rule cannot be held to be absolute. Similarly, the individual legal personality of a corporation can also be disregarded when warranted. When companies misuse the benefit accorded to them by law, courts must have the power to intervene and act in the interests of justice.

At this juncture, the definition of a company given by **Justice Marshall** finds relevance. He says, "*A company is a person, artificial, intangible, invisible and existing only in the eyes of law*"[14]. Therefore, it follows through common logic that if the company violates or acts in contravention of the law, liability can be imposed on the members who are otherwise personally immune from the company's actions. After all, *mens rea* can only be possessed by individuals, for the corporation is an abstraction which has no mind of its own.[15]***If not for this exception, unscrupulous actions of many directors or members would be ignored and unpunished. This would be against the rule of law, interests of equity, justice, good conscience and public policy.***

After the Indian experience with the Bhopal Gas tragedy, there has been a heightened urge to lift the veil and hold those responsible liable. The Supreme Court rightly pointed out in ***DDA v. Skipper Construction Pvt. Ltd.*** that the corporate veil can be lifted by the court to identify the men behind it who deliberately utilize illegal and corrupt means to defraud others.[16]***The doctrine that has been developed to promote trade and commerce must not be used to the detriment of the society***.

[13]Krishna Bahadur, *Personality of Public Corporation and lifting the corporate veil*, 14 JILI 1972 207.

[14]NALSAR PRO.ORG, http://nalsarpro.org/Portals/23/Courses/MA%20-%20ALATM/Semester%20III%20PPTs-2018-20/16.%20Company%20Law-I-%20Definition%20and%20kinds.pdf (last visited October 6, 2021)

[15]Lennards Carrying Co. v. Asiatic Petroleum, [1915] A.C. 705 at 713.

[16]DDA v. Skipper Construction Pvt. Ltd, (1996) 4 SCC 622.

In light of the above reasons, thejudgement given in the Salomon case, has become quite outdated in the current scheme of events.

III. Areas of inadequacy in the Salomon judgement

Negation of Agency argument :

Earlier judgements similar to Salomon like ***Adams v. Cape Industries PLC***[17], and ***Dennis Wilcox Pte Ltd v. Federal Commissioner of Taxation***[18]all suggest that agency relationships are difficult to discern from the fact that its controlled and influenced by a single individual alone. Similarly, the house of Lords in Salomon outrightly ignored the possibility that Salomon & Co Ltd could be an agent of Mr. Salomon since an express agreement to that effect was absent.

However, ***this argument has become impractical since implied agency relationship are now recognised by the judiciary***. This implied relationship is said to exist even between parent and subsidiary companies if they are inextricably connected so as to look like a single entity. In the ***NSEL scam***, Financial Technologies (India) Ltd was the parent of NSEL, an electronic trading platform. When the investors who lost their money wanted to be reimbursed, the parent was held responsible for the legal liabilities of its subsidy.[19]A similar decision was arrived at in ***State of U.P v. Renusagar Power Co.***[20]

Fraudulent Conduct:

The judges in Salomon asserted that they did not find evidence of fraudulent conduct on part of Mr. Salomon since the purpose for their association was lawful and the fact that he raised money through debentures was evidence of his good faith. The latter reason cited by the judges, in my opinion, has several loopholes in it since the same could be considered as evidence of bad faith and an intention to defraud his creditors. The ***court turned a blind eye***

[17]Adams v. Cape Industries PLC, [1990] 2 WLR 657.

[18]Dennis Wilcox Pte Ltd v. Federal Commissioner of Taxation, (1988) 79 ALR 267.

[19]Drushan Engineer &Charu Singh, *The Nsel Scam: Bridging the regulatory Hiatus and its fallout on the corporate sector in India*, 5.2 NLIU LR (2016) 70.

[20]State of U.P. v. Renusagar Power Co. (1988) 4 SCC 59.

to the numerous possibilities of fraud that can occur when the major shareholder is also the major creditor.

Even **Section 339** of the Companies Act imposes liability on directors who carry on business with an intention to defraud other creditors and makes them responsible for the debts and liabilities of the company.[21] In light of this provision, the above observation made in Salomon would not stand in the current legal regime. Fraudulent conduct was also grounds for lifting the veil in ***Gilford Motor Company v. Horne***[22]

Responsibility of Mr.Salomon vs. unsecured creditor:

A very interesting comment was made by the judges in Salomon that, the unsecured creditors only have themselves to blame for their misfortunes. According to the court, they must have exercised caution and been sufficiently cognisant before dealing with the company. In an era where jurisprudence has shifted from the idea of "caveat emptor/buyer beware" to "caveat venditor/seller beware", assigning such heavy responsibility on the unsecured creditors seems excessive.

CONCLUSION

In a century where incorporation of companies has been misused to a large extent for engaging in anti-competitive practices, evade taxes and perform other illegal acts, lifting the corporate veil has become a common practice. Moreover, through judicial interpretation and legislative amendments, several grounds on which corporate personality can be disregarded are already laid out. To name a few, Sections 34-35 on misstatements of prospectus, Section 39 on failure to return application money, Section 121 on misdescription of name etc of the Companies Act; several provisions of the Income Tax Act, 1961; those of the Foreign Exchange Regulation Act, 1973, Competition Act, 2002 etc.

In the current era of purposive interpretation, it is difficult to only look at the words and not the spirit of any enactment. An increased amount of human rights and other violations have led to the rights of the corporation to assume a background position. Moreover, India being a welfare state has stuck by its obligation of ensuring justice to the masses and not just the rich.

[21]Companies Act, 2013, §339, No.18, Acts of Parliament, 2013 (India).

[22]Gilford Motor Company v. Horne, 1991 70 27

Therefore, ***preserving the corporate veil has now become the exception rather than the norm***.

In light of all these reasons, the corporate veil established by Salomon had to be revisited and realigned with the existing line of judicial thought. However, it is important to assert that excessive judicial inroads beyond what the statute allows must also be taken with caution. Otherwise, the rights of corporations will be severely impacted.

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