DISROBING OPC'S: THE BATTLE WITH THE CLOAK OF LIMITED LIABILITY

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ABSTRACT

With the introduction of One-Person Companies (OPCs) in the Companies Act, 2013, a lot is hoped to be achieved in India's growth story. Given that judicial intervention in the execution of One-Person Companies is yet to see the light of the day, this paper seeks to discuss and propose some precautions with respect to the administration of 'Lifting of the Veil' and its corollaries. The paper has been divided into three parts. The first part presents a lucid introduction to OPC as incorporated in the Companies Act, 2013, followed by a deliberation on its historical evolution. The second part ventures into the doctrine of limited liability, while the third part dwells into intricate issues concerning disregard of limited liability and its application to an OPC. The authors have limited the scope of research to the application of the aforementioned doctrines before common law courts or tribunals and hence, the paper does not in any manner justify the whole range of issues which may arise out of other equally significant variables. The objective of the paper is so uncover a neutral mechanism which allows the courts to scrutinize the alleged wrongs of the company while encouraging innovation and securing the ends of justice.

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I. INTRODUCTION: THE CONCEPT OF A ONE-PERSON COMPANY

The concept of One-Person Companies existed in various countries for a significant amount of time before it was made available for implementation in India. Although still in its nascent stages, it is still striving to achieve its aim of benefitting the Indian economy. With the economy shifting its focus from the agrarian sector to making growth in sectors such as banking, insurance, real estate, industries, construction, foreign investment power, etc., OPC's are expected to be a boon to such businesses. Albeit criticized for the delay in its entry into Indian company law, it is seen as an extremely welcome move, more so in an economy in which family businesses and sole proprietorship play a major role. It brought in the much needed relief to sole entrepreneurs who wished to enter the corporate field.

The genesis of the One-Person Company is based on the advantages afforded out of a symbiotic combination of incorporation, which manifests itself as personhood, and a complete dominion of the sole proprietorship. A sole proprietor, with a moderate sized business, organizes a corporation to which he surrenders his business and assets. In return, he takes all the shares except the few necessary to comply with statutory provisions with respect to incorporators and directors. The few shares he does not take may be allotted to his relatives or employees in order to qualify them as incorporators or directors of the company, in accordance with the requirements of the corporation statute. Thus, the principal shareholder is able to retain the exclusive control and full dominion of the company and secures the desired privilege under the laws concerning corporations.[1]

The concept of 'One Person Company' was first introduced in Dr. J. J. Irani's Expert Committee Report on Company Law, which tried to take a comprehensive view in developing a perspective on changes necessary in the Companies Act, 1956 in context of the present economic and business environment. Its primary aim was making India globally competitive in attracting investments from abroad, by suggesting systems in the Indian corporate environment which are transparent, simple and globally acceptable. [2] It was not mentioned in the Naresh Chandra Committee of 2003 or in the working paper on Company Law issued by the Ministry of Company Affairs dated 4th August, 2004. The J. J. Irani report categorically states the following,

1 Note, 45 Harv. L. Rev. 1084 (1932)

2 J.J Irani, *Report of Expert Committee on Company Law*, 31st May 2005

"The law should recognize the potential for diversity in the forms of companies and rather than seeking to regulate specific aspects of each form, seek to provide for principles that enable economic interaction for wealth creation on the basis of clear and widely accepted principles."

It was in this report that the concept of 'One Person Company' was recommended. It stated the following:

"6. With the increasing use of information technology and computers, emergence of the service sector, it is time that the entrepreneurial capabilities of the people are given an outlet for participation in economic activity. Such economic activity may take place through the creation of an economic person in the form of a company. Yet it would not be reasonable to expect that every entrepreneur who is capable of developing ideas and participating in the market place should do it through an association of persons. We feel that it is possible for individuals to operate in the economic domain and contribute effectively. To facilitate this, the Committee recommends that the law should recognize the formation of a single person economic entity in the form of 'One Person Company' Such an entity may be provided with a simpler regime through exemptions so that the single entrepreneur is not compelled to fritter away his time, energy and resources on procedural matters.

6.1 The concept of 'One Person Company' may be introduced in the Act with following characteristics :-

a) OPC may be registered as a private Company with one member and may also have at least one director;

b) Adequate safeguards in case of death/disability of the sole person should be provided through appointment of another individual as Nominee Director. On the demise of the original director, the nominee director will manage the affairs of the company till the date of transmission of shares to legal heirs of the demised member.

c) Letters 'OPC' to be suffixed with the name of One Person Companies to distinguish it from other companies."

Thus, it was on the basis of this report that the concept of OPC's was incorporated into the Companies Act of 2013. It was aimed at helping small entrepreneurs start their micro businesses or small scale enterprises in a systemized corporate sector.

One may argue that the concept of a corporate enterprise does not owe any servitude to the institution of an OPC;[3] however, it is an indisputable reality that in the twenty first century, modern legislations have given credible cognizance to the concept by dedicating provisions on the same in laws framed. [4] Similarly, judicial pronouncements have been nothing short of consistent in crystallizing the concept of OPC vis-à-vis corporate enterprise. [5] The usual argument advanced by the courts benefitting OPCs revolves around the generic attitude of the law affording privileges, i.e., one who organizes a one-man corporation in compliance with the formalities of such a law for attaining statutory protection in a commercial venture, is merely taking advantage of a privilege conferred by law.[6] The argument that the legitimacy of the act of using this advantage is muddled with malice and self serving interests and hence must be shunned is an argument that has been nullified consistently.[7]

II. THE CONCEPT OF LIMITED LIABILITY

Limited Liability has been hailed as one of the greatest invention of the Corporate World.[8] To quote President Nicholas Murray Butler of Columbia,

> *"I weigh my words when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times.... Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it."*[9]

This theory, familiar to every elementary student of corporation law and finance, treats the corporation as a legal persona or juristic person constituting an entity in itself, which is separate and distinct from the members. The essence of this theory, stated in stark terms, is that the shareholders own "the corporation" and the latter owns and operates the assets and the business. The judicially accepted reasoning with regards to limited liability based on the legal entity theory is that since the corporation is a separate entity, the obligations incurred in the operation of the business are those of the corporation itself and the shareholders are not

3 Rutledge, *Significant Trends in Modern Incorporation Statutes*, 22 Wash. U. L. Q. 305 (1937)
4 Katinka, B, *Concept of Single Member Company in the Light of EU Harmonization- A Comparative Analysis of Serbis, Germany, UK*, Central European University, Hungary. Pg 54-58 (2010)
5 Elenkrieg v. Siebrecht, 238 N. Y. 254, 144 N. E. 519 (1924); Inland Revenue Commissioners v. Sansom, 2 K. B. 492, 500, 125 L. T. R. 37 (1921)
6 Macan v. Scandinavia Belting Co., 264 Pa. 384 (1919)
7 In re John Koke Co., 38 F. 2d 232, 233 (1930); Commerce Trust Co. v. Woodbury, 77 F. 2d 478, 487 (1935); Earp v. Schmitz, 334 Ill. App. 382, 79 N. E. 2d 637 (1948); Corley v. Cozart, 115 F. 2d 119 (1940)
8 Dodd, *The Evolution of Limited Liability in American Industry: Massachusetts*, 61 Harv. L. Rev. 1351 (1948)
9 William M. Fletcher, *Cyclopedia Of the Law of Corporations*, §21 (1917)

personally liable on those obligations.[10] The following are the economic justifications behind the protection of limited liability:[11]

> First, limited liability reduces the need for shareholders to check the managers of companies in which they invest because the financial consequences of company's failure are limited. Shareholders may have neither the incentive nor the expertise to monitor the actions of managers.
>
> Secondly, it may facilitate free transfer of shares by providing an incentive for managers to act efficiently. An inefficient management compels the shareholder to sell his shares as a discounted price, which may in turn lead to consequences such as a takeover and therefore a replacement of the management.
>
> Thirdly, limited liability may assist the efficient operation of the securities markets as the price of shares does not depend on the individual wealth of the concerned shareholder.
>
> Fourthly, it encourages risks and hence supports diversification. Consequently, the companies are able to raise capital at a lower cost. Further, it also facilitates optimal investment decisions.

This distinction between corporate and individual obligations and the ensuing limited liability of the sole shareholder cannot be overlooked even in the presence of objective economic justifications.[12] In fact, such separation has definite extra-legal or practical significance as well. The client under a contractual obligation has an opportunity of knowing and choosing the individual he is going to deal with, whether it is the company or the person behind the company. He should be attentive to the decision he makes and should be bound by his choice. The equities of the former are no greater than those of the latter. The former will be limited to the corporate assets and the latter to the individual assets. By this marshalling, equal equities of both groups are preserved in the usual and ordinary case. An instance supporting the same will be the case of *Louisville Banking Co. v. Eisenman*,[13] where a draft was accepted by the drawee in his company's name and was later discounted by a bank. The company was an OPC. In case of default, despite uncovering the real identity of the owner in control of operations, the bank will be precluded from isolating the personal assets of the individual. If the bank and other corporate creditors were permitted to hold the sole shareholder liable, the latter's individual assets would be depleted

10 Floating Services Ltd. v. M.V. San Fransceco Dipalola, 52 SCL 762 (2004)
11 F Easterbrook and D Fischel, The Economic Structure of Corporate Law, 41-44 (1 ed. 1991)
12 Bank of Tokyo Ltd v. Karoon, 3 All ER 468 (1986)
13 Louisville Banking Co. v. Eisenman, 94 Ky. 83, 21 S. W. 531 (1893)

at the possible expense of his personal creditors who dealt with him as an individual and should have priority in his personal assets.

Another important decision in this regard is In re John Koke Co.[14] Here the Court has appreciated a different commercial perspective. An individual dealing with an OPC makes a conscience election of either dealing with the sole director or dealing with his corporate entity. The "election" once made has to be upheld by the courts as a matter of law based on the cognizance of the contractual obligation underlying herein. The same was done in the aforementioned case where money was borrowed personally by the sole shareholder of a corporation for the declared purpose of paying off corporate debts. Upon the subsequent bankruptcy of both, the shareholder and the corporation, the lender sought to divide the liability between the company as well as the concerned shareholder. The United States Court of Appeals for the Ninth Circuit denied his claim and said that since he knew the purpose of the loan, he was "*bound by the election thus made, in view of the possible intervening rights of other creditors.*"[15]

III. DISREGARDING SEPARATE LEGAL ENTITY

The general .rule in the present state of affairs is that a company will be looked upon as a legal entity distinct from its members, 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. [16] No court of law shall permit a perversion of the concept for dishonest motives.[17] Furthermore, the courts shall always seek solace in finding a remedy based in equity[18] in cases where simple disregard of the corporate personality fails to secure the ends of justice.[19]

With an array of remedies to discipline an errant company, including an OPC, discussions emerging from courts have resulted in a controversial economic burden[20] on an OPC

14 In re John Koke Co., 38 F. 2d 232, 233 (1930)
15 *ibid*
16 United States v. Milwaukee Refrigerator Transit Co., 142 Fed. 247, 255; Eichelberger v. Arlington Building, Inc., 280 Fed. 997, 999 (D. C. Cir. 1922); Kutz Canon Oil & Gas. Co. v. Harr, 56 N. M. 358, 244 P. 2d 522, 527 (1952); Lazarus Estates Ltd v Beasley (1956) 1 QB 702
17 Neily Co. v. London & Lancashire Fire Insurance Co., 148 Fed. 683 (3d Cir. 1906)
18 D. N. & E. Walter & Co. v. Zuckerman, 214 Cal. 418, 6 P. 2d 251 (1931); Wenban Estate, Inc. v. Hewlett, 193 Cal. 675, 696 f., 227 Pac. 723 (1924); Thornburgh Construction Co. v. College Heights Development, 244 P. 2d 735 (Cal. App. 1952)
19 Metropolitan Holding Co. v. Snyder, 79 F. 2d 263, 266 (8th Cir. 1935)
20 Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 Harvard Law Rev. 1373, 138I (1938)

to ensure that the establishment of a corporate venture is done on an adequate financial basis.[21] The idea is to ensure that the incorporator, as a cost of the benefits of incorporation, finances the company in such a manner so as to enable it to meet the normal and expectable strains of a business of the size and character involved.[22] The dictum laid by the Judges in *Arnold v. Phillips*[23] perfectly sums up this burden:

> *"It is not denied that a corporation, owned by one man save for qualifying shares, is lawful in Texas. That it was created to shield the owner from liability beyond the capital set up by the charter does not show an unlawful or fraudulent intent, for that is a main purpose of every incorporation. It becomes an evidence of fraud only when the capital is unsubstantial and the risk of loss great, or the contributions to capital are greatly overvalued, and the like."*[24]

IV. CAN THE SOLE SHAREHOLDER OF A COMPANY BE PERMITTED TO BE A CORPORATE CREDITOR OF THE SAME COMPANY?

One may ponder upon the significance of this question at this juncture. However, in an era where corporate frauds loom large over the fate of the commercial strata, threatening the fine balance between the inherent risk involved in any business, versus the desire of attaining a compelling cordial business environment that Governments are seeking to affirm, the freedom of being the sole shareholder as well as a corporate creditor of a corporate entity may reveal some significant loopholes in the estimated plan of progression. This is because as a corporate creditor of the company the sole shareholder may misuse his status and gain the assets of a company that is being wound up and thereby dismiss better claims of other unsecured creditors. The troublesome reality is that the courts may find little reluctance in doing so as, was evident in the ruling given in the infamous *Solomon case*.[25] Keeping in view of the fact that the company in the given case was constituted just for the benefit of limited liability and was ordered to be wound up within 14 months of incorporation, the result in the court of law was a celebration for Solomon who received 1000 pounds out of the proceeds of liquidation as the "beneficial owner of the debentures" forwarded to Broderip. In the process, he successfully sidelined the claims of

21 Pepper v. Litton, 308 U. S. 295, 308-310 (1939); Wittman v. Whittingham, 85 Cal. App. 140, 259
22 Hanson v. Bradley, 298 Mass. 371, 10 N. E. 2d 259 (1937)
23 Arnold v. Phillips, 117 F.2d. 497, 502 (5th Cir.)
24 *ibid*
25 Salomon v. Salomon & Co.,Ltd. (1897) A. C. 22.

all the unsecured creditors of the company which was worth a whooping 8000 pounds. To this extent, the law seems to favour the claims of the sole director-cum-assured-creditor[26] despite the strong possibility of an attempt to hijack justice. The dictum of the court in the famous case of *Wheeler v. Smith*[27] seems to narrate the same, where the Judges pronounced,

> *"While the claim of a sole stockholder against a bankrupt corporation should be scrutinized with care, it is not the law that such a claim should be rejected merely because the claimant is such sole stockholder."*[28]

However, concerns regarding the aforementioned possibility are, to some extent, legitimate,[29] despite its popularity and approval within the legal hemisphere.[30] If for no other reason, it has been discussed that this advantage must not be afforded to the sole director at the cost of putting the assets of the company under liquidation beyond the reach of prospective creditors of the company.[31] It is submitted that at least the process of obtaining such assets as may be decided, must be made more cumbersome for the sole shareholder.

V. THE QUESTION OF THE HOUR: LIFTING OR PIERCING THE VEIL?

It is commonly seen that corporate lawyers, scholars and judges have been using the two phrases interchangeably, almost as synonyms.[32] The dismal usage of the phrases interchangeably is furthered by authorities which have stated the phrase "piercing of the veil" as "now fashionable"[33] and its sibling, "lifting of the veil" as "out of date".[34] However, the English courts have categorically maintained the difference between these two phrases. The difference in the words of Judge Staughton is expressed in the following manner:

> *"To pierce the corporate veil is an expression that I would reserve for treating the rights and liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil*

26 Peckett v. Wood, 234 Fed. 833 (3d Cir. 1916); Gardner v. Rutherford, 57 Cal. App. 2d 874, 136 P. 2d 48 (1943); Cl. Pott v. Schmucker, 84 Md. 535, 36 At. 592 (1897).
27 Wheeler v. Smith, 30 F. 2d 59, 61 (9th Cir. 19229)
28 *ibid*
29 William Z. Ripley, Main Street And Vall Street 64-65 (1927).
30 Inland Revenue Commissioners v. Sansom, (1921) 2 K. B. 492, 125 L. T. R. 37
31 Dollar Cleaners & Dyers, Inc. v. MacGregor, 163 Md. 105, 109, 161 at. 159, 161 (1932).
32 Commissioner of Land Tax v Theosophical Foundation Pty Ltd (1966) 67 SR (NSW) 70
33 Brewarrana v Commissioner of Highways (1973) 4 SASR 476, 480
34 Walker v Hungerfords (1987) 44 SASR 532, 559

or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose."[35]

In reality, the term lifting of the veil is looking beyond the veil.[36] It allows the courts to disregard the corporate personality at any time they want to examine the operating mechanism behind a company.[37] Piercing the veil on the other hand, leads to a complete dissolution of the separate personality and is to be used sparingly in limited cases involving corporate sham or impropriety.[38] However, for all practical purposes, piercing the veil automatically entails lifting as well.[39]

The most-recent seminal English case on the difference between the two doctrines is *Prest v. Petrodel Resources Limited.*[40] The landmark ruling entails the Lordships to be referring to lifting with concealment cases and piercing with evasion, with only the latter interfering with the company's separate legal personality.[41] To quote Lord Sumption,

"[The expression] "Piercing the corporate veil" is often indiscriminately applied to a range of situations in which the law attributes the acts or property of a corporation to those who control it, but without disregarding its separate legal personality."[42]

He clarifies further by saying,

"When we speak of piercing the corporate veil, we are not speaking of any of these situations, but only of those cases which are true exceptions to the rule in Salomon […] i.e. where a person who owns and controls a company is said in certain circumstances to be identified with it in law by virtue of that ownership and control."[43]

VI. PIERCING THE CORPORATE VEIL AND OPC

35 Atlas Maritime Co SA v Avalon Maritime Ltd (No. 1) (1991) 4 All ER 769; Brewarrana v. Commissioner of Highways (1973) 4 SASR 476, 480; Walker v Hungerfords (1987) 44 SASR 532, 559;
36 Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549, 558
37 Ian M Ramsay and David B Noakes, *Piercing the Corporate Veil in Australia,* (2001) 19 Company and Securities Law Journal 250-271
38 AB v. Smallbone (No 2) (2011) 1 WLR 1177
39 *Supra* 34
40 Prest v. Petrodel Resources Limited (2013) UKSC 34
41 Lloyd's Maritime and Commercial Law Quarterly, *Lifting the Veil on Piercing the Veil*, at https://www.i-law.com/ilaw/doc/view.htm?id=333154 (last updated 22/10/2016)
42 *Supra* 38 at Para 16.
43 *ibid*

Having discussed the difference between piercing and lifting and laying the groundwork of the central premise, it is a must to analyze the judicial exercise of piercing the corporate veil and juxtapose it with a functional OPC that has been caught in a controversy involving scrutiny by institutional adjudicatory bodies. This analysis becomes even more pertinent in the presence of emerging reports which suggest that courts, particularly ones following common law traditions, are inclined towards piercing the corporate veil in case of corporations with sole proprietorship.[44]

At the outset one must admit that this conclusion is not devoid of compelling reasons. Logic suggests that a corporation with multiple people playing different roles and dividing authority between themselves which has a lesser propensity to defy statutory regulations, enacted to serve the larger public interest, that is protection of investors. The same may not be that obvious in case of an OPC where one individual may end up corrupting the better claims of other creditors of the corporation with an ease of impunity as happened in the case of Solomon. However, the next segment shall present an argument against the use of this doctrine while dealing with OPCs.

VII. DANGERS OF PIERCING OF THE VEIL IN THE CASE OF AN OPC

The primary argument here is that the judiciary should exercise the power to pierce the veil sparingly and with caution, especially in the case of an OPC. This can be taken further under three heads: **[i]** the ambiguity revolving around the use of the said doctrine will be highlighted; **[ii]** deference will be paid to the original intent behind the introduction of OPC in the Companies Act of 2013 and **[iii]** due regards will be paid to balance of equities claimed by different types of creditors.

A. THE AMBIGUITY AROUND PIERCING

While legal scholars, historians and corporate pundits may find the theoretical principles behind piercing absolutely valid, the actual application of the theory in practise is riddled with

44 Ian M Ramsay and David B Noakes, Abstract, *Piercing the Corporate Veil in Australia*, (2001) 19 Company and Securities Law Journal 250-271

controversies. [45] Far from being clear, the commonwealth authorities on the subject of application of this doctrine by the courts have been called as "incoherent and unprincipled."[46] The caution stems from another note picked up from the opinion given by the Australian Federal Court in *Commissioner of Land Tax v. Theosophical Foundation Pty Ltd*[47] wherein the Court said:

> *"Authorities in which the veil of incorporation has been lifted have not been of such consistency that any principle can be adduced. The cases merely provide instances in which courts have on the facts refused to be bound by the form or fact of incorporation when justice requires the substance or reality to be investigated…"*[48]

There is no common, unifying principle, which underlies the occasional decision of the courts to pierce the corporate veil. Although an ad hoc explanation may be offered by a court which so decides, there is no principled approach to be derived from the authorities. [49] The rationale behind this paucity of distinct principles underlying the application of the doctrine is the necessary dependence of courts to the facts and circumstances of each case which are peculiar to that particular case.[50] Taking this rationale to its logical end, it has been argued that common law courts have developed an inclination towards securing the discretion to apply the said doctrine for themselves according to the merits of each case.[51]

Further, there may be extraneous situations where due to specific circumstances involving the concerned case, the judges may refuse to pierce the veil in case of an OPC. Take for instance the ground of agency which is often used for piercing the veil.[52] In case of an OPC, where the proprietorship puts the concerned individual in an extremely tight spot with respect to the functioning of the company, the courts have found instances where the impugned action was

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45 S Ottolenghi, *From Peeping Behind the Veil to Ignoring it Completely*, 53 The Modern Law Review' 338, 352 (1990); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89, 89 (1985)
46 Farrar, *Fraud, Fairness and Piercing the Corporate Veil*, 16 Canadian Business Law Journal 474, 478 (1990)
47 Commissioner of Land Tax v. Theosophical Foundation Pty Ltd (1966) 67 SR (NSW) 70
48 *ibid*
49 Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549
50 H Gelb, *Piercing the Corporate Veil – The Undercapitalization Factor*, 59 Chicago Kent Law Review 1-2 (1982)
51 C Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 Company Financial and Insolvency Law Review 15 (1999)
52 Brewarrana v. Commissioner of Highways (1973) 4 SASR 476, at 480

so inherently diffused with the nature of work done by the Corporation that it could not be distinguished from an act of agency.[53]

Another instance where the veil is often pierced is fraud. However, an assessment of the fraud exception to limited liability will reveal that the argument of fraud is closely related to an argument that the corporate form is a sham or façade, [54] which in law constitutes separate grounds for piercing.[55] It is submitted that the courts must restrain reliance on piercing and instead must initiate judicial scrutiny with lifting of the veil so as to first allow investigation to establish that the company indeed is a facade. This retrain, though one that requires patience, shall go a long way in realizing the original intent behind the introduction of OPC-which shall be further discussed in the succeeding segment.

B. THE OBJECTIVES OF OPC

That judicial actions must defer to the intent and will of the legislature is one of the oldest principles under common law.[56] Judicial deference *inter alia* refers to the proposition that the will of the legislature must be respected by the courts adjudicating claims under a statute made by the concerned legislature.[57] The will of the legislature behind introduction of OPC in the Companies Act of 2013 can be unearthed by looking at the relevant portion of the J.J. Irani Committee Report.[58] The report, in no uncertain terms, states that the concept of OPC must be imbibed in the law so that "*entrepreneurial capabilities of the people are given an outlet for participation in economic activity.*" It has been argued that OPCs indeed have a huge potential to impact our growth by boosting the entrepreneurial sectors. [59] Therefore, it is submitted that severity of judicial scrutiny over the affairs or conduct of the OPC must be less stringent. The plea is based on the dicta laid down in the *Atlas Maritime Co. Case*.[60] The doctrine of piercing the corporate veil is one

53 Dennis Willcox Pty Ltd v. Federal Commissioner of Taxation (1988) 79 ALR 267; The Electric Light and Power Supply Corporation Limited v Cormack (1911) 11 NSWSR 350
54 Donnelly v Edelsten (1994) 13 ACSR 196
55 J Farrar, *Legal Issues Involving Corporate Groups*, 16 Company and Securities Law Journal 184, 185 (1998)
56 Borgmann, Caitlin E., *Rethinking Judicial Deference to Legislation Fact-Finding*, Indiana Law Journal: Vol. 84: Iss. 1, Article 1(2009)
57 Dickerson, Reed, *Statutory Interpretation: A Peek into the Mind and Will of a Legislature*, Indiana Law Journal: Vol. 50: Iss. 2, Article 2 (1975)
58 *Supra* 2
59 One Person Company, The Institute Of Company Secretaries Of India, June 2014
60 *Supra* 33

that is based on equity.[61] By limiting themselves to lifting and not piercing the veil, the courts allow themselves a substantial degree of flexibility to deal with the innumerable circumstances which may render the use of stricter principles inequitable. Such usage leaves further scope for investigation into the affairs as well as the management of the company, thereby entitling the courts to make an informed choice about the last resort to be undertaken, while keeping in mind the conflicting interests of all the stakeholders involved and showing comity to the entrepreneurial spirit underlying OPCs at the same time.

C. BALANCE OF EQUITIES

With the idea that lifting as opposed to piercing affords courts with flexibility, retraint and time to investigate the matter instead of completely disregarding the corporate personality in the contextual backdrop, it is finally submitted that lifting would help balance the cross-firing equitable claims of personal creditors of the sole shareholder against those of the corporate creditors. In the ideal cover of corporate identity, claims of personal creditors, those who had formed legal relations with the sole shareholder of the OPC based on personal connections, would be met by his personal assets, whereas claims of corporate creditors would be satisfied by the assets of the Company. However, if there are circumstances calling for disregard of corporate personality, the problem of the respective claims of the personal and the business creditors presents some complexity. If and when the corporate personality is disregarded, the formal consequence is that the company shall disappear leaving the sole proprietorship occupying the entire scene. This would mean that

> the erstwhile sole or principal shareholder shall no longer be entitled to limited liability; he may be denied reimbursement for any loans advanced to the business; and all the assets remaining after secured or lien creditors have exhausted their security will now be used for the satisfaction of the unsecured claims held by the business and the personal creditors alike.

The third point mentioned is the genesis of difficulty pertaining to the utilization of claims of such unsecured creditors. When insolvency has overtaken the business venture, or the shareholder, or both, the competing equities of the personal and the business creditors may

61 Oh, Peter B., *Veil-Piercing Unbound.* BUL Rev. 93 89 (2013); Richmond McPherson & Nader Raja, *Empirical Study, Corporate Justice: An Empirical Study of Piercing Rates and Factors Courts Consider When Piercing the Corporate Veil*, 45 Wake Forest L. Rev. (2010)

require a skilled management of assets. It may be proper or necessary to give the business creditors priority in the business assets, and the personal creditors priority in the personal assets, or to make some other alignment, under the particular circumstances. The point is that complete disregard of corporate personality is not a panacea to the quagmire.[62] In the wake of disregarding corporateness there may be need of adjustments in order to resolve the conflicting equities of rival claimants especially in cases where debtors resort to the one-man company or family corporation as a device to defraud creditors. A businessmen with financial stress stemming from unpaid loans may choose to form a company to keep him creditors at bay. He may transfer the business to it, take in return all or most of the shares, and operate the business as a corporate officer at a fixed salary, with the powers and influence of a sole proprietor. In cases of this kind the courts have righteously disregarded corporate personality, and permited the defrauded creditors to trace and seize the assets transferred.[63] However, consideration must also be given to those persons who have innocently dealt with and subsequently extended credit to the business on a corporate basis. In fact to that very end, courts have preferred the claimraised by such corporate creditors over and above those creditors whom the sole shareholder intended to defraud.[64]

However, the position will change when the original creditors acquire a lien on the assets transferred to the corporation, before the new corporate creditors acquire such a lien. In such a case, appreciating the promptness and due diligence shown by the original personal creditors the courts have ruled that the lien established first shall prevail.[65] Thus, the position of the defrauded creditors will depend on the diligence with which they have followed their claims against the debtor and shall be evaluated in comparison to the actions of the corporate creditors.[66] For instance, where is has been established that the corporate creditor invested in the compnayy concerned with the full knowledge of the fact that such company had been set up with the intention to defraud certain money lenders, the courts found little reluctance in disregarding the claims of such creditors.[67] An instance of the similar practise will be Hanson's case[68] in which an employee of a one-man company sought to satisfy his pending wages against the personal assets

62 Bullard, Edward M., *Review of Subsidiaries and Affiliated Corporations by Elvin R. Latty*, University of Chicago Law Review: Vol. 4: Iss. 2, Article 23 (1937)
63 Matchan v. Phoenix Land Investment Co., 159 Minn. 132 (1924); Folsom & Co. v. Detrick Fertilizer Co., 85 Md. 52, 36 Alt. 446 (1897)
64 Jackson v. N. H. Thomas Investment Co., 46 F. 2d 252 (5th Cir. 1931); Kellogg v. Douglas County Bank, 58 Kan. 43 (1897)
65 Booth v. Bunce, 33 N. Y. 139 (1865)
66 Sampsell v. Imperial Paper & Color Corp., 313 U. S. 215 (1941)
67 *ibid*
68 Hanson v. Bradley 298 Mass. 371, 10 N. E. 2d 259 (1937)

of the director when the company went into liquidation despite being fully aware of the fact that the company was bereft of any secure source of funding and was thriving only due to borrowed aid of the sole shareholder. However, as can easily be expected, when the separate corporate personality is completely disregarded, such personal creditors may not get appropriate and reasonable opportunity to make their case, which is why it shall be better for the courts to lift the veil before conclusively disregarding the personhood of the company.

However, this does not mean that the courts must show partiality towards OPCs. It is certain that there may be convincing circumstances where the separate corporate identity must yield before a higher cause of justice. In an interesting case on the point, an OPC, due to unpredicted insolvency, established inability to pay the fine due to concerned persons, which gave the Court an opportunity to pierce the veil and hold the director liable to pay the fine.[69]

VIII. THE END OF THE KALEIDOSCOPE: FUTURE OF OPCS

OPCs have yet to be subject to a lot of analyses in India; but its juxtaposition with the well established principle of corporate limited liability proves to result in an array of different possibilities and resulting variants. Though limited liability has its own set of advantages, the method used in fixing liability upon the person running the OPC should not make it detrimental to the concept of an OPC itself, which will inevitably result in rendering its intention futile. The onus lies on the courts to ensure that the difference that lies between Lifting of the Corporate Veil and Piercing of the Corporate Veil is be acknowledged and implemented accordingly, while duly calculating the risks that are posed if the OPC is pierced. This suggested approach will help create balance between the polar ends of having a pro-market outlook and that of investor safety along with public interest. One can only wait to see how the result unfolds with time in regard to fixing liability in an OPC.

69 Chesterman, *The Corporate Veil, Crime and Punishment: The Queen v Denbo Pty Ltd and Timothy Ian Nadenbousch*, 19 Melbourne University Law Review 1064 (1994)