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LIC v. Escorts Ltd. (1986) 1 SCC 264

Authored By - Gunvi Rattrra

Background

A non-resident portfolio investment scheme existed under the FERA¹. Non-resident companies were allowed to invest 1-5% of the paid-up equity capital in companies from India. The non-resident companies could be completely owned by NRIs, or their interest could be at least 60%. In this case Caparo group Ltd. (13 companies) invested in Escorts Ltd. 60% of the shares of the companies under the Caparo group were held by one person, Swaraj Paul, and members of his family. LIC and other shareholders (holding 52% of the total shares) in Escorts Ltd., issued a requisition to hold an extraordinary general meeting to move a resolution to displace the directors removed. UOI, RBI and the Caparo group claimed that the requisition was illegal, ultra vires and arbitrary. During this, the investment by 12 Caparo companies was challenged that they attempted to evade the limit of investment of 1%.

Judgement by the Supreme Court

First the court held that the requisition notice by LIC is not ultra vires to the powers of the shareholder, not contrary to S. 284² of the Companies Act and violative of Article 14³ of the Constitution. The institutions with huge stakes objected to them not being consulted. The resolution was to remove the non-executive directors hence, it would not impede the functioning of the company itself. Majority shareholders have the right to call an EGM and power to appoint and remove the Directors. When the state is a shareholder, it has all the rights as that of any other shareholder and the court has no right to grant an injunction for the EGM. The concept of 'corporate democracy' was highlighted. The court further held that the Reserve Bank of India made no mistake in granting the Caparo group permission to invest under the scheme. "Nor was it guilty of non-application of mind."⁴

¹ Foreign Exchange Regulation Act 1973

² Companies Act 1956, s 284

³ India Constitution 1950, Article 14

⁴ LIC v Escorts Ltd [1986] 1 SCC 264

Analysis

This is one of the first cases in India that deals with the independent juristic personality of a company and the corporate veil. Firstly, the court mentioned the *Salomon case*⁵ stating that a company has an independent legal personality which is separate from its members. There are certain situations in which justice cannot be prescribed without lifting of the corporate veil. In this case the contention was that “one has only to pierce the corporate veil to discover Mr. Swaraj Paul lurking behind.”⁶

The court ruled that lifting of corporate veil is only necessary in exceptional cases due to which the corporate nature of the company is removed and the actual members are taken into recognition. Some of these exceptional cases are fraud, improper conduct, intention to evade tax or such companies if are a question of concern. In the present case the corporate veil needs to be lifted only till the limit of finding the nationality or origin of the holders of the stock of the foreign company wanting to invest in an Indian company and not the individuality of each of the shareholders.

Just because more than 60% of the shares of the Caparo Group of companies are held by different non-residents with one person in common i.e., Mr Swaraj, the foreign company should not be denied the authorisation to invest in Indian companies. Afterall, the intention of the investment scheme under FERA was to attract NRIs to invest in Indian Companies. The only fact that needs to be determined is that of the nationality/origin of the shareholders and not their individual identity. ‘Lifting of the veil’ is necessary only to determine if 60% of the shares are held by NRIs or not. It should not matter if 100 different shareholders own the shares of the foreign company or one person owns it and is behind it. What matters is that more than 60% of the shares should be owned by a non-resident Indian.

In my opinion the court rightly gave the judgment since in the present case the ‘lifting of veil’ is not necessary nor is it permissible under the FERA⁷ and the portfolio scheme beyond what the court ordered. The statute made the decision clear and easier. The RBI also could not be

⁵ Salomon v Salomon [1896] UKHL 1

⁶ LIC v Escorts Ltd [1986] 1 SCC 264

⁷ Foreign Exchange Regulation Act 1973

held responsible because they were correct in granting permission to Caparo group for investing since it created no violations as such. The only point at which they could be held responsible was for not replying to the letters sent by the company about the shares bought by them (which was a fact found by the court). The other step that the court should have taken was to hold Escorts Ltd. responsible for not being transparent to the other shareholders about the investment from foreign companies. Moreover, the resolution was not even discussed before which the Writ petition was filed.

Development of the Law

India does not have a distinct regulation which mentions the parameters and procedure so lifting of the corporate veil is not a concept that is well established. The courts over the years have shed light on the various instances in which the veil should be lifted. In case of a parent company and a subsidiary the lifting of the veil has been deemed useful as the court has held in one case that finding out who controls the act of the business is an important factor⁸. Corporate veil has been lifted by the courts in instances when a subsidiary is only comprised to conceal the real workings and commit fraud as in the case of *DDA v Skipper Constructions Co. (P) Ltd.*⁹ and to “look at the realities of the situation and to know the real state of affairs”¹⁰. In the case of *State of UP v Renusagar Power Company Ltd.*¹¹, lifting of the veil worked in favour of HindalCo. The Supreme Court found that HindalCo and its subsidiary, Renusagar, were two separate legal entities but since the subsidiary was wholly owned by Hindalco, they were so intertwined in their workings that they were inseparable. This meant that the electricity produced by the subsidiary was considered to be produced by Hindalco and they could avail the reduced rate of duty. This was only possible because the court lifted the veil and ignored their separate legal personalities. Further in another landmark case *New Horizons Ltd. v UOI* the Supreme court held that the veil has to be lifted when the corporate personality is found to be “opposed to justice, convenience or interest of revenue”¹².

Doctrine of lifting of the corporate veil is an exception to the general rule which has enabled courts to identify the perpetrators of fraud. Like in another case, a partnership firm converted

⁸ Hackbridge – Hewitt & Easun Ltd. v GEC Distribution Transformers Ltd. [1992] 74 Comp Cas 543 (Mad)

⁹ Delhi Development authority v Skipper Constructions Co. (P) [1996] 4 SCC 622

¹⁰ Subhra Mukherjee v Bharat Coking Coal [2000] 3 SCC 312

¹¹ State of UP v Renusagar Power Company Ltd [1988] AIR 1737

¹² New Horizons Ltd v Union of India [1995] 1 SCC 478

itself into a private company to carry out transactions which they normally would not have been able to. The court noted that the transactions separately were not circumventing the law but when seen together they are evidently illegal.¹³

Conclusion

Courts in India have a huge discretion in deciding to lift the veil or not. “Indian Law requires that courts take into account economic reality, transaction substance and other relevant factors, and the whole transaction in order to defend the rights.”¹⁴ They should exercise caution while giving out judgments related to this doctrine since it can lead to the benefit of the general public in various scenarios too, finding a balance in this area of law is crucial; even though it is ever evolving since some modifications were made to the **Companies Act in 2013**.

The doctrine of lifting of corporate veil has acted as a watchdog for all the companies and forces them to exercise caution since it makes sure that the real perpetrators do not walk Scott free. It should however not be exercised frequently since it is inherently the exception to the general rule. Also, **Article 21**¹⁵ of the Constitution includes corporations and their right to life and independence of operations too. Hence, in India the court is the apex and after *LIC v Escorts Ltd.* the doctrine has evolved and developed over the years. It makes it clear that certain unusual circumstances arise and certain factors when enter the picture, the court is compelled to lift the corporate veil and providing for the court to reveal the shareholders and other entities that have to be taken into consideration. This doctrine is dynamic and still continues to advance.

¹³ State of Rajasthan v Gotan Lime Stone Khanji Udhog [2016] SCC Online SC 62

¹⁴ Divyansh Choudhary and Raneeta Pal, ‘CORPORATE GOVERNANCE: A DETAILED ANALYSIS OF CORPORATE PERSONALITY WITH A SPECIAL REFERENCE TO COMPANIES AMENDMENT ACT 2013’ [2022] International Journal of Early Childhood Special Education 2878.

¹⁵ India Constitution 1950, Article 21