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UNVEILING CORPORATE RESPONSIBILITY: A STUDY OF THE EFFECTIVENESS OF REVERSE LIFTING OF CORPORATE VEIL IN INDIA

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ABSTRACT

The doctrine of piercing the corporate veil has been a crucial tool for imposing liability on controllers of corporations who misuse their corporate façade for wrongful purposes. In India, where closely held companies are numerous, the chances of fund diversion, siphoning, and financial mismanagement are high, given that the control of companies largely lies in the hands of a few individuals. The corporate irresponsibility crisis has further highlighted the need to address this issue, and while the enactment of the laws such as the Insolvency and Bankruptcy Code 2016 is a step in the right direction, it can be argued that the application of reverse piercing can effectively supplement these efforts.

INTRODUCTION

A company has its own separate legal identity, different from its members. In exceptional situations, piercing of the corporate veil is done in cases where the company's identity is used by the owners to disguise their malicious acts and intent. To achieve justice the doctrine of corporate veil piercing, forward or reverse is used by courts.

Under the traditional method of corporate veil piercing, the Courts pierce the veil to cut through the legal fiction and hold the person in control of the corporation liable for illegal actions undertaken at the behest of an artificial legal person. On the other hand, reverse piercing the corporate veil, involves imposition of the individual liability of the controller of the corporation on the corporation itself. Simply put, reverse corporate veil piercing is the opposite of corporate veil piercing.

In recent years, the concept of corporate responsibility has gained significant attention and importance in the global business landscape. Corporations are increasingly being held accountable for their actions and their impact on society and stakeholders.

In the context of India, lifting the corporate veil has been a topic of significant controversy and discussion, particularly in light of several high-profile corporate scandals in recent years. Critics argue that current legal provisions are inadequate to hold corporations accountable for their actions, and that the principle of limited liability allows corporations to engage in risky behavior without fear of retribution. This research paper aims to analyze the effectiveness of the reverse lifting of the corporate veil in India in promoting corporate responsibility.

ORIGON OF PIERECING AND REVERSE-PERCING OF CORPORATE VEIL

The concept of corporate governance is founded on the principle that a company is a distinct legal entity separate from its members and shareholders, providing them with limited liability protection. However, courts have gradually realized that this concept can be abused by individuals for their own selfish motives."As a result, the equitable doctrine of "piercing the corporate veil" has emerged as a way to hold accountable those individuals who hide behind the corporate structure. The idea of lifting of corporate veil is not new to corporate governance. In the well-known case of **Salomon v A Salomon & Co. Ltd.**, which was decided in the year of 1897, It has been unequivocally proven that the corporation possesses its own distinct legal identity, separate from the individuals who incorporated it. In this case, it was observed that: The company is at law a different person altogether from the subscribers...; and, despite the possibility that the business remains unchanged after incorporation, with the same individuals acting as managers and receiving profits, the company is not considered, in legal terms, as the agent or trustee of the subscribers.

"India being a colony of England till mid-1947, its company law jurisprudence has been exactly in line with the English law." In India, the doctrine of piercing the corporate veil has its origins in the statutory provisions of the Companies Act, 1956, which codified the principles of corporate personality and limited liability. Indian courts, to this day, continue to apply the English cases as precedents

In recent years, there have been notable developments in Indian jurisprudence regarding piercing the corporate veil. Indian courts have shown a willingness to pierce the corporate veil in cases involving tax evasion, money laundering, or other forms of financial fraud. For example, in the landmark case of **Vodafone International Holdings B.V. v. Union of**

India, the Supreme Court of India held that the corporate veil could be pierced if a company is incorporated with the sole purpose of avoiding tax liabilities or perpetrating fraud. This decision clarified that the doctrine of piercing the corporate veil can be applied in cases where the corporate form is used as a shield to commit illegal or fraudulent activities.

The conventional method of piercing the corporate veil typically entails holding the individual or entity in control of the corporation accountable for the misuse of the corporate façade in various manners. Reverse piercing the corporate veil involves imposing the liability of an individual or parent corporation upon the corporation controlled or its subsidiary, as the case may be, irrespectively.” Simply put, reverse piercing is just an antithesis to the piercing veil of the corporation.

This ‘specific progress’ plainly reverses the vector of piercing. Following this concept, a creditor has the ability to take legal action against a corporation that has utilized the owner's personal assets to aid the owner in evading personal liability.

The doctrine of reverse piercing the corporate veil is primarily an American term and first came into prominence in the case of **Kingston Dry Dock Co. v Lake Champlain Transportation Co.** In this case, the board of directors of the defendant and its subsidiary were nearly identical. When the defendant failed to make payment, the plaintiff sued and sought to attach the assets of the defendant's subsidiary to satisfy its claim. The court granted the plaintiff's request, but the appellate court took a narrow stance on reverse piercing of the corporate veil, stating that holding a subsidiary liable for the actions of its parent company should be done only in rare circumstances. For the next thirty years, the observation made in this case remained the sole authority on the concept of reverse piercing of the corporate veil.

It should be noted that in order for reverse piercing to be applicable, two crucial elements must be present: domination and perpetration of fraud or injustice.

In the UK, the courts often express their reluctance to lift the corporate veil and try to save the corporate legal entity in most cases, even if it is necessary to lift the corporate veil to ensure justice. The English courts have been asked to disregard the separate legal personality of a company and its shareholders, but they rarely respond to this issue.

In the case of **In Re Phillips**, where an outsider reverse piercing claim was allowed, provides an interesting perspective on the distinction between traditional and reverse piercing. The court stated that in traditional veil piercing, the veil protects a shareholder who is abusing the corporate fiction, while in reverse piercing, the corporate form protects the corporation which is being used by insiders to perpetuate fraud or defeat a rightful claim of an outsider. This approach places the creditors of the individuals in a higher position and considers their rightful claim against the debtor. This approach can be adopted in Indian jurisdictions as well, recognising the concept of reverse piercing.

The doctrine of "reverse piercing of corporate veil" is a relatively new concept in India, and there is resistance in accepting it. The arguments against accepting reverse piercing in India include lack of statutory recognition, reluctance to depart from established principles, equitable considerations, lack of clarity, limited case law, less prevalence in India, and no guidelines from the Supreme Court.

The doctrine was recognised in India in the landmark case of **Standard Chartered Bank v. Directorate of Enforcement**, the Supreme Court ruled that a corporation can be prosecuted and penalized for offences with fines, regardless of the mandatory punishment prescribed under relevant statutes on behalf of its owners. The Supreme Court further clarified this position in the case of **Aneeta Handa & Ors v. Godfather Travels**, which dealt with section 141 of the Negotiable Instruments Act, of 1881. It was clarified that the criminal intent of the owner or individual can be attributed to the company to establish criminal liability on the corporate entity.

CROSS-JURISDICTIONAL APPLICATION OF REVERSE PIERCING

The concept of reverse piercing the corporate veil is not as firmly established in legal practice. Although several States have expressly rejected the doctrine, an increasing inclination towards acknowledging reverse piercing as a viable theory of recovery.

Despite the existence of reverse piercing in some states, the approaches taken in such cases lack uniformity. These approaches are designed to balance the interests of the plaintiff, innocent shareholders, and other corporate creditors, unlike traditional piercing where only the shareholder is held liable for their proactive role in wrongdoing without adversely

affecting the corporation, its creditors, and other shareholders. Due to the conflicting interests involved in reverse piercing, any allowance of this doctrine must delicately balance the needs of all parties involved in order to adequately protect their respective interests.

USA

In the USA, the application of the reverse piercing doctrine varies by state. In general, to apply the reverse piercing doctrine, the creditor must show that the owner of the corporation has used the corporation to shield assets from creditors.

The creditor must also show that the corporation is the alter ego of the owner, meaning that it has no separate identity from the owner. The court will consider several factors to determine whether the corporation is the alter ego of the owner, including whether the owner has commingled funds, failed to observe corporate formalities, and whether the corporation was undercapitalized.

The court will also consider whether the application of the reverse piercing doctrine is necessary to prevent fraud or injustice.

UK

In the UK, the courts have been reluctant to apply the doctrine of piercing the corporate veil, and it is only used in exceptional circumstances. The UK courts have only allowed the veil to be pierced in cases where the company was used to perpetrate a fraud or other wrongdoing.

The UK courts have made a key distinction between using the corporate form to evade or conceal existing legal obligations or wrongs on the one hand, and using it to insulate oneself from future or contingent liabilities on the other. Only the former could justify veil piercing in the UK. The court will consider several factors to determine whether to pierce the corporate veil, including whether the company was used to perpetrate a fraud or other wrongdoing, whether the company was a sham or facade, and whether the company was undercapitalized

In summary, while the courts in both the USA and the UK consider whether the corporation was used to perpetrate a fraud or other wrongdoing, the courts in the USA also consider whether the corporation is the alter ego of the owner, while the courts in the UK make a key distinction

between using the corporate form to evade or conceal existing legal obligations or wrongs on the one hand, and using it to insulate oneself from future or contingent liabilities on the other.

A notable legal case that pertains to the doctrine of 'reverse' piercing is **C.F. Trust Inc. v. First Flight Ltd. Partnership**. In this instance, two creditors who had obtained judgments against an individual debtor sought to collect their debts from the corporate entity, claiming that it was essentially the alter ego of the debtor. The Court permitted the application of reverse piercing, citing Virginian law that recognizes the dominant owner as equivalent to the corporation under the "alter-ego" doctrine. As a result, the creditors were able to access the company's assets through reverse piercing.

Prest v Petrodel has emerged as a pivotal case in shaping contemporary perspectives on corporate structures, including the doctrine of reverse piercing the corporate veil. The Supreme Court of India, in its comprehensive analysis of the piercing of the corporate veil in the **case of Balwant Rai Saluja**, made reference to and relied upon the principles established in this case. The Court emphasized that this (reverse lifting of corporate veil) rule should be applied in cases where it is clear that the company was intentionally used as a facade or sham by those in control of the company to evade liability.

Requirements for the application of the doctrine

In order to apply the reverse piercing of the corporate veil, there are generally four elements that are considered, known as the "hybrid test". These include assessing the degree of similarity between the shareholders and the corporation by applying the alter ego doctrine, evaluating public policy considerations to determine if piercing the corporate veil would harm any other parties through cost-benefit analysis, examining whether there was any fraudulent intent involved, and exploring alternative remedies that may be available before invoking the equitable doctrine to promote justice. It should be noted that the application of this doctrine is subjective and relies heavily on the specific facts and evidence of each case, and there is no one-size-fits-all formula that can be used.

When analyzing the application of reverse piercing doctrine, it is crucial to take into account the level of control exerted by the person over the corporation that is subject to a reverse piercing claim in relation to the debts owed by that person.

In larger private corporations or public companies, the individual with the highest shareholding or the one asserting the maximum influence over corporate decisions is considered to be in control.

In **India**, there is no specific test for determining control, as clarified by the Securities and Exchange Board of India (SEBI) in a notification dated September 8, 2017. SEBI stated that control should be determined on a case-by-case basis, making it a question of fact. Additionally, the Companies (Amendment) Act 2017 introduced changes relevant to the argument, including the amendment to the definition of an associate company. The amendment now sets a numerical threshold of at least twenty per cent of the total voting power or control of or participation in business decisions under an agreement, which could assist courts and tribunals in examining reverse piercing claims. The legislative intent behind this amendment, as highlighted in the Companies Law Committee Report (2016), is to ensure compliance with corporate governance requirements under the Companies Act 2013. Furthermore, the expression control over or participation in business decisions could be interpreted to encompass direct or indirect agreements and arrangements between the corporate debtor and its associate companies in the context of examining reverse piercing claims.

Current Scenario in India

Due to the lack of acceptance and the inflexible approach of Indian courts, the question regarding the applicability and implementation of the doctrine of reverse piercing has remained unresolved until now. Unlike courts in other jurisdictions like the United States of America and the United Kingdom, Indian courts have been unable to establish clear guidelines or tests for the smooth implementation of this doctrine in their legal system. The absence of a governing law in India exacerbates the dilemma surrounding the determination and implementation of this doctrine. Therefore, considering the global acceptance and increasing prevalence of this doctrine, it is crucial to at least contemplate its applicability in India and establish specific guidelines or tests that can assist the Indian judiciary in effectively implementing this doctrine.

There are two recent examples of claims for the application of reverse piercing in India, including the cases of **State Bank of India v. Kingfisher Airlines** and **Punjab and Sind Bank v. Skippers Builders Pvt. Ltd.** In the Kingfisher Airlines case, it was suggested to consolidate all group companies under one platform and hold Vijay Mallya as the common

denominator for the responsibility to repay dues to the Industrial Development Bank of India. The court stated that -

“it is necessary to lift the corporate veil of Defendant No. 4 and hold them liable for the entire OA claim jointly and severally with defendant nos. 1 and 3. It is further stated that in the light of the fact that Defendant no. 4 is a wholly owned subsidiary of Defendant no. 2 and that it is being entirely controlled by Defendant no. 2 on a day to day basis; and as defendant no. 4 does not have any independent business of substance, defendant no. 4 is also jointly and severally liable along with Defendant nos. 1 to 3”

In the **Skippers Builders case**, where the property of Tej Properties Pvt. Ltd. was attached to satisfy the dues of Mr. Tejwant Singh, who was in charge of the affairs of the company. Although the court did not explicitly use the term "reverse piercing" in this case, the facts suggested the application of this doctrine.

However, it should be noted that the Supreme Court of India has not yet applied this doctrine in any case, nor has it provided guidelines for its application, and the statutes are also silent on the implementation of this doctrine. Thus, the status of the reverse piercing of the corporate veil in India remains uncertain and subject to persuasive value in courts and tribunals. Additionally, Corporate Criminal Liability is an emerging concept in India, which holds corporations responsible for the actions of their owners, considering the increasing influence of corporations on the economy and society. This concept grants more power to corporate entities to engage in wrongful conduct, while being less susceptible to punishment and disgrace. The principle of "Respondent Superior" is considered the guiding principle towards corporate criminal liability, and the Indian Supreme Court has held that a company can be held liable for the acts of its agents or employees that involve mens rea, a crucial element of criminal intent.

The increasing number of corporate frauds indicates that traditional remedies are inadequate in dealing with new forms of fraud that are creatively designed. Therefore, it is imperative to adopt and apply new rules and doctrines, such as the doctrine of reverse piercing, in India. Failure to recognize and implement this doctrine would deny justice to the aggrieved and protect the guilty by exploiting the concept of the separate legal entity of a corporation. Thus, it is crucial to evaluate and apply the doctrine of reverse piercing to safeguard the rights of stakeholders.

Challenges in the implementation of the reverse piercing of the corporate veil principle in India

- Legal Framework: Adopting a clear and well-defined legal framework for reverse piercing can provide certainty and guidance to the courts, legal practitioners, and businesses. This framework should outline the conditions, principles, and procedures for applying reverse piercing.
- Evolving Doctrine: The Indian courts can evolve the doctrine of reverse piercing to adapt to changing corporate trends. By considering emerging business structures and evolving legal principles, the courts can ensure that the doctrine remains relevant and effective.
- Punishment Strategy: India needs to implement a punishment strategy along the lines of that used in the USA and the UK to deal with the rise of corporate crime. Strengthening enforcement and imposing significant penalties for corporate wrongdoing can act as a deterrent and foster a culture of compliance.
- Promoting transparency and accountability: One of the concerns surrounding reverse piercing is the potential for abuse or misuse. The US and UK jurisdictions have implemented measures to promote transparency and accountability, such as disclosure requirements and stringent corporate governance standards. India can enhance its existing legal and regulatory framework to ensure transparency in corporate structures and discourage the misuse of reverse piercing. This could include measures like mandatory disclosure of beneficial ownership and strengthening corporate governance norms.

In summary, the Indian courts can learn from the US and UK and implement the principles of alter-ego, weighing the interests of the plaintiff, innocent shareholders, and other corporate creditors, and considering the public policy implications of piercing the corporate veil. India needs to implement a punishment strategy to deal with the rise of corporate crime. The Indian courts can evolve the doctrine of reverse piercing to deal with the changing corporate trends, analyze the concept of reverse piercing, and consider whether the company was used to perpetrate a fraud or other wrongdoing, whether the company was a sham or facade, and whether the company was undercapitalized.

REVERSE PIERCING: A SOLUTION TO CORPORATE IRRESPONSIBILITY

Corporate irresponsibility refers to the failure of a corporation or business entity to act in a responsible, ethical, and socially accountable manner. It involves actions or practices by a corporation that result in harm or negative impacts on various stakeholders, including shareholders, employees, customers, suppliers, local communities, and the environment. Corporate irresponsibility can manifest in various forms, such as unethical business practices, non-compliance with laws and regulations, labour exploitation, financial fraud, corruption, and disregard for social and human rights.

Corporate irresponsibility, which refers to unethical or fraudulent behaviour by corporations, has become a significant concern in modern business environments, to ensure that corporations operate in a responsible and sustainable manner, uphold ethical standards, and fulfil their social and economic responsibilities. Reverse piercing, a legal doctrine that allows a court to disregard the separate legal entity of a corporation and hold corporations liable for the debts or obligations of the individual/shareholder has been proposed as a potential solution to address corporate irresponsibility. However, reverse piercing also raises several challenges and concerns, including potential abuse or misuse, lack of clear legal standards, and potential negative impacts on innocent shareholders. In this chapter, we explore possible solutions to corporate irresponsibility in regard to reverse piercing, focusing on legal, regulatory, ethical, and cultural measures that can promote responsible corporate behaviour while safeguarding the rights and interests of all stakeholders.

Reverse piercing of the veil enables, in Insolvency and bankruptcy matters, the courts and resolution professionals are encouraged to consider a broader range of assets beyond those owned solely by the corporate debtor, which may otherwise be excluded due to the legal separation of entities. Section 18 of the Code currently only allows for assets owned by the corporate debtor to be included in the resolution process. However, the application of the doctrine would enable assets owned by the personal guarantor to also be incorporated into the resolution process.

It is well-known that the magnitude of bad loans can have detrimental effects on the overall economy. The utilization of reverse piercing as a tool to tackle bad loans not only enhances

the financial health of banks but also empowers various creditors, regardless of their size, to seek recourse against defaulting debtors. The doctrine of reverse piercing, as a supplementary remedy to the existing provisions of the Insolvency and Bankruptcy Code, 2016, has been proven effective in addressing cases of debt payment evasion, even in the absence of fraud. In light of the current economic situation and the principles of fairness and justice, the application of reverse piercing can serve as a viable solution to alleviate the burden of bad loans in the country.

It is noteworthy that the **Insolvency and Bankruptcy Code** introduced a significant change in the priority of claims compared to the Companies Act, 2013, indicating a shift towards enhanced protection of creditors' interests and promoting credit advancement in the country. Therefore, empowering creditors through the application of reverse piercing would further strengthen their position, which is crucial in the current context of increasing bad loans.

Similarly, the case of **In re Mass** allowed a reverse piercing claim based on the existence of circumstances that warranted the application of the doctrine. The court reiterated that even in the absence of allegations of fraud or misconduct by the debtor-shareholder, a claim of reverse piercing could be sustained if it serves the larger public interest. This approach emphasizes that irrespective of the existence of fraud, a creditor of the controller can legitimately bring a claim against the corporation to satisfy their debt.

Scholars have suggested an alternative solution to pay off the relevant portion of shareholding owned by the individual in control. This approach would avoid any impact on the company's property and prevent any priority issues with the claims. However, some argue that admitting a new shareholder, particularly in a private corporation where decisions are made primarily through agreement of other shareholders, could potentially impact the interests of the creditor making the claim.

In the case of **Commissioner of Environmental Protection v. State Five Industrial Park, Inc.**, the Commissioner of Environmental Protection sued State Five Industrial Park, Inc. and its parent company, alleging that they were both responsible for environmental contamination. The court found that the parent company had complete control over the subsidiary and that the subsidiary was merely an alter ego of the parent. Therefore, the court applied the doctrine of reverse veil piercing and held the parent company liable for the subsidiary's environmental

violations.

Reverse piercing can increase corporate responsibility by holding parent corporations accountable for the actions of their subsidiaries. If a court pierces the subsidiary's veil, its activities or citizenship will be imputed to the parent, thereby giving the court personal jurisdiction over the parent. This means that the parent corporation can be held liable for the actions of its subsidiary, which can incentivize the parent corporation to ensure that its subsidiary is acting in a responsible and ethical manner.

How reverse piercing principle can promote greater corporate responsibility in India:

Clarify the scope of the doctrine: The Indian courts should provide clear guidance on the scope of the reverse piercing principle and the circumstances in which it can be applied. This will help ensure that the principle is applied consistently and fairly.

Strengthen the enforcement of corporate responsibility: The Indian government should strengthen the enforcement of corporate responsibility by imposing stricter penalties on companies that engage in illegal or unethical behaviour. This will help deter companies from engaging in such behaviour in the first place.

Increase transparency and accountability: The Indian government should increase transparency and accountability in corporate governance by requiring companies to disclose more information about their operations and financial performance. This will help investors and other stakeholders make more informed decisions about the companies they invest in.

Encourage responsible business practices: The Indian government should encourage responsible business practices by providing incentives for companies that adopt sustainable and socially responsible practices. This will help create a culture of corporate responsibility in India and encourage companies to act in the best interests of all stakeholders.

CONCLUSION

"Fraud is infinite." The law cannot rely solely on traditional remedies or it will find itself "perpetually eluded by new schemes" contrived by "the fertility of man's invention."

To prevent misuse, the corporate form should only be used for legitimate business

purposes. However, courts that deny the use of reverse piercing are allowing wrongdoers to misuse corporations to shield their assets, while also depriving plaintiffs of a necessary remedy. The traditional remedies are not enough to address the fraud that triggers reverse piercing claims. Therefore, new remedies are needed to prevent justice from being evaded by new schemes. To protect all parties involved, courts can allow reverse piercing in cases where traditional remedies are insufficient and where it applies to both legal and equitable owners, with an exception for innocent shareholders who have made a capital investment. Additionally, reverse piercing should comply with existing creditor priority rules.

The implementation of the reverse lifting of the corporate veil principle faces challenges that need to be addressed for effective application. Some challenges include the lack of clear statutory provisions, inconsistent judicial interpretation, and the need for a delicate balance between protecting stakeholders' interests and respecting the principle of separate legal personality of corporations. Additionally, the lack of precedence and limited awareness among legal practitioners and corporate actors also pose challenges to the implementation of this doctrine in India.

To overcome these challenges, there is a need for legal reforms to provide clear statutory provisions that explicitly recognize and define the reverse piercing doctrine in Indian corporate law. Consistent judicial interpretation and guidance through well-reasoned judgments can also help in establishing a robust legal framework for the application of reverse piercing. Increased awareness among legal practitioners, corporate actors, and stakeholders about the concept, scope, and implications of reverse piercing can facilitate its effective implementation.

Furthermore, the legal framework and judicial interpretation of the reverse lifting of the corporate veil principle can be helpful in promoting greater corporate responsibility. This can be achieved through stricter enforcement of corporate governance regulations, imposing liabilities on corporate actors who abuse the corporate form, and holding them accountable for their actions. Lessons can also be learned from experiences of other jurisdictions that have successfully implemented the reverse piercing doctrine, such as the United States and the United Kingdom, in terms of legal frameworks, judicial precedents, and best practices.

In conclusion, while the doctrine of separate legal entity is a fundamental principle of corporate governance, courts must be willing to consider and apply the doctrine of reverse

piercing of the corporate veil in appropriate cases where traditional remedies are inadequate to achieve justice. By analyzing and developing the doctrine further, courts can strike a balance between the interests of various parties involved and ensure that justice is done in complex commercial situations.

