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A HOLISTIC APPROACH OF SHREDDING THE CORPORATE VEIL OF BUSINESS ENTITIES TO COMBAT WHITE-COLLAR CRIMES

AUTHORED BY - BHAVANA SURAGANI
& SRAVISHTHA T

Abstract:

The growth and diversification of businesses in contemporary times has opened the floodgates for the commission of white-collar crimes. These crimes apart from being construed as marginally distinct from traditional crimes, predominantly occur due to unethical business practices which are incentivized solely on the grounds of financial gains. It is instructive to note that with the advent of industrialization and revolution of technology, white collar crimes have escalated at an alarming rate, and are typically the most prevalent in the arena of corporate jurisprudence. In fact, the concept of corporate criminal liability has precipitated a host of debates revolving around whether a corporation as a distinct artificial body is endowed with the capability of committing a crime and can be subject to the sanction of criminal law. To this end, this essay would offer a succinct breakdown of whether corporations can indulge in criminal activities and would further delve into the nuances of piercing the corporate veil in light of white -collar crimes through a host of illustrations. The article would also intend to show how the concept of "separate legal entity" of business corporations, has been tactically used to the advantage by individuals controlling the company, in order to shelter themselves from any penal sanctions.

Paper:

The fundamental axiom governing Indian Company law is that a corporation is a separate legal entity, distinct from and independent of its members[1]. Essentially, a corporation is bestowed with the authority to enter into multiple contracts, make transactions, bear its own name and sue or be sued. The case of Salomon v Salomon, serves as a good starting point to understand how the concept of

[1] *Kunal, Kaushik, "A Critical Study on Corporate Criminal Liability with Special Reference to India and USA"*

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separate corporate personality crystallised as a core element in corporate law[2]. The House of Lords incisively ruled that a company is an independent person with its rights and liabilities appropriate to itself and that the motives of those engaged in the promotion of the company is deemed irrelevant when examining what those rights and liabilities are.[3] The second doctrine that was propounded in the case of Salomon is labelled as limited liability. The rule of limited liability is fashioned on the understanding that the liability of the shareholder is restricted to the nominal value of shares invested by him.[4] Moreover, in circumstances where the shareholder has paid the entire amount that is payable towards his shares, he cannot be held accountable for the debts of the company, even if he holds virtually the entire share capital.[5] It is pertinent to note that the separate corporate personality of a company forms the bedrock of all commercial and business transactions and is construed as the most pervading of the fundamental principles of company law. Notably, a corporate veil is described as a metaphoric veil which endeavours to separate the company from its members, concomitantly restricting the transmission of liability on either side. A gripping observation made in the case of *Gallaghar v. Germania Brewing Company* was that while a corporation is a legal fiction forming a distinct entity, in reality, it is an amalgamation of individuals who are the beneficiaries of the corporate property[6]. It is important to bear in mind that given the complexity of commercial transactions and the ensuing illegalities, courts are empowered to pierce the veil of the company and disregard the independent status of the entity in instances when the principle of corporate personality is flagrantly opposed to justice, convenience and is employed as a vehicle to promote fraud or illegalities.[7] A cursory reading of the above, prods the readers to take cognizance of the fact that the court is entitled to break through the corporate cloak and to pay adequate heed to the realities behind the legal facade. The case of *Santanu Ray v Union of India*, would offer further clarity and nuance to better grasp the circumstances under which the corporate veil can be lifted.[8] The central contention in this case was that the company had infringed upon Section 11(a) of the Central Excises and Salt Act, 1994.[9] The court asserted that in the case of economic offences, the veil of the corporate entity

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[2] *[1897] AC 22*

[3] *Dahal, Rajib, "Salomon v Salomon & Co. Ltd. [1897] AC 22 – its impact on modern laws on corporations – selected studies from the UK and the USA"*

[4] *Ibid*

[5] *Kumar, Abhimanyu, "Corporate Criminal Liability"*

[6] *[1893] 53 MINN.214., cited on Majumdar.A.K, & Dr. G.K.Kapoor, Company Law &*

[7] *Pareek, Shanin, "LIC v. Escorts and Beyond – Lifting the Corporate Veil"*

[8] *1989 65 CompCas 196 Delhi*

[9] *Ibid*

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could be immediately pierced by the adjudicating authorities in order to examine whether the directors engaged in fraud, concealment or wilful misstatement or violation of the provisions of the act and the rules made thereunder. [10]

Corporate Criminal Liability

Another searing question that needs to be addressed here, is that while individuals managing the company can be made liable for wrongful acts committed by them, the thornier issue one must engage with is whether the acts of the individuals can be attributed to the company despite its separate legal existence. Before embarking on the arena of white-collar crimes, it is important to dwell into the trajectory of corporate criminal liability and the myriad of reasons adopted by courts to justify how corporations can be subject to criminal punishments. The courts in the early twentieth century articulated that the importance of corporate immunity has substantially watered down since criminal statutes were engrafted with words such as "everyone". [11]Essentially, the courts were of the ardent belief that the word "everyone" could potentially include under its purview both business entities and corporations.[12] Gradually, corporations were slapped with a host of criminal law suits, thereby making it difficult for them to wiggle out of the corpus of criminal law.

It is important to note that corporate criminal liability was crafted in order to achieve a balance between the goals of criminal law and the economic inefficiency stemming from ineffectual corporate law. Legislators were pushed to design corporate criminal liability with a two-pronged approach. The first, is to ensure that individuals engaged with a business entity are held morally accountable for their actions and second is to ascertain the criminal liability of corporations given their percolation in various spheres of social existence. In India, the lineage of criminal liability of corporations can be traced back to the Indian Penal Code, 1860. Sec 11 of The Indian Penal Code, 1860 defines "person" as any company, or association or body of persons and further extends the meaning to include all body corporations regardless of their incorporation[13]. For eons, the prevalent notion was that corporations, being an artificial entity, are bereft of the ability to commit white collar crimes since

10 Ibid

11 Kumar, Abhimanyu, "Corporate Criminal Liability"
12 Ibid
13 S.11, "Indian Penal Code, 1860"

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one of the core elements of criminal law is to provide unflinching evidence with respect to mens rea, i.e guilty mind. However, over the years, the Indian Judiciary has emphatically stated that a corporation also has the ability to commit criminal offences. The case of *Iridium India Telecom Ltd. vs. Motorola Incorporated and Ors* is revolutionary in how it converses with the existing formulation of corporate criminal liability[14]. In a very intuitive and incisive way - the supreme court ruled that the criminal intent of the corporate body i.e. the individual or group of individuals that manage and guide the day to day affairs of the business, would be attributed to the corporation. The court extensively drew from the doctrine of attribution and imputation.[15] By embracing the principles of attribution and imputation, the court asserted that mens rea can be imputed to a corporation in criminal cases, when the affairs of the company are controlled and executed by an individual or a group of individuals. It is pertinent to note that the control of the company should be so intense that one can easily decipher that the company was functioning through the actions of the person or body of persons.[16] Therefore, a corporation would be convicted of both statutory and criminal offences. An acute observation made in the case of Standard Chartered Bank was that where the law provides for both imprisonment and fine as punishment, corporations can only be penalised through fines since it is impractical to imprison an artificial entity. [17] Moreover, the severity of punishment for corporate bodies in terms of fine would tantamount to the quantum of gain secured by the corporation in the wrongful act.

Another interesting observation made was that the fulcrum of corporate criminal liability in India is that the criminal act of the employee must have meted out some kind of benefit to the corporate entity[18]. It is not a prerequisite that the entity receives the direct benefit from the acts of the employee nor is it essential that the benefit is completely enjoyed by the entity[19]. For instance, when an individual managing a corporate entity strives to amass a heap of wealth by evading taxes or indulging in any economic offences, their acts have directly benefited and exacerbated the wealth of corporations as well. Moreover, the nexus between white collar crimes and corporate criminal liability hasn't gained much steam within the Indian jurisprudence, therefore it is vital to provide a comprehensive breakdown of the same with the aid of two seminal contemporary case studies.

14 (2011) 1 SCC 74
15 (2011) 1 SCC 74
16 Ibid
17 AIR 2005 SC 2622
18 Amlan, Amtin, "Corporate Liability in India"
19 Ibid

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Nexus between white collar crimes and corporate criminal liability studied through the lens of case studies:

Sahara India – Case Study

Sahara India pariwar an Indian conglomerate was founded in the year 1978, it was termed as 'the second largest employer in India' after the Indian Railways at the time. By reaching out to the rural population in the country as the 'world's largest family', Subrata Roy the 'managing worker and chairman' of the Sahara Group had collected the hard-earned money of almost four crore Indian citizens as deposits and managed to cumulate deposits worth Rs.86, 673 crore through four of his cooperative societies, the group had also claimed that it had raised funds of about Rs.2, 25, 000 crore since inception.[20] The fraudulent scheme that Subrata Roy executed from the Sahara group's initiation began to unfold when Sahara Prime City a real estate venture of the group filed a Draft Red Herring Prospectus (DRHP) with the Securities and Exchange Board of India (SEBI) on September 30, 2009 which is a an initial document that is required to be filed with SEBI in order to roll out an IPO or initial public offer of shares to public investors. While perusing the said DRHP, SEBI uncovered a large-scale fund -raising exercise by two Sahara firms i.e. Sahara India Real Estate Corp Ltd and Sahara Housing Investment Corp Ltd and further receive two complaints alleging that these two firms used illegal means in the process of issuance of certain bonds. Consequently, after conducting scrupulous inspections it was revealed that the funds were raised through Optionally fully-convertible debentures (OFCD) following the filing of Red Herring Prospectus with the Registrar of Companies, while acting in complete ignorance of the fact that there was a mandatory requirement in place for acquiring clearance from SEBI for any issue of securities to fifty or more investors. Not only did the number of investors in the present case exceed fifty, the number went over crores.[21]

Eventually, on November 24, 2010, SEBI issued an interim order against the two firms, directing them to repay the money collected from investors, after which the regulator issued a final order on June 23, 2011. Subsequently, the group filed a complaint with the Securities Appellate Tribunal on

[20] *Narayan, Kushboo, "Sahara red-flagged for fraud probe: Rs 86,000 crore from 4 crore depositors".*
[21] *Sebi-Sahara case: How it all began, Hindusthan Times.* https://www.hindustantimes.com/business/sebi-sahara-case-how-it-all-began/story-u0G51dtoU5yP1nD3ZFjGuJ.html

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October 2011, however, the tribunal merely affirmed the orders laid down by SEBI and directed the companies to repay Rs.25, 781 crore to almost three crore investors.[22] Aggrieved by this the group moved to the Supreme Court contending that the jurisdiction of SEBI is limited to administration of listed public companies which "intend" to get their securities listed on a recognized stock exchange. However, the court invariably ruled that what was intended by the company could not be contrary to the mandatory requirement of law, which in this case stipulated that "listing" with a recognized stock exchange was a mandatory procedure that was to be undergone in order to invite subscriptions to the company's OFCDs. Therefore, the apex court concluded that the jurisdiction of SEBI would be automatically brought in and it further reiterated the orders given by SEBI.[23] Subsequently, the Sahara group defaulted on the repayment of funds even after repeated orders of the court, due to this the Supreme Court was constrained to put the Amby Valley project of the Sahara group up for auction to recover the amount necessary to repay the debt.

While the fraudulent acts committed by the group have been brought to light, it was argued by numerous experts in investment banking at the time that the Sahara Group had executed what is famously known as a Ponzi scheme. A Ponzi scheme is an investment fraud in which funds given by new investors are used to pay out purported returns to the already existing investors giving them the idea that the investment scheme is beneficial; however, when the number of new investors begins to deplete the company would be in a mound of debt. Where a simple regulatory check through lifting of the corporate veil or merely peeking through the corporate veil could have ensured securing numerous investors' hard-earned money, the regulatory authorities remained completely oblivious of the massive Ponzi scheme carried out by the Sahara group which had defrauded crores of Indian citizens.[24]

Even throughout the initial trial proceedings in this case the doctrine of lifting of corporate veil was never a subject of discourse, it was only brought forth a few years later when an appeal was filed in the Securities Appellate Tribunal Mumbai as a result of SEBI cancelling the certificate of registration of the Sahara Mutual Fund. SEBI took this measure on the grounds that Sahara India Financial

[22] *Ibid.*
[23] *Sahara India Real Estate Corporation Limited & Ors. V. Securities and Exchange Board of India & Anr. (2012) CIVIL APPEAL NO. 9813 OF 2011*
[24] *Kaul, Vivek, "Sahara and Ponzi schemes: What are the parallels?"*

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Corporation Ltd. is not a 'fit and proper person' because its Promoter-Director is not a fit and proper person and hence the Sahara Mutual Fund and Sahara Asset Management Company P. Ltd. were no longer fit and proper to carry on the business of mutual fund. The appellants (Sahara group) contended that since the groups of companies constituted as distinct legal entities SEBI could not inspect the private actions of one of the directors as it would lead to lifting of the corporate veil. Conversely, the respondents stated that lifting of the corporate veil is permitted under circumstances in which it is intended to find out who is acting on behalf of the company to determine whether the company satisfies the 'fit and proper' criteria. The court upheld the arguments put forth by the respondents as lifting of the corporate veil was in the interest of justice.[25]

Nirav Modi – Case Study

The other fraudulent scheme that has stunned the financial sector of the country was carried out by the infamous businessman Nirav Modi. It was reported that Modi and his company leveraged the Letters of Undertaking (LoUs) which were fraudulently issued by two of Punjab National Bank's (PNB) employees without securing cash reserve or collateral and without recording the transactions in the bank's core banking software in Hong Kong to secure buyers' credit from the local branches of Allahabad Bank, Union Bank, Axis Bank, Bank of India, and State Bank of India. The fraudulent procedure executed by the firms was uncovered when three of Modi's firms approached PNB in January 2018 for bank credit via an LoU, the officer in charge of the bank requested a hundred percent cash margin because these enterprises had no pre-sanctioned limit. The diamond companies opposed the bank's claim, alleging that they had previously used this service; however, the branch records revealed no evidence of such a facility being granted to the aforementioned firms.[26] After further investigation, Nirav Modi was declared a 'fugitive economic offender' and was accused of committing a Rs.14, 000 crore scam with the assistance of a few others. Consequently, a restraint order had been passed against a number of persons associated with these companies; even though this was done in the interest of justice it had also encumbered innocent people who have had no involvement in the commission of the fraud.

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[25] *Sahara Asset Management Company P. Ltd. and Ors. v. Securities and Exchange Board of India (2017) Appeal No. 428 of 2015*

[26] *"PNB scam: Chronology of Nirav Modi's case", Times of India.* http://timesofindia.indiatimes.com/articleshow/81209698.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

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In the case of *Union Of India v. Gitanjali Gems Ltd. And Ors*.[27] , the respondents contended that they have had to undergo hardships in a way that they could not even withdraw money from their bank accounts and have been penalised for the fraud committed by someone else. After reviewing all the respondent's state of affairs the bench ordered for the restraint order to be vacated against all of the respondents. Customarily, the separate legal entity of a company is regarded with utmost respect and the court predominantly has not allowed the lifting of the corporate veil in several occasions wherein the parties were inclined to disregard the separate legal entity of a company. However, in order to exempt innocent persons from undergoing such adversities it is necessary to regularise the procedure of piercing the corporate veil.

Conclusion

White collar crimes committed in the corporate realm in such a massive proportion not only affect the person(s) responsible for the crime but they invariably have an impact on the financial status of the company as well as have a substantial bearing on every person associated with the company. After a thorough scrutiny of the aforesaid cases, it is conspicuous that damages ensued from crimes are usually reimbursed by the company itself as most often, assets of the economic offender are not sufficient to retain status quo. This results in the company deeply plunging into losses and placing individuals behind the working of the company in a state of austerity. On that account, it is essential to take precautionary measures by the regulatory authorities in the country to ensure that these crimes are uncovered before causing damages at such a huge scale and further adopt steps to alleviate the commission of such crimes. In numerous instances, the courts and the regulatory authorities defer from piercing the corporate veil as the separate status of business entities are construed as the cardinal doctrine in corporate jurisprudence. However, this misguided notion paves way for persons working in the corporations to commit economic offences safely under the disguise of a separate corporate entity. Therefore, it is essential for the regulatory authorities and the legal fraternity to be more lenient while executing the doctrine of lifting the corporate veil and to conduct systematic regulatory checks in order to ensure such situations do not arise.

[27] *Union Of India v. Gitanjali Gems Ltd. And Ors. C.P. No. 277/241-242/NCLT/MB/MAH/2018*