

## **“Lifting of the Corporate Veil for Environmental Degradation: Enterprise Liability in India”**

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### **ABSTRACT**

The lifting of the corporate veil is an exception to the norm of separating the company and its members in the eyes of law. It entails disregarding the limited liability in a company to hold the members personally liable for any wrong they commit under the company name. This is necessary because influential companies have increasingly caused damage to various sections of the society. This research paper will concern itself with companies indulging in widespread environmental degradation and where the Courts have recognized that holding the subsidiary company accountable is not sufficient; the damage must be counter-balanced by holding those in control of this company. Today, because of the reach of transnational companies, it is vital that this principle be applied extensively in India to hold parent companies liable for environmentally harmful acts of their subsidiary companies in India. These acts are even penalized by criminal statutes, and thus can be attributed criminal liability. The paper will provide a background of the veil doctrine and focus on companies' involvements in ecologically hazardous activities by analysing certain judicial decisions.

### **INTRODUCTION**

*“Executives can no longer hide behind the corporate veil. They need to be accountable for what their companies do, because entities are responsible for socially irresponsible behaviour.”*

- *Simon Mainwaring*

One of the basic principles of company law is that a company has a Separate Legal Personality (SLP) which is distinct from the persons working for, managing, or holding shares in the company. For all purposes in law, the company is an artificial and juristic person, which can sue and be sued in its own name. When a company is incorporated, its shareholders and directors have limited liability for any damages or penalties that the

company in its course of business might incur. This is the cardinal principle of company law, and why incorporation is chosen in the first place. In 1897, the British House of Lords laid down that a company is incorporated so that it can have a Separate Legal Personality and it is a creation of law.<sup>1</sup> However, in the years after industrialisation, companies' influence increased to an extent that a company's business had an impact on the society. The privilege granted to corporations started being misused by those behind the working of the company. Many set up (and still do) 'shell' companies, where they were controlling all the assets and properties, but using the company's corporate personality to hide their illegal dealings. Thus, it was necessary to put an end to this blatant abuse of privilege and hold those committing frauds accountable. Over the years, Courts stated that the corporate veil behind which members are placed, can be lifted or pierced and they can be held personally liable. The doctrine has hence developed and used by Courts to disregard the limited liability structure of a company to see who is truly liable for the damage or fraudulent act. An important developing aspect of this doctrine is that it may be applied to hold a parent company liable for the debts and liability of the subsidiary company.<sup>2</sup>

In recent years, the impact of environmental degradation has been the subject of much furore. A World Bank report estimates that companies throughout the globe have been substantially contributing to the earth's destruction.<sup>3</sup> Despite regulation and statutory laws that penalize companies for causing environmental damage, many companies do not adhere to these provisions. This inevitable leads to widespread harm, akin to the Bhopal Gas Tragedy in India or the Exxon-Valdex oil spill.<sup>4</sup> Here, Courts felt it was necessary to hold accountable the persons directly responsible for the magnanimous damage caused. Thus, in such cases, the piercing of corporate veil may be justified. Before delving into the questions as to who, how and what kind of liability should be attributed for environmental damage, it is necessary

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<sup>1</sup> *Salomon v. Salomon and Co. Ltd.* [1897] AC 22.

<sup>2</sup> *The Corporate Veil and when it can be pierced*, LAW PATH, (Sept 13, 2017), <https://lawpath.com.au/blog/corporate-veil-can-pierced>

<sup>3</sup> Juliette Jowit, *World's top firms cause \$2.2tn of environmental damage, report estimates*, THE GUARDIAN, (Feb 18, 2010), <https://www.theguardian.com/environment/2010/feb/18/worlds-top-firms-environmental-damage>; Madhavi Rajadhyaksha, *Environmental degradation costing India 5.7% of its GDP: World Bank*, TIMES OF INDIA, (Jul 17, 2013), [http://timesofindia.indiatimes.com/articleshow/21122955.cms?utm\\_source=contentofinterest&utm\\_medium=text&utm\\_campaign=cppst](http://timesofindia.indiatimes.com/articleshow/21122955.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst)

<sup>4</sup> Drea Knufken, *The World's Worst Environmental Disasters Caused by Companies*, BUSINESS PUNDIT, (June 10, 2010), <http://www.businesspundit.com/the-worlds-worst-environmental-disasters-caused-by-companies/>

to understand corporate veil and the circumstances in which Courts have pierced the corporate veil of a company.

### **PIERCING THE VEIL OF INCORPORATION**

The corporate veil of a company separates the liability of a company from the liability of its shareholders. One of the most illustrative cases relating to a company's separate legal personality is *Salomon v. Salomon*<sup>5</sup>, which was a starting point for the veil doctrine.

#### **Salomon v. Salomon**

The case concerned one Mr. Aron Salomon, a sole trader engaged in leather and boot making who decided to set up a company where him and some of his family members were made shareholders. However, within a year, the company went into liquidation as the debentures could not be paid in full. As a result, the creditors could not get back their dues and approached the Court, contending that the debentures were liable to be cancelled. They argued that the company set up by Salomon had no independent existence of its own and was merely an agent to further Salomon's agenda. The House of Lords rejected this argument and held that the incorporation is done so as to separate the person from the company and thus limit liability. The company's legal existence is a creation of law which forms the basis of company and insolvency law. Thus, the Court upheld this veil to protect the shareholders and directors and has been cited in many cases since.<sup>6</sup>

#### **When lifting of the veil is permissible**

The Court has held that the corporate veil must be lifted in specific circumstances only – for example when it is found that the company is being used as an instrument to commit fraud or for other 'unscrupulous ends'. In the famous cases of *Gilford Motor Company Ltd v. Horne*<sup>7</sup> and *Jones v. Lipman*<sup>8</sup>, the Courts have held that if it is found that the primary purpose of incorporating a company is to commit fraud or evade the law, the veil must be pierced and those responsible must be held liable. Apart from this, other grounds for refusing to differentiate between company and members are<sup>9</sup> –

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<sup>5</sup> *Supra* at note 1.

<sup>6</sup> *Macaura v. Northern Assurance Co. Ltd* [1925] AC 619; *Lee v. Lee's Air Farming Ltd* [1961] AC 12.

<sup>7</sup> (1933) Ch. 935 C.A. Horne.

<sup>8</sup> (1962) 1 WLR 832 L.

<sup>9</sup> Anubhav Pandey, *Lifting the Corporate Veil – Provisions under the Companies Act, 2013*, IPLEADERS, (AUG 11, 2017), <https://blog.ipleaders.in/corporate-veil/>

1. Benefit of Revenue/Evasion of Tax

This is the most common reason for lifting the veil, where a company is set up for the sole reason to avoid taxes or claim benefits in taxation.<sup>10</sup>

2. Company having an ‘enemy character’<sup>11</sup>

In this instance, the Court pierced the corporate veil of the company to reveal that all the directors and management persons were of Germany, which was at war with UK. Thus, the veil was lifted to ensure that there was no dealing with an enemy nation.

3. Company is set up to avoid or circumvent legal obligations

This is when the members are hiding behind the façade of the company to conceal true facts and it becomes necessary to pierce the corporate veil.<sup>12</sup>

4. If the Companies are said to be one single economic entity<sup>13</sup>

In the present case, the Court also held that *Salomon’s* case might be disregarded on grounds of justice and equity. This is when the group of companies cannot be distinguished from the parent company. In *DNH Food Items*<sup>14</sup>, the parent company was given compensation for appropriation of land registered in the name of its subsidiary. The Court held that three subsidiary companies could be treated as one single economic entity for receiving compensation.

5. Company is an agency for the shareholder’s illicit interest<sup>15</sup>

6. Statutory Provisions

This concerns the newly enacted Companies Act, 2013, where various sections lay down the instances where the Court can lift the veil. For instance, fraudulent conduct<sup>16</sup>, failure to return application money<sup>17</sup>, misrepresentation in prospectus<sup>18</sup> (in case of public company), liability

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<sup>10</sup> *Vodafone International Holdings B.V. v. Union of India*, (2012) 6 SCC 613.

<sup>11</sup> *Daimler Co Ltd. v. Mainland Tire & Rubber Co. Ltd.*, [1916] 2 AC 307.

<sup>12</sup> *Prest v Petrodel Resources Ltd.* [2013] UKSC 34; *Woolfson v Strathclyde Regional Council*, [1978] SC (HL) 90

<sup>13</sup> *DHN Food Items Ltd. v. Tower Hamlets*, [1976] 1 WLR 852.

<sup>14</sup> *Ibid.*

<sup>15</sup> *Re FG (Films) Ltd* [1953] 1 WLR 483.

<sup>16</sup> COMPANIES ACT, 2013, at section 339.

<sup>17</sup> COMPANIES ACT, 2013, at sections 34, 25.

<sup>18</sup> COMPANIES ACT, 2013, at section 39.

for ultra vires acts, etc. This is to make corporations comply with certain statutory frameworks.<sup>19</sup>

### 7. In the interest of the public

The case of *Daimler Co Ltd. v. Mainland Tire & Rubber Co. Ltd.*<sup>20</sup> can be used as an illustration where the UK Court held that as the company had German directors and was run by German nationals, the lifting of veil was necessary on account of the war with Germany. Hence, in the interest of public policy the distinct personality of the company was disregarded. It is this ground that must be focussed upon, when looking at corporations engaging in hazardous activities.

### RESEARCH QUESTION

After evaluating the background of the lifting of the corporate veil, there is one primary question that this research paper aims to answer –

1. Whether the holding company can be held liable for acts of subsidiary companies which cause substantial environmental damage, through piercing its corporate veil?

Thus, this paper aims to examine enterprise liability when it comes to large-scale environmental damage and how Courts have responded to it.

### CRITICAL ANALYSIS: ATTRIBUTING ENVIRONMENTAL LIABILITY TO PARENT COMPANY

A subsidiary company has its own corporate personality distinct from the holding company and cannot be an agent of the parent company.<sup>21</sup> The holding company owns a controlling stock of the subsidiary company but may have an entirely separate business and entity. Section 2 (87) of the Companies Act lays down the conditions in which a company may be considered as the subsidiary of another.<sup>22</sup> In today's globalized world, many transnational corporations own several subsidiaries in other countries and operate through them. These

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<sup>19</sup> Jonathan R. Macey, *The Three Justifications for Piercing the Corporate Veil*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE & FINANCIAL REGULATION, (Mar 17, 2017), <https://corpgov.law.harvard.edu/2014/03/27/the-three-justifications-for-piercing-the-corporate-veil/>

<sup>20</sup> *Supra* at note 10.

<sup>21</sup> *Adams v Cape Industries Plc* [1990] Ch 433.

<sup>22</sup> ““subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.” COMPANIES ACT, 2013, at section 2(87).

corporations have their presence in developing countries. In India, many subsidiaries have been set up. Since the Bhopal Gas Tragedy, a lot of focus has been placed on these subsidiaries as they cause environmental damage but the parent companies claim exemption from liability as they are distinct from the subsidiary. Thus, whether the corporate veils of these subsidiaries can be pierced to hold the parent companies liable is something that needs to be dealt with.

In *Life Insurance Corporation of India v. Escorts Limited and Others*,<sup>23</sup> the Court held that the veil could be pierced if associated companies are inextricably linked and are part of one concern. The Indian Courts have by and large determined that the grounds upon which the veil doctrine can be applied depends on a myriad of factors, and thus it has been difficult to narrow the scope.<sup>24</sup> In *State of Uttar Pradesh v. Renusagar Power Company*<sup>25</sup>, the Supreme Court lifted the veil of Renusagar, a wholly-owned subsidiary of Hindalco which had entered into a sale-purchase agreement for electricity. Under this agreement, Hindalco used the electricity produced by Renusagar and claimed certain benefits under the State law. Here, the Court held that Renusagar was an alter ego of Hindalco and hence had no independent existence. The Courts have widespread discretion to decide when to lift the veil. However, Courts are hesitant to attribute liability to parent company for causing environmental harm through its subsidiary. This becomes difficult for victims of environmental catastrophes to get compensation, as most of the companies causing damage are subsidiaries of transnational corporations. It becomes important to hold the parent company directly liable, which is only possible if Courts pierce the veil of the subsidiary. In 1976, the Organisation for Economic Co-operation and Development (OECD) passed a 'Declaration on International Investment and Multinational Enterprises' which contains Guidelines for Multinational Enterprises. This code, though not legally binding, discusses the piercing of corporate veil for transnational corporations.<sup>26</sup> The primary reason for holding parent companies accountable for the wrongful acts of subsidiary companies in case of environmental damage is so that victims can get greater access to compensation in the interest of public policy. Even the United Nations has come up with *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* which deals with liability standards with

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<sup>23</sup> (1986) 1 SCC 264.

<sup>24</sup> *State of Uttar Pradesh v. Renusagar Power Company*, 1988 AIR 1737.

<sup>25</sup> 1988 AIR 1737.

<sup>26</sup> Kolvenbach Walter, *European Reflections on Bhopal and the Consequences for Transnational Corporations*, 14 INT'L BUS. LAW. 357 1986

respect to environmental damage. In the US case of *United States v. Bestfoods*<sup>27</sup>, the Supreme Court held that it can lift the veil of the subsidiary for its wrongful conduct and hold the parent company liable. However, there is again a condition prescribed to this: the parent company must be a direct participant in this conduct. The parent company must exercise control over the subsidiary in order for it to be held liable as well. The position in India is the same.<sup>28</sup> It may be argued that this reasoning is sound as no company must be held liable for acts it did not commit. The veil is put in place so that it may be protected in these very circumstances. However, when we talk about widespread environmental damage, it is agreed that companies must be penalized heavily. Courts have developed the theory of ‘directing mind’ to impose criminal or civil liability.<sup>29</sup> This may be interlinked with the ‘degree of control’ test as it aims to identify who was responsible for the wrongful act committed. Often, transnational parent companies shift their liability onto the subsidiary, thus absolving themselves of any obligation to pay compensation or penalties. As quick as these parent companies are to shift the liability, they are just as quick to profit off the subsidiary companies.<sup>30</sup> This situation leaves the victims hapless. The above scenario was actually experienced in India during and in the aftermath of the Bhopal Gas Tragedy.

### **Bhopal Gas Tragedy**

The Bhopal Gas Tragedy is perhaps the first instance where the Court was dealing directly with the question as to whether a holding company is liable for the environmental hazard caused by the subsidiary. In December 1984, a lethal gas escaped from a pesticide plant which was a subsidiary of Union Carbide, causing the immediate death of approximately 8000 people. In the aftermath, numerous petitions were filed against the parent corporation. The case dealt with attributing liability to parent company<sup>31</sup> for causing one of the world’s largest manmade environmental disasters. Justice Seth observed that the corporate veil could be pierced in the present case on equitable considerations, when the subsidiary companies are deficient to pay the required compensation to victims. As the parent company was registered in US, claimants filed against the holding company in US Court. The parent company argued against claims being filed in US courts, denying any liability and the Court accordingly

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<sup>27</sup> 524 US 51 (1998).

<sup>28</sup> *Hackbridge-Hewittic & Easun Ltd. v. G.E.C. Distribution Transformers Ltd.* (1992) 74 Comp Cas 543 (Mad).

<sup>29</sup> Prabhleen Gurunay, *The Directing Mind and Will Test in Corporate Criminal Liability*, INTERNATIONAL JOURNAL OF LEGAL INSIGHT, I, Issue 3.

<sup>30</sup> Meredith Dearborn, *Enterprise Liability: Reaviewing and Revitalizing Liability for Corporate Groups*, CALIFORNIA LAW REVIEW, VOL. 97, NO. 1 (FEB., 2009), PP. 195-261.

<sup>31</sup> *Union of India v. Union Carbide Corp. Ltd*, Bhopal Gas Claim Case No.113 of 1986).

agreed. The Indian Courts also did not expressly pierce the corporate veil of Union Carbide, even though there was evidence that UCC owned and controlled the subsidiary. Interestingly, a similar incident happened in France where a tanker, Amoco Cadiz, spilled oil off the coast of Northern France. The aggrieved persons lodged negligence claims against the subsidiary Amoco Transport as well as the parent company Standard Oil Co.<sup>32</sup> The US District Court found both the subsidiary and parent company liable.<sup>33</sup>

### **Degree of Control**

The Bhopal Gas case was historic because it introduced strict liability in India and introduced the duty of care test. It examined the liability of the parent company through the test of ‘control’ it exercised over the subsidiary company (in the case before the US Court). A counter-argument to the ‘degree of control’ test is that the parent company must be held liable as it ought to have known or was likely to know of the possibility of irreversible environmental damage. This was true in the case of the Bhopal Gas Tragedy, where an internal memo actually proved that the company had knowledge about the potential risk of the plant.<sup>34</sup> In another case, several chemical plants were causing pollution in Bichri village in Rajasthan. While it did not go into specific enterprise liability or veil doctrine, the Supreme Court did order all the affiliated companies to compensate the claimants as they were absolutely liable.<sup>35</sup> Perhaps one of the best judgements on enterprise liability was given a year after the Bhopal Gas Tragedy, in the oleum gas leak case<sup>36</sup>, where absolute liability for ultrahazardous industries was introduced. On the other hand, in *New Horizons Ltd. v. Union of India*<sup>37</sup>, the Court held that there needs to be direct control by the parent company in order to hold it liable. This highlights the inconsistency surrounding enterprise liability as there is wide discretion possessed by Courts to decide upon when to pierce the corporate veil.

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<sup>32</sup> 954 F. 2d 1279 (7th Cir. 1992).

<sup>33</sup> Peter Muchlinski, *Limited liability and multinational enterprises: a case for reform?*, CAMBRIDGE JOURNAL OF ECONOMICS, VOL. 34, NO. 5, Corporate Accountability and Legal Liability: On the Future of Corporate Capitalism (September 2010), pp. 915-928.

<sup>34</sup> Evelina Singh, *Parent Company Liability for Environmental Disaster Caused by Subsidiary Company*, IMPERIAL JOURNAL OF INTERDISCIPLINARY RESEARCH (IJIR), 2, Issue 7, 2016.

<sup>35</sup> *Indian Council for Enviro-Legal Action v. Union of India*, (2011) 8 SCC 161.

<sup>36</sup> *M.C. Mehta v. Shriram Food and Fertilizer Industries*, I.R. 1987 S.C. 1086.

<sup>37</sup> 1995 SCC (1) 478.



### **Wide discretion with Courts**

Though the Companies Act, 2013 does include some codified instances where corporate veil can be brought down, the Courts are empowered to decide in majority of cases as to when this veil warrants piercing. This has left often contradictory or ambiguous precedents. The Indian Courts have emphasized on examining the facts and circumstances of each case and then determining whether or not to lift the veil.<sup>38</sup> Traditional corporate liability still holds strong in cases of piercing the corporate veil. In *Novartis v. Adarsh Pharma*<sup>39</sup>, the Court expressed its reservations about lifting the corporate veil when there was evidence of abuse of the corporation for unjust and inequitable purpose, holding that they will still need to determine upon the facts of the case. Though one might understand the Court's hesitancy to surpass the traditional principle of corporate liability, the truth is that companies have had a substantial adverse impact on the environment already. As pointed out, having discretion in an area of law which has been either not fully explored or left ambiguous has let many transnational corporations go scot free.

It needs to be clarified that an abolition of limited liability is not the answer, but the scope of instances when a corporate veil is lifted must be widened. Attributing liability to holding companies forces them to internalise the environmental risks that they likely are aware of, but do not take any action against.<sup>40</sup> Many argue that extending such a liability would entail the disappearance of the distinction between the company and its members. However, as Robert Thompson puts it –

*“Even if piercing would be harsh to a passive parent corporation that did not participate in the wrongful action, it would seem to be outweighed by the harshness of those injured.”*<sup>41</sup>

Thus, there needs to be a comprehensive framework to guide the lower courts when they are facing with a possibility of having to pierce corporate veil of a company.

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<sup>38</sup> *Subhra Mukherjee v. Bharat Coking Coal*, (2000) 3 SCC 312

<sup>39</sup> 2004(3) CTC 95.

<sup>40</sup> *Supra* at note 24.

<sup>41</sup> Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1 (1994)

## CONCLUSION

Though the concept of Separate Legal Personality is important, it is also true that it is being used to shield any liability for causing widespread economic and environmental damage. This paper aimed to highlight the lacuna that exists in law when it comes to attributing environmental liability to parental corporations. India is already forward in this aspect but if the principle of enterprise liability is properly developed, the rights of those harmed by wrongful acts of companies could be much better protected. For instance, the recent protests against Sterlite copper plants were against not only Sterlite as a subsidiary, but also the holding company, Vedanta Group. In context of the recent acid leak<sup>42</sup> at Thoothukudi and taking into account the development of enterprise liability, Indian Courts will tend to pierce the corporate veil of the subsidiary and hold the parent company liable. However, in the absence of clear code or guidelines, there is ambiguity as to which exact circumstances warrant lifting the veil. In the meantime, enterprise liability in cases of environmental damage must be seen as the norm, as they will provide a deterring effect on parent companies. As we are the precipice of causing irreversible environmental damage, a higher onus needs to be put upon multinational companies. This will ensure that they do not flout environmental regulations merely because they can escape liability, especially where they own subsidiary companies in developing states. Courts must use the veil doctrine in close connection with absolute liability doctrine on public interest grounds.

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<sup>42</sup> B. Tilak Chandar, *Thoothukudi in for a catastrophe, says Vedanta*, THE HINDU, (June 20, 2018), <https://www.thehindu.com/news/national/tamil-nadu/thoothukudi-sterlite-plant-sulphuric-acid-leak-severe-says-vedanta/article24211334.ece>