Crossing the Rubicon

An Essay on the Lifting of the Corporate Veil in Pakistan

By

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INTRODUCTION

Lifting of the corporate veil is a doctrine that is seeped in doubt and divergence. It lives in a vicious cycle of its own. From *Salomon*[2] to *Adams*[3] it has seen itself emerge from fiction to force and then back again. In subsequent cases since *Salomon*[4] it has been employed by judges to reach the reality of the matter in question. However, with the decision in *Adams*[5] it has again receded into the state of being used in very exceptional circumstances. Surprisingly, it has met a different fate in the jurisdiction of Pakistan. It has surfaced from the corporate shell in *Justice Shaukat Ali*[6] and it has submerged into frailty in the legal polemic of the *Union Council*[7]. Nevertheless, judges in Pakistan accept the importance of the doctrine and admit in their decisions the necessity of its application where an element of escape or evasion from law is apparent.

The door of jurisprudence has given this doctrine considerable form and vigour over time. At certain times its application is inviolable. At times it has been reasoned that lifting of the veil will be against the doctrine of separate corporate entity. Lifting of the veil is regarded in some situations to take away the very protection of limited liability afforded by the doctrine of separate corporate entity. Thus there is a constant conflict of the two doctrines. The importance of both cannot be denied as far as corporate law is concerned. More often judicial reasoning has refrained from applying the doctrine. It is, however, well established in precedents that the principle of lifting of the corporate veil only serves the endeavour of all law, that is, equality and justice.

The law in Pakistan derives from a common law background. It is in many ways still subject to the English law system. As far as company law is concerned, apart from the amendments made to the *Companies Ordinance 1984*, most of it is similar to the English

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[2] Salomon V A Salomon & Co Ltd [1897] AC 22(House of Lords)
[3] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)
[4] Salomon V A Salomon & Co Ltd [1897] AC 22(House of Lords)
[5] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)
[6] The President –Referring Authority V Mr. Justice Shaukat Ali PLD [1971] SC 585
[7] Union Council, Ali Wahan Sukkur V Associated Cement(pvt.) Limited [1993] SCMR 468

company law statutes. Therefore, it is no surprise that in deciding cases related especially to the veil of incorporation that reliance is placed on English law and precedents.

The judges in Pakistan seem to look at the lifting of the veil with the same reluctance as the English judges. However, there are certain areas where they have readily lifted the veil. There is thus a difference of opinion in certain areas. The judges accept more readily the lifting of the veil where an evasion of law for economic ends is apparent. This study, therefore, also focuses on such cases that highlight this difference of opinion in the jurisdiction of Pakistan.

Unfortunately, none of the commentaries on *Companies ordinance* in Pakistan contain an exhaustive or significant text pertaining to the veil of incorporation. Recourse can only be placed on case law. It is hard to find a set pattern in the cases as is the situation in UK. However, not all law is based on the backbone of tried and tested models. It is not easy to chalk out a trend as far as lifting of the corporate veil is concerned. At times judges lift the veil easily to reach the reality of the transaction. At other times they do not lift the veil even after much deliberation. There is thus a need to arrive at a broad test with the help of significant precedents in the jurisdiction of England and Pakistan. This study attempts to take a first step to streamline just such a test.

The foremost issue that we see when a judge is faced with the question of lifting the veil is how much of his own creative interpretation he will exercise and how much will he rely on precedents and commentators to bring his reasoning home. A test or rule that can help the judge arrive at a decision that will not be blatantly labelled by the critics as absolute discretionary lifting of the veil. To avoid such a situation there is a need to bring more mandatory directives in the sphere of corporate law. There is room for such mandatory lifting of the veil in the jurisdiction of Pakistan. This direction can be brought about by proposing and integrating the instances and tests that have been formulated by judges and commentators in different jurisdictions.

For wherever there is reason to believe that there is foul play it is not a sin to lift the veil and investigate. Therefore, this paper seeks to analyze the veil of incorporation doctrine in its historical and present context in the jurisdiction of Pakistan and propose a legislative guideline for piercing the veil of incorporation where it becomes necessary to do so. The focus primarily remains on trying to bring a meaningful solution to the inconsistency that plagues the issue of the corporate veil. In order to reach the conclusion the paper is divided into three main sections.

Part one of this essay deals with a brief purview of the jurisprudential evolution of the corporate veil. It analyzes the different key areas that have been highlighted by commentators and judges alike as instances where the veil of incorporation can be lifted. In doing so, there is a special emphasis on the jurisdictions of England and India. A special emphasis is placed on the Indian decisions as they highlight some key issues regarding the lifting of the veil in some famous Indian cases. It will be demonstrated that even though the decisions of *Salomon*[8] and *Adams*[9] hold strong there is room to provide

[8] Salomon V A Salomon & Co Ltd [1897] AC 22(House of Lords)

equivocal justice where lifting of the corporate veil is required. More so the current judicial view in the light of recent decisions appears to be constrained and to serve justice one must not hesitate to lift the veil. American case law has contributed substantially to the doctrine of the corporate veil thus there are brief references to the same as well.

Part Two of the essay looks at the jurisdiction of Pakistan and how over the decades it has seen itself accept and decline the piercing of the veil. Special emphasis is placed on the two leading cases that have set the benchmark for future cases. In Pakistan the judges have expressed an implied need in their judgments for such a law or guideline that can help them to arrive at a decision with less discretionary and more mandatory element in the lifting of the veil.

Part Three of the essay concludes with a special proposal for Pakistan for mandatory lifting of the veil of incorporation. This can help to provide the necessary guideline for commentators and judges alike to base their reasons on concrete grounds in a given case. Therefore, the paper aims to dispel the counter arguments of the broad discretion and creative interpretation used by the judges in the piercing of the veil. The argument simply suggests that the principles are there and if coherently and clearly applied they can help maintain that delicate balance between the sanctity of the two conflicting doctrines. This special proposal is in the form of a test which I will call the *five point Rubicon*. This can at least provide some kind of starting point for the jurisdiction of Pakistan.

[9] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)

PART ONE

The metaphors are great many like corporate shell, corporate veil, cloak, alias, alter ego, agent, fiction, instrumentality, puppet and sham.[10] The intention only is to provide the company with a separate personality distinct from its members. So that it can sue and be sued in its own name. Likewise, the metaphors to disregard the separate corporate personality are many like lifting, piercing, cracking open, peeping et cetera but the intention only to ignore the separate personality and arrive at a just and equitable conclusion.

When a judge lifts the corporate veil he reasons on what grounds the veil of incorporation is lifted. Though he follows certain precedents and case law he has to decide on a case by case basis. It is undeniable that the facts of each case will be different; however certain laws and their transgressing should hold the same implication.

It can be seen from the case law surrounding the corporate principle of the veil that varying number of instances where judges and commentators believe that the veil can and should be lifted are substantially persuasive. Where fraud or tax evasion is apparent one should not let the transgressor hide behind the veil of separate entity.

It would be more acceptable though to have a set criterion. Different writers in their writings have given their versions of instances and criteria that justifies lifting of the veil. Such criterion exists but the questions that remain pertain to what test should the facts of each case be put to arrive at the conclusion of lifting the veil. Such a test can be more easily derived from the existing precedents and rules available in the sphere of corporate law. Such a test will allow the judges to cross the *Rubicon.*[11]

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[10] S. Ottolenghi, Peeping behind the Corporate Veil, 1990 53 MLR 338

[11] The **Rubicon** (*Rubico*, in Italian *Rubicone*)
When Julius Caesar crossed the river in 49 BCE, supposedly on January 10 of the Roman calendar, in pursuit of Gnaeus Pompeius Magnus he broke that law and made armed conflict inevitable. According to Suetonius he uttered the famous phrase 'the die is cast'. Suetonius also described how Caesar was apparently still undecided as he approached the river, and the author gave credit for the actual moment of crossing to a supernatural apparition.
The phrase "crossing the Rubicon" has survived to refer to any person committing himself irrevocably to a risky course of action

Under the company law in Pakistan there is room for such criteria. The cases reflect that the judges have quoted the same instances that have been quoted by the likes of Gower and Palmer and the English Judges. The same situations can be brought forth in the form of a test. This test can then help build a legislative guideline for future reference in the jurisdiction of Pakistan.

The test is not an all encompassing test but like many commentators it provides the basis with respect to the socio legal background of Pakistan for lifting of the veil. Therefore, in order to understand the applicability of the test in Pakistan it is necessary to scrutinize the evolution and the current position of the doctrine. A special emphasis will be put on the different instances laid down by leading legal thinkers and a final proposal for the *Rubicon* five point test will be laid down. An application of just such a test in Pakistan will allow the courts to achieve and uphold what Sanborn J., in Milwaukee[12] has surmised eloquently:

"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."

However, before delving into the development in Pakistan it is necessary to know the situations by commentators in general. Great many cases over the decades in the U.K., U.S. and India have contributed to certain situations where it is necessary to lift the veil of incorporation. Judges in their decisions have mentioned instances where the veil should be lifted. Rules can be derived from such instances. These very rules can be used as a guideline to arrive at the five point test.

Recently, however, with the decision in *Adams*[13] there is a general impression of fading out of the doctrine of lifting of the veil. There is more argument against the lifting of the veil. Unfortunately, commentators after *Adams* [14] are of the view that none of the situations have the force to work out as mandatory lifting of the veil. It has been said that 'for the interests of justice lifting of the veil is too broad'[15] to apply on every case. A similar argument surfaces in *Union Council*[16] as well. A trend has emerged again after *Adams* and *Union Council* that has shifted the argument against lifting of the corporate veil. In the latter precedent it is noted more strongly that where required judges should not hesitate to lift the veil. This should be sufficient to keep the doctrine from falling victim to a trend. A trend that leaves its application to very exceptional circumstances.

It is true that it cannot be applied on every case but rather than giving it a shade of inconsistency it will be more appropriate to have a liberal approach to the doctrine. It cannot be denied that every situation is different but the crime or wrong committed has a similar connotation. Eventually a certain case will lead to a criminal element of fraud,

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[12] United States V Milwaukee Refrigerator Transit Company [1905] 142 F, edn. 247
[13] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)
[14] ibid
[15] ibid
[16] Union Council, Ali Wahan Sukkur V Associated Cement(pvt.) Limited [1993] SCMR 468

wrongful trading et cetera or maybe none at all. If it does lead to one then it is up to the judge to determine whether the evidence substantiates it. If the evidence leads to the conclusion that there was a sham or a facade then the doctrine of separate corporate personality should not be an excuse for the wrongdoers. The evidence differs in each case and that is why the *Rubicon* test stresses on a transparent and thorough investigation by the officer of the court or the SECP[17] officer in Pakistan.

The judge can then take a more informed decision applying the rules laid down by commentators that justify lifting of the veil. It can be seen from the following situations and precedents that there is ample history behind the lifting of the veil to formulate legislation that lays down certain rules where it is mandatory to lift the veil. It is not possible though to shift the focus entirely from discretionary to mandatory lifting of the veil. Commentators have discerned no set patterns in the decided cases[18] as the judicial inroads are many in the corporate field. It would thus be unreasonable to say that an absolute mandatory rule can be laid down. However, there is a need to include some principle guidelines in the sphere of corporate law. This need brings us to some mandatory standpoint from where we can have instances or situations where it is more mandatory and less discretionary approach involved when it comes to lifting the veil of incorporation. Hence the whole debate of discretionary lifting by the judges can be set aside and the sanctity of the doctrine of separate corporate entity can be kept intact.

This can only be done if the legislature takes a radical step and brings forth some guidelines. This will take judges out of the infamy they sometimes face by lifting of the corporate veil. They will be able to base their judgments on those guidelines. Furthermore they have to be broad guidelines as there should always be room for some flexibility to deter fraud, oppression and sharp practice[19]. It is imperative though that eventually a case where fraud or criminal intent is proven should not provide grounds of escape. Cases differ but it is better to have law for the mandatory lifting of the veil rather than the discretionary lifting of the veil. More reliance on the test will mean that it is seen more and more as an acceptable principle of law and less as a creative interpretation on part of the judges.

Great many commentators have attempted to insert such rules and principles with reliance on precedents. In their own way they have laid down their instances and test that help in answering the question whether to lift or not to lift the veil. These instances should be seen in the light of the basic definition that categorizes the lifting of the veil. The corporate veil has three separate and distinct meanings[20]. Firstly, it can be said to exist where there is a veil between the members of the company and outsiders. Secondly, when there is a veil between the company and its members and thirdly where several economic realities may be joined or one economic entity divided by the corporate veil.

[17] Securities and Exchange Commission of Pakistan
[18] See for further reading P.L. Davies Gower's Principles of Modern Company Law 6th edn 1997, chapter 8; W G Friedmann, Legal Theory 5th edn 1967 pp 556-572; O Kahn Freund 'Some reflections on company law reform' 1944 7 MLR 54; S Ottolenghi 'From peeping behind the corporate veil to ignoring it completely' 1990 53 MLR 338
[19] See Re Darby 26; Re Bugle Press Ltd 262; Gilford Motor Co Ltd v Horne
[20] Murray, Company as a separate legal entity 31 (1968) MIR 482

The idea of corporate veil demarcates and distinguishes between the artificial person or company and natural persons in a company. In the light of this perspective one should look at the different instances where the veil of incorporation can be lifted if an element of evasion or escape from law is apparent. The following are the cases where lifting of the veil can and should take place if the evidence substantiates it[21]:

(1) Agency
(2) Fraud;
(3) Group enterprise;
(4) Trusts;
(5) Tort;
(6) Enemy;
(7) Tax;
(8) The companies' legislation;
(9) Other legislation.

The above is a very broad category and there are commentators who have tried to narrow it down. However, in the concise approach there will always be a need to have one or two rules that leave room for unforeseen circumstances. There are great many cases where the veil of incorporation has been lifted to reach the reality of the matter. However, there will always be cases where the veil of incorporation will have to be lifted but it cannot be categorized in any of the above heads. Hence the need for discretion will remain. Most of the cases otherwise are fraught with economic issues and problems at the core. These very economic issues make it more difficult to protect the corporation under the veil of incorporation. Farrar outlines broadly the different categories. However, categories like Agency and Group Enterprise are hard to justify after precedents like *Adams.* In tax matters, though, judges in Pakistan and other jurisdictions have shown more readiness to lift the veil.

Gower[22] has made similar observations in the sphere of taxation and in the recognition of enterprise. Gower believes that till now courts have only lifted the corporate veil where the legislature or the relevant statute can form the backbone of the argument. They have been circumspect and cautious about it. They have not taken major steps towards lifting the veil of incorporation. Gower lists seven different instances where the veil of incorporation has been lifted. However, his stress is on mostly cases where element of fraud is proven, trading with enemy is sought to be defeated et cetera. He believes that a rational and inflexible principle to lift the veil is impossible to evolve. A classic case that voices the complexity involved in arriving at a rational principle for lifting the veil is where a case comes against decisions that make it necessary to lift the veil. In the Indian case of life insurance[23] the court would refuse to resort to the doctrine of lifting the corporate veil when it would defeat instead of promoting the aims of statutory enactment.

[21] Farrar's Company Law[21], 4th edn

[22] Principles of Modern Company law 3rd edition 1969
[23]Life Insurance Corporation of India v Escorts Limited (1986) 59 com cases 548; AIR (1986) SC 1370

It is true that an inflexible principle is hard to arrive at nonetheless, a workable rational principle that can guide the judges is not impossible. If the very instances by the commentators and precedents of the courts are perused one can arrive at certain cogent arguments to lift the veil whenever one faces them.

In Pakistan a similar stance has been taken by the judges as the jurisdiction of United Kingdom. They differ to the extent that judges in Pakistan are more acceptable towards the doctrine of lifting of the veil when the evidence on record substantiates that there is an evasion of tax liability. Judges in India have been more flexible and radical in their decisions. In a case[24] it was held that when a question of fraud is on the anvil, the court cannot be precluded from tearing of the veil to reach the substance of the matter. Similarly where unjust enrichment has resulted from a transaction the veil would be pierced by court to prevent the same.[25]

Generally in the cases of fraud it is seen that the trend is to lift the corporate veil. In a case a Division Bench of the Delhi High Court granted to the plaintiff company an order of interim injunction restraining defendant companies from alienating the properties of their ownership on the ground that the defendant companies were merely nominees of its defendant, who had fraudulently used the money borrowed from the plaintiff company and brought properties in the name of the defendant companies. Protection under the doctrine of the corporate veil could not be invoked in the facts and circumstances of the case.[26] It is imperative to have the element of fraud as part of the five point test.

Furthermore there are cases where the element of control is in question. In such cases the focus should be to establish the degree of control. If control is established then the veil of incorporation should be lifted. In a famous case[27] the court held that it will be a travesty of facts to hold that the American company and American president were merely agents of the English company for producing the film. Shareholders cannot be principals of the company but if so it should be proved that the company was their agent in one or more transactions. It is therefore, not denied that there is always room left for that element of proof. If it was proved on evidence that shareholders were the principals of the company then the outcome of the case could have been different.

There are great many cases in the jurisdictions of India and Pakistan where judges have not lifted the veil but noted that if there was more proof as to the alleged misdemeanour they could lift the veil. Commentators provide their own insight and analysis but the goal of all remains the same. They are trying to construe lifting of the corporate veil in a manner that will make the doctrine more coherent and convincing for application to future cases of law.

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[24] Shri Ambica Mills Ltd *Re* (1986) 59 com cases 368, 392 Gujarat
[25] Nellie Wap-Share v Pierce Leslie &co AIR 1960 MAD 410
[26] PNB Finance Limited V Shital Prasad Jain 1983 54 com cases 66 Del See Also A Company, RE (1985) BCLC 333 CA as reliance was placed on it.
[27] *Re* FG Films [1953] 1 All ER 615 CH D

Judges have given their own instances of situations where they can lift the veil. An Indian commentator[28] has cited Palmer in a very interesting way in the following cases:

1. Where companies are in the relationship of holding and subsidiary (or sub-subsidiary) companies, the companies Acts require, on principle, group accounts.

2. Where a shareholder has lost the privilege of limited liability and has become directly liable to certain creditors of the company on the ground that, with his knowledge, the company continued to carry on business six months after the number of its members was reduced below the legal minimum.

3. In certain matters pertaining to the law of taxation, particularly where the question of the "controlling interest" is in issue.

4. In the law relating to trading with the enemy, where the test of control is adopted.

5. In the law of the merger of control in the United Kingdom. The Fair Trading Act, 1973 adopts the test of 'distinct enterprises'. Cessation of being 'distinct enterprises' irrespective of the legal form of these enterprises, constitutes subject to certain conditions, a merger situation.

6. In the competition law of the European Economic Community as contained in articles 85 and 86 of the EEC treaty and in secondary legislation on that subject, a holding company and a subsidiary which does not determine its behaviour on the market in an autonomous manner are treated as forming an economic unit. An arrangement between holding company and its non autonomous subsidiary does not fall under article 85 and a holding company incorporated in a country which is not a member of the EEC is regarded as being present in the EEC if it has a non autonomous subsidiary in the EEC territory.

7. The court will not allow an abuse of section 429 by the formation of a new company by members holding nine tenths of the shares in an existing company if the new company is formed solely for the purpose of expropriating the shares of the minority shareholders in the existing company.

8. The courts have further shown themselves to lift the veil where the device of incorporation is used for some illegal or improper purpose. However, rearrangement of a group of companies so as to minimise the extent of any future tort liability that could be enforced in respect of the group activities in a proper use of the possibilities provided by company law and will not entitle the court to lift the corporate veil.

9. Where a private company is founded on a personal relationship between the members the court is prepared to order the winding up of the company under the just and equitable

[28] D.P. Wadhwa J in New Horizons Limited vs. U.O.I. (1997) 89 com cases 785 in Palmer 25th edn. Para 2 1508

clause.[29] If a member commits a breach of good faith which the members owe each other as the result of the personal relationship and thereby acts inequitably. That these quasi partnership companies may be wound up by the court by virtue of section 122(1) (g) in appropriate circumstances constitutes a lifting of the veil of corporate ness, because here the substance of the association prevails over the legal form.

In Ebrahimi[30] Lord Wilberforce when commenting on the words just and equitable said that words are just a recognition of the fact that a limited company is more than a mere judicial entity with a personality in law of its own: that there is room in company law for recognition of the fact that behind it or amongst it there are individuals with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.

10. Where the court considers it appropriate to issue a Mareva injunction or another injunction founded on section 37 of the Supreme Court Act 1981 the court will use its power to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficacy of the corporate situation under consideration.

11. It has sometimes been argued that there is emerging in English and Scottish law as a general principle that all companies in a group of companies will be treated as a single entity. Certainly there are many cases in which the distinction between parent and subsidiary company has been ignored by the court. , of which notable recent examples are DHN[31] .

12. In *amalgamated*[32] the plaintiffs undertook a guarantee for loans advanced by the defendant bank to one of the plaintiff's subsidiaries. Some of these loans were given for exchange control reasons through a wholly owned subsidiary of the bank in the Bahamas named Portsoken but the guarantee was never expressly extended to the Portsoken loans. The court of appeal held that the plaintiff‘s guarantee covered by the Portsoken loans. Lord Denning M.R. said that Portsoken had to be regarded as the alter ego of its parent, the bank but the other judges preferred to found their judgements in favour of the bank on an estoppel created by the course of dealing between the parties.

As mentioned earlier there are cases that do not fit neatly into any category. These cases make it all the more necessary for the need of a broad guideline. As there may be cases in the future that represent a new perspective and a different problem altogether. Creasey[33] is just such a case. A commentator puts the following comments on the case: this decision does not appear to fit neatly into any of the established categories where the courts have been prepared to pierce the veil. The employer dismissed its general manager. He issued a writ alleging wrongful dismissal. Shortly thereafter Welwyn ceased trading. The

[29] Section 122(1)(g) of the Insolvency Act 1986
[30] Ebrahimi v Westbourne galleries Ltd [1973] AC 360 HL
[31] DHN Food Distributors Ltd vs. Tower Hamlets LBC [1976] 1 WLR 852
[32] Amalgamated Investment and Property Co Ltd in Liquidation v Texas Commerce International Bank Limited (1982) QB 84 CA
[33] Creasey v Breachwood Motors Ltd. [1993] BCLC 480 QBD noted 1993 JBL 41

company paid off all its creditors and then transferred its remaining assets to another company. The plaintiff obtained a default judgment against the company but by that time it had no assets and stood dissolved. The transferee company to which the company's assets were transferred was ordered to pay the decree. The court stated that the take over of the company's assets had been carried out with regard to the separate entity of the company and the interests of its creditors, particularly the plaintiff. When the directors transferred the company's assets and business they did do in total disregard of their duties as directors and shareholders. Accordingly, it was held that this constituted a case in which the courts would be justified in lifting the corporate veil and treating motors liable for the company's liability to the plaintiff.

Thus even where there is a conundrum that the issue does not fall into place of any of the categories of lifting of the veil. Judges feel justified in lifting the veil if it is necessary for the interests of justice. As noted by a commentator[34] that adherence to the *Salomon* principle will not be doggedly followed where this would cause an unjust result. Such an approach was given explicit judicial recognition in the American case[35] in which Stone J. said "many cases represent avowed disregard of corporate entity….but they all come to just this that courts simply will not interposition of corporate entity or action prevent a judgment otherwise required." Against this background then, the decision can be more readily explained. The problem that can naturally arise from the approach is the uncertainty which it casts over the safety of incorporation. The use of policy to erode established legal principle is not necessarily to be welcomed.[36]

This amply summarizes the fears of commentators regarding the sanctity of the separate corporate entity. The use of policy such as quoted above should not gnaw at the legal principle of separate corporate entity. The inconsistency thus surfaces again with cases like *Creasey*. They cannot be categorized easily and hence provide the basis for a less streamlined test and at the same time a broader legislative step. This inconsistency should not be looked as a hindrance to take legislative action. As the commentator notes himself that an unjust result should not see the light of day because we cannot go beyond an established legal principle.

Furthermore an alternate argument is sometimes supported to say that there are statutory provisions as well to lift the veil of incorporation. The very existence of such provisions is proof that the legislature is prepared to overlook the doctrine of separate corporate entity where justice so requires. They are as follows[37]:

1. Reduction of membership below statutory minimum

2. Improper use of name

[34] John P. Lowry 'lifting the corporate veil' 1993 JBL 41 and 42.
[35] Re Clark Will 204 Minn 574 at 578 1939
[36] John P. Lowry 'lifting the corporate veil' 1993 JBL 41 and 42.
[37] See further Sec. 24, 349(4), Companies Act, Section 213, 214,215,216, Insolvency Act 1986

3. Liability for fraudulent conduct of business

4. Personal liability of signatories of company documents

5. Duties of groups of companies to produce group accounts

These statutory exceptions thus justify lifting of the corporate veil if they exist. Furthermore, they are ample proof of the fact that the legislature accepts the importance of lifting of the corporate veil in the interests of justice. Overtime with the help of commentaries and precedents further clarification can be possible in order to remove the inconsistencies that plague the application of the doctrine.

As far as tax matters are concerned there is more likely chance of lifting the veil of incorporation if an element of tax evasion is found to exist. In an important judgment in India[38] the court held that the income tax authorities in India were entitled to pierce the veil of incorporation and to look at the reality of the transaction to examine whether the corporate entity was brought into existence outside the taxable territory with the ulterior motive of evading the tax obligation. An important observation was made on page 616 of the judgment by the Supreme Court:

"It is true that from juristic point of view, the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties which are not same as those enjoyed or borne by its members. But in certain exceptional cases the court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation."

Furthermore in Indian precedents we find a similar concern of arriving at some kind of formula or test that can be applied to lift the veil of incorporation. It is required so as to deter tax evasion but also to provide guidance to judges and commentators alike to arrive at a just conclusion without great conflict or compromise. Such an attempt was made in the *Cheran Transport case*[39] an engineering company and a transport company about which it was observed that they were once by mistake assessed separately and that their income should have been brought under single assessment, the court could not dispose of the matter on merits and remitted it back to the assessing officer for reconsideration saying that in cases like this that it is not enough to say that companies were two separate legal entities and whether it is necessary to examine whether they are truly separate or independent or one was dependent on the other. Mishra J conducted a vast survey of English American and Indian precedents cited passages from Pennington's company law and keeping in mind the six point formula[40] as well as the facts of the case gave the

[38] CIT v Sri Meenakshi Mills Ltd AIR (1967) SC 819
[39] Deputy Commissioner CT v Cheran Transport Corp. LTD (1992) 74 com cases 563 MAD
[40] Apthorpe v Peter Schenhoffen Brewing Co. [1899] 4 TC 41 CA

following as guidance in cases of tax evasion as well as cases of the veil of incorporation noted on page 571:

Were the turnovers treated separately for each corporation?
Were the persons conducting the business guided by the same head and brain?
Were the persons conducting the business of the engineering corporation the same as those conducting the business of the transport corporation?
Did the engineering corporation decide for itself what should be done and what capital should be embarked upon the venture?
Did the business turnover of the engineering corporation stand separately and independently?
Who effectually controlled the engineering corporation?

Such questions can be asked in the courts of Pakistan. A further step can be taken and it can be asked whether or not guidance can be devised for corporate matters even outside the ambit of tax matters. A question oriented format will leave it to the judges to answer each problem in the light of the evidence of each case. Therefore, a guidance for lifting of the veil in general can be formulated.

The list of instances is exhaustive and does not end here. The argument of the group entity and the single economic unit has had its interesting share of cases. However, the precedent that emerged with the greatest of force was *Adams*. *Adams* as known by all eventually is against the lifting of the veil. *Adams*[41] is a case that set out some serious and cogent arguments for the single economic unit. However it was not to be so. The court of appeal held that the judgment could not be enforced against the English parent Cape. The court rejected the arguments that Cape and the relevant subsidiaries should be treated as a single economic unit following Denning in *DHN*.[42]It was eventually decided that the subsidiaries were not used as a facade to conceal the true facts and there was no agency relationship between Cape and NAAC.

However, it's certainly not the final nail in the coffin. It did go against the single economic unit argument. It is seen, however, that there is a tendency of courts of different jurisdictions to treat holding subsidiaries as one whole where there is an element of companies working as one single economic unit. In U.S.A. a body of law has been developed where the separateness of the group may be disregarded. Where it is seen that the broader business entity controlling the subsidiaries falls under the non observance of any of the following the veil of incorporation can be lifted[43]:
:
(1) Where the business affairs of both the parent company and the subsidiary are intertwined and the business transactions, property, bank and other accounts, employees, management et cetera are intermingled.

[41] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)
[42] DHN Food Distributors Ltd vs. Tower Hamlets LBC 1976 1 WLR 852
[43] See further Ramaiya's Guide to the Companies' Act (Fourteenth Edition)

(2) Where the subsidiary is inadequately financed as a separate business as regards meeting its normal obligations

(3) Where the parent company and the subsidiary are operating portions of a single business and the financing as well as managerial activities come from the holding or parent company.

(4) Where the enterprises of both the companies are not held out to the public as separate.

(5) Where the subsidiary is being operated in an unfair manner, that is, not in its interests primarily but in the interest of the parent company so as to funnel its profits to the parent company.

This is a very strong argument of lifting of the veil in group subsidiary relationships. In *DHN*[44] Lord Denning said and the court of Appeal upheld that in many respects a group of companies are treated together for the purposes of general accounts, balance sheet, and profit and loss account as one concern. He further noted that it is especially the case when the parent company owns all the shares of its subsidiaries. In fact Lord Denning goes on to say that the subsidiary is a mere puppet in the hands of the holding company. Technically, there is protection afforded to companies in holding subsidiary relationships under the veil of incorporation. However, as no one will deny that Denning notes rightfully that justice should not be defeated on a technical point. There should not be an abuse of the corporate form. Even though here is evidence of a general tendency to ignore the separate legal entities of various companies within a group and look instead at the economic entity of the whole group.

Still, after the decision in *Adams* the trend is towards keeping intact the sanctity of the doctrine of separate corporate entity. Court of appeal in Adams holds that the court is not free to disregard the *Salomon* principle merely because it considers that justice so requires. Save in exceptional circumstances where it can be shown that the company is a sham or the agent of the shareholder the parent company is simply regarded as a shareholder. The preceding argument leaves us again suspended in the legal field. Instead of exceptional circumstances the argument should be to bring more balance to the two doctrines. Where required the instances quoted in the preceding paragraphs should be employed to reach a more equitable conclusion. There is ample proof that holding subsidiary relationships result in abuse of the corporate form. Therefore the principles enunciated by the likes of Gower and Palmer should be looked before judges reach a verdict.

There is no reason why the same principles should not be applied to the holding company –subsidiary relationships in jurisdiction of Pakistan. Where the separate corporate entity of a subsidiary is put to improper use, such as to defraud creditors, or evade the law or escape any legal obligation, there is no reason why for achieving the ends of justice the

[44] DHN Food Distributors Ltd vs. Tower Hamlets LBC [1976] 1 WLR 852

Courts in this country should not disregard the separate corporate entity of subsidiary and make the larger business entity comprising the parent company, and the subsidiary or subsidiaries as single business entity answerable for all obligations of the group as a whole.

Gower in his book[45] also observes the tendency of the courts is to recognize "enterprise entity" rather than "corporate entity" and readily lift the veil where fraud or improper conduct is involved. This recognition should be reinforced and refreshed when required. Only in its reinforcement can the courts keep a check on corporate crime in the holding subsidiary relationships. Otherwise, group or individual anyone with the certificate of incorporation will have a license to exploit and abuse the corporate form at their leisure.

Even in England the application of the rigid rule in *Salomon's* case has been departed from in several cases where the circumstances showed that the company was a mere facade concealing the true facts. *Freund*[46] believes that the decision in Salomon's case was calamitous. He thinks while developing the fiduciary principle to protect the shareholder failed to realize that this development would be fatal for the creditors. It was supposed to benefit group investors but was indeed hijacked by sole traders.

Even commentators[47] who have supported with dedication the decision in Salomon's case could not deny that lifting of the corporate veil is, nevertheless, necessary to meet the ends of fairness and justice. A special emphasis on the "Controlling issue" is highlighted in the previous cases. Where such a control is proven then there is a need of lifting the veil and the law is more inclined toward the same when the veil of incorporation pertains to matters of "control" rather than "ownership." It is easy to achieve control in a holding subsidiary relationship. Such control can easily lead to abuse of the corporate form. It is not easy to establish such control but if the investigative process at the evidence stage is helped by a report of the SECP[48] officer, then there is a greater chance of reaching a more just and equitable decision.

The issues regarding the veil of incorporation are floating on a sea of jurisprudence that speaks for it and against it. Recently in the jurisdictions of UK and Pakistan *Adams*[49] and *Union Council*[50] have respectively shifted the argument against lifting of the veil. However, this does not take us away from the fact that the need for judicial intervention and inroads remains[51]. Therefore, to completely disregard the lifting of the veil will be

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[45] Principles of Modern Company Law'' 1979 4th edition page 133
[46] O Kahn-Freund ' Some reflections on Company Law reform' (1944) 7 MLR 54
[47] Palmer's Company Law 20th edn also see Preface of the book
[48] Securities and Exchange Commission of Pakistan
[49] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)
[50] Union Council, Ali Wahan, Sukkur V Associated Cement(pvt.) Limited [1993] SCMR 468
[51] Though Michael J. Whincop notes in his book ' An economic and jurisprudential genealogy of corporate law', that the corporation has a unilateral capacity to thwart legal obligations. The same makes it difficult to differentiate between cases. Hence the problem of whether to lift the veil or uphold the Salomon Principle. He further notes that treating entity formalistically gives judges a look of having interests in the company. In the famous words of Lord Thurlow L.C. the corporation has 'no soul to damn, and no body to kick.'

stark injustice. Rather there is a need to remove the argument of inconsistency and bring forth a broad lined test. Before elaborating on the *Rubicon* test it is necessary to scrutinize the jurisdiction of Pakistan and analyze that how the judicial thinking there has shifted with the passage of time. The next part of the essay analyzes the evolution and trends of the corporate veil in Pakistan.

PART TWO

PAKISTAN- A CASE STUDY

In Pakistan cases pertaining to lifting of the veil have been great many over the decades but there are some that carry substantial legal reference to the foreign jurisdictions primarily of the United Kingdom. There is always recourse to *Salomon* rather than the prime reference to the statutory provision that protects the separate corporate entity of the company. In general there is a similar reluctance of the judges as their English counterparts to lift the veil. In certain areas, however, as for example on grounds of public policy they are more likely to lift the veil than the English judges. Cases like *Justice Shaukat Ali* are evidence of such decisions. In cases where there is an ulterior motive apparent for economic ends then judges tend to cross the *Rubicon*. In most other cases, however, *Salomon*[52] and *Cape*[53] hold their fort.

As far as the concept of separate corporate personality is concerned in the early corporate law cases a similar stance that was taken in *Salomon* was taken by judges in Pakistan. In the *Ikram bus service case*[54] the Supreme Court of Pakistan upheld the principle of separate corporate personality. It elucidated that the company is neither an alias for its shareholders nor is it an agent for them. The same was thus followed in subsequent cases. In the case even the argument of Agency was strongly rejected. This however, did not deter the judges in the *Shaukat Ali case*[55] to lift the corporate veil where it was required for the interests of justice. The judges quoted extensively from English jurisprudence and affirmed that where necessary they can lift the veil of incorporation.

The following paragraphs shed some light on the issues of the prominent cases in Pakistan on the lifting of the veil of incorporation. It also highlights the trends and principles that these cases have laid down in the jurisdiction of Pakistan to lift the corporate veil. The first and foremost of these cases is the *Shaukat Ali* case.

The *Justice Shaukat Ali case*[56] was an inquiry into capacity or conduct of the judge of the High Court. The proceedings were not in the nature of a subsequent criminal indictment, they were more administrative in nature to determine professional fitness of the judge. The judge submitted the statement of his properties and assets to the Supreme Judicial Council.[57] The council scrutinized and then after the scrutiny of the President the report stated that the Judge may be guilty of gross misconduct. The case is elaborate on the refutation by the respondent. However, what is within the scope of this study is that in the same case there was an issue of the veil of incorporation.

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[52] Salomon V A Salomon & Co Ltd [1897] AC 22(House of Lords)
[53] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)
[54] Ikram Bus Service v. Board of Revenue PLD (1963) SC 564
[55] The President v. Mr. Justice Shaukat Ali PLD (1971 SC 585)

[56] The President v. Mr. Justice Shaukat Ali (PLD 1971 SC 585)
[57] Under Article 3 of the Judges Declaration of Assets Order 1969

Reference was taken to an Article of the Constitution of Pakistan.[58] In the reference to the Article some of the charges against the judge were that prior to the elevation to the Bench he was a shareholder in two private limited companies and he continued to be the respective shareholder after his elevation. It was alleged that he involved himself in trading with these companies for the pursuit of wealth. He incurred such financial obligations that put him in an "embarrassing" position and furthermore he was found in contravention of Article 4 of the Code of Conduct. It was therefore, held that the corporate veil can be lifted to look at the real relationship of the respondent with the companies.

The counsel appearing on behalf of the respondent contended that the company was a separate entity and there was no substantial proof of the respondent in the management and control of the company. It was contended that his involvement as a shareholder was no hindrance on his other functions of being a judicial officer.

It was held by the judges[59] that the trend of decisions since the *Salomon's* case showed that both the Courts and the Legislatures have lifted the veil. The judges did not allow their vision to be clouded by the shadow of the corporate personality. It was decided that where the corporate personality is being used merely as a cloak for fraud or improper conduct or where it can be established that the corporate personality is merely acting as an agent or trustee for someone else, be it be an individual or another subsidiary company the veil of incorporation can be lifted. Furthermore, the judges concluded that where it is necessary to determine the true character of the corporate personality for other purposes, such as to determine its tax liability or its quasi-criminal liability the Courts have not hesitated to look behind the veil of incorporation.

A similar stance that is taken by the English judges is taken here. It can be surmised with ease that the reference alludes to discretionary lifting of the veil where it is deemed necessary by the judges. English judges have concluded similarly in great many cases but precedents like *DHN* have not gained the same influence as *Adams*. Nevertheless, In the preceding reference from the judgment it is apparent that the judges have stated with clarity that where issues like tax liability, quasi criminal liability, agency, trust or group corporate liability are involved the court if required can lift the veil in order to determine the real nature of the transaction in question.

The court stated further in the case that the Council is not concerned with the liability of the respondent as a member of the companies but is concerned, in terms of a Code of Conduct drawn up under the Constitution, to determine as a matter of public policy as to whether the association of a Judge of a Superior Court with such concerns constitutes involvement in activities of trade, business or industry. Therefore, the court felt entitled

[58] Article 165 Constitution of Pakistan of Pakistan 1973
[59] Hamoodur Rahman J., Chairman, Muhammad Yaqub Ali J., Sajjad Ahmad J., B. A. Siddiqui J.and Qadeeruddin Ahmad J., Members

to lift the veil of incorporation and find out the association of the Judge with the Companies under question.

This further highlights the fact that sometimes the shadow of incorporation can cloak matters that should otherwise be brought to the attention of the court. If in such matters incorporation protects the individual or group of companies then it would be stark injustice. In the case, the Council is concerned therefore with dispensing justice rather than anything else. This concern can be addressed if there is a broad guideline that can help them in approaching the matter of lifting the veil without being subject to criticism. In their decision, finally, the judges held the judge responsible on grounds of misconduct of duties or obligations that fall outside the scope of his judicial functions.

The above decision of the judges highlights the broad principles for crossing the *Rubicon*. They have laid down firmly the different instances where by the protection of the constitution as well as that of their judicial function they can exercise their powers to lift the veil of incorporation. This case has been reported and has become a guiding precedent in many subsequent cases of the lifting of the veil in Pakistan. It notes strongly that on matters of pubic policy the corporate veil should be lifted to reach the veracity of the case in question. Therefore, it is necessary to embrace questions of public policy when formulating the five point test in the jurisdiction of Pakistan.

The second case that boldly challenges the doctrine of separate corporate entity in the corporate history of Pakistan is the *Union Council* case[60]. It has referred extensively to the doctrine of the lifting of the veil as well as to English law cases. The Judges[61] referred extensively to different legal writings as well to determine whether there is a need to lift the veil of incorporation or protect the sanctity of the separate corporate entity.

The judges were of the view that it is well established that the Courts are entitled to pierce the veil of corporate entity and look at the reality of the transactions. They affirmed the juristic view that the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to certain duties. But even in a case that ultimately did not lift the veil, the judges noted that in certain exceptional cases, the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade.

Here again the judges' press on the lifting of the veil to verify the economic realities of the case in question. There is no denial of the fact that the case establishes that where for economic ends there is an abuse of the corporate form, then the judges are unanimous that the lifting of the corporate veil should take place.

[60] Union Council, Ali Wahan, Sukkur V Associated Cement(pvt.) Limited [1993] SCMR 468
[61] Ajmal Mian J., Sajjad Ali Shah and Saleem Akhtar, JJ

In the *Union Council* case there was extensive recourse to the precedents by the judges so it will be safe to say that this is a judgment that has ample research and reasoning to support the lifting of the veil in Pakistan. The judgment is replete with the reasoning that when required the lifting of the corporate veil should take place. In a way this case, safely prophesizes the future scenario where the *Rubicon* test will be applied to a case and it is not necessary that the individual or holding company will be held responsible. There are times when the evidence does not impute the people behind the veil. Sometimes the evidence on record, therefore, points towards keeping intact the doctrine of separate corporate entity.

The Supreme Court did agree that the veil is to be lifted where reality of the transactions has to be scrutinized. As far as the question of the veil was concerned there was an all-embracing commentary on the veil of incorporation. The judges expounded primarily relying on the *Salomon* decision. They quoted the celebrated case in order to reach their judgment.

The *Salomon* decision was used as a guiding precedent in the case. There was acknowledgment of the fact that if the reasons enumerated in this essay for the lifting of the veil are found then disregard of the separate corporate entity is justified. Thus the judges in Pakistan express the need for lifting of the veil where the reasons require one to do so. Even in *Union Council* the judges quote decisions like *Salomon* and *Adams* yet they cannot forgo of the fact that such decisions should not defeat the very purpose of law, that is, to bring justice to the wrongdoers.

Establishing the degree of control is also seen as a necessary question to be asked when lifting the corporate veil. In the *Fauji Foundation case*[62] the Court pressed into service the doctrine of lifting of veil of incorporation in order to ascertain the real nature of the ownership and the dealings of those concerned. The words echoed the same stance as was taken in the case of *Justice Shaukat Ali*. The judges established the true nature of ownership and control by lifting the veil of incorporation.

Similarly in tax matters and other financial concerns judges lift the veil. It is already apparent that where an escape from financial liability is proven it makes a strong case for lifting of the veil. In the *Rice*[63] case, the veil of incorporation was lifted by the judges in the case to assess whether the corporation was liable or not in the case.

However, even with the categorization of different situations there is a constant inconsistency that plagues the corporate veil. Judges have noted the same problem in their decisions. In an unreported judgment dated 29-12-1991 rendered by the Court in the *K.D.A case*,[64] it was noted that it is necessary and appropriate in certain cases to lift the veil of incorporation with a view to find out the true state of affairs and to determine

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[62] Fauji Foundation and another v. Shamimur Rehman PLD (1983) SC 457;

[63] Messrs Rice Export Corporation of Pakistan Ltd. v. Karachi Metropolitan Corporation through Director Octroi and another (PLD 1990 Kar.186);

[64] Karachi Development Authority v. Central Board of Revenue and another (Civil Appeal No.284 of 1987),

the rights and liabilities of the parties. The judges concluded in the case that the wide divergence of views on the question of lifting the veil reveal a fundamental uncertainty about the nature and effect of corporate personality. The judges affirmed that it is highly unlikely that a theory can be found which will reveal that all past cases are consistent. A general incorporation statute allows people to create separate legal persons very easily. In the case the judge further alludes to the same unforeseen disadvantages that the courts might face in company cases. It is therefore, rather wise to disregard the separate corporate entity to overcome such disadvantages. The judge highlights the key issues that need to be addressed in arriving at the five point test. There is a need to eliminate the fundamental uncertainty around the doctrine. However, there is no absolute answer as to the removal of the inconsistency. It can only be left to the judges to be dealt on a case by case basis.

The judges further noted in the case that the sum and substance of the views of various authors is that no hard and fast rule can be laid to limit the cases in which veil of incorporation can be lifted. Some definite instances as stated above have attained universal acceptance but it would not be safe to limit them to these given cases alone. In view of the broad spectrum in which the commerce, business and industry are developing creating novel commercial relationships and innovative dealings unknown in the past, the piercing of the veil of incorporation will entirely depend on particulars of each case.

In the latest *M.T Tasman Spirit case*[65] there was no lifting of the veil as the Judge reasoned otherwise. However, the judge did not say that lifting of the veil would only be required if there was any allegation of fraud and deceit on the part of any of the owner companies. So if there had been evidence supporting such allegations then the outcome of the case might have been different. These cases reinforce all the more that laying down principles and rules for lifting the veil of incorporation will not necessarily mean piercing of the veil in every case.

Criminal intent and corporate crime are two factors that have to be included in the test as well to embrace the cases pertaining to the same. The veil of incorporation can cloak corporate crime easily. If lifting of the veil is left for exceptional circumstances then the inequitable abuse of the corporation[66] will be a reality in great many cases. Examples of such crimes exist in Pakistan.

Another case where the judges lifted the veil concerned just such a corporate crime. The *PIA*[67] case involved a dishonour of cheques. The company was alleged of cheating and criminal breach of trust. In the case Justice Doreb Patel used some strong words citing *Salomon* as well as *Justice Shaukat Ali* to bring his point home. He said that even though a company is a distinct legal entity as cited in *Salomon* this does not alter the fact that a company can only act through its directors and officers therefore, an allegation of a criminal offence against a company can only mean that the company's directors have

[65] Central Insurance Company Ltd and Others vs. M.T. Tasman Spirit and Others (2004) CLD 695
[66] See further Micheal J. Whincop 'Inequitable Abuse of the Corporation' Company Lawyer 1981
[67] Pakistan International Airlines Corporation vs. Khalid Waheed and Others (1981) SCMR 573

committed the alleged offence and in order to decide who has committed the offence the court has to lift the veil of incorporation.

The courts, therefore, have the powers to lift the veil and assess the real situation. They have done so in many cases. In the *Maheenu Agha case*[68] the court further affirmed the same as to its inherent powers. The case used the term of exposing camouflage to reach the real nature of the matter. However, in Paragraph seven there was an affirmation of lifting of the veil where necessary. The judges noted that it was alleged that the name SCAN MARITIME SA taken by defendant no. 13 was a camouflage and a cover for some unidentified persons who were in fact nationals of Pakistan. Therefore, the court validated its power to lift the veil of incorporation and uncover the third party behind such veil. Reliance in the case was placed again on the *Justice Shaukat Ali case*. Similarly in the *Khatoon Begum case*[69] the court again exercised its Inherent powers[70] to ignore existence of a company. Again and again the courts have established that there is a need to lift the veil. It has used arguments of Inherent powers, arguments from different commentators and from guiding precedents. All have been used to arrive at a more just and equitable decision.

In Pakistan there is a constant recourse to English precedents. However, there have been decisions that exceptionally highlight the argument in favour of lifting of the veil where justice so requires. As held in Union Council[71] no hard and fast rules can be laid down to limit the cases in which veil of incorporation can be lifted. Decided cases which lay down the principles for lifting the veil have to be read with particular reference to the facts of those cases. The Judge only confirms what Lord Parker asserted in *Daimler*. This should not be a deterrent for formulating guidelines to help judges in future case law. More so it should be taken by the legislature as a challenge in order to provide a better approach to defeat abuse of the corporate form.

Justice Shaukat Ali reaffirms that the tendency should be to look at the substance rather than the shadow of the corporate personality. Furthermore, it says that one can go behind the veil for the sake of public policy. We see that generally the judges have not been reluctant to use their inherent powers where necessary to lift the veil. They rather want to lift the veil in order to reach a more informed decision. As the preceding judgments and commentaries highlight that there are five instances that have surfaced again and again in the jurisdiction of Pakistan when referring to matters regarding lifting of the veil. The final part of the essay therefore, looks at the five point *Rubicon* test and how it can help achieve a reinforcing and more acceptable approach to lifting of the corporate veil in Pakistan.

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[68] Miss Mahenu Agha vs United Liner Agencies of Pakistan Limited and 12 Others PLD (1990) Karachi 198

[69] Khatoon Begum and 4 Others vs. Messrs Hyesons Commercial and Industrial Corporation Ltd Karachi and 4 others (1980) CLC 1666

[70] Section 151 of the C.P.C. 1908

[71] Union Council, Ali Wahan, Sukkur V Associated Cement(pvt.) Limited [1993] SCMR 468

PART THREE

It is apparent from the preceding chapters that there is a constant altercation between the advocates of the doctrine of separate corporate entity and the ones who advocate for the lifting of the veil. Confusion plagues the cases revolving around the lifting of the veil. At times judges reason that the veil cannot be lifted as it is only to be employed in very exceptional circumstances and then at other times they lift it easily. Generally, the trend is to follow the *Salomon* principle. Though using the tradition of *Salomon's* analogy is remarkable in two senses. First, it is at odds with the established approach of precedents in England. The approach involves elucidating a narrow ratio based on the particular facts and issue before the court. This limits the effect of the reasoning in the case on later cases. Secondly, the authority is regarded a degree of interpretative formality that elevates the case to a quasi legislative statement despite the absence of any specific legislative basis for doing so. However, as already scrutinized the Court will use its powers to pierce the corporate veil if it is necessary to achieve justice[72]. There are some discernible trends in the doctrine of lifting of the veil as well. At places judges have quoted various situations where the veil can be lifted. The legislature can however, use these instances cited by commentators and the test itself to take a legislative step. The judicial inroads are many and as we have seen over the century since *Salomon*[73] that there have been many instances in different legal jurisdictions where there has been an expressed[74] need for lifting of the veil.

In the end it is safe to conclude that there can be no absolute rule. However, there can be something close to the absolute. There is always room in jurisprudence to formulate the absolute from the abstract. There is always thus room for new jurisprudential approaches to the same questions. The law of lifting of the veil in Pakistan provides room for such an approach. The *Rubicon* five point test therefore lays down the already mentioned five points as a broad guideline for the jurisdiction of Pakistan.

The test requires an officer of the Securities and Exchange Commission of Pakistan to make an investigation into the affairs of joint or related companies and file a report against the same. Alternatively, the court may appoint any other officer of the court. On filing of the report the judge may put the case to the five point test. The test inquires on the following five points:

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[72]See in Re a Company (1985) BCLC 333 p.337-8
[73] Salomon V A Salomon & Co Ltd [1897] AC 22(House of Lords)
[74] Lord Parker,'' the legislature might, but no court could possibly, lay down a hard and fast rule. 'Daimler Co Ltd. V Continental Tyre and Rubber Co(GB) Ltd. [1916] 2 AC 307 (House of Lords)

I) Who effectually controls and conducts the business in question therefore establish the degree of control?

II) Whether it is necessary on grounds of public policy to lift the corporate veil?

III) Whether there is element of any of the following:
a. Fraud or breach of trust
b. Wrongful trading
c. Corporate Crime

IV) Whether an element of escape or evasion from tax liability is apparent?

V) Whether the evidence substantiates a single economic unit or not?

It will primarily require a very transparent and thorough investigation by the SECP[75] officer or any other officer appointed by the court to reach the heart of the matter. The officer should play a greater role in providing the court with more in-depth information than is usually available to the court. The officer should file an impartial report to the court and if the conclusions of the report are in the negative the judge should then scrutinize the evidence on record. If the report also alludes to any other point of the test then it substantiates a strong argument for lifting of the veil.

Where there is an element of fraud the judge can assess whether the evidence points to a certain level of evasion from law on part of the company. He can further ask as to how much such element of fraud, breach of trust or criminal intent affected the other party. In the case of the single economic unit argument or when the court wants to establish a degree of control it is necessary to look at the motives of the ones responsible. Such questions have to be left to the judge to be answered on a case by case basis. How the legal rights and obligations affect the parties in question. When the investigative report and the scrutiny of the evidence by the judge are based around such questions, there is a greater chance of finding the truth behind the corporate veil.

It is true that the test will certainly bring evils of its own. As noted by a commentator certain states may also lack the legal machinery, such as resources to undergo complex discovery of documents, to unravel the corporate veil which may shield an asset-rich parent company behind an asset poor local subsidiary.[76] The courts and legislature in third world countries are especially aware that such radical steps bring greater financial burden. It will increase the duration of the assessment of the evidence and that of the decision itself. However, time and money should not be an excuse to taint the hands of justice.

[75] Securities and Exchange Commission of Pakistan
[76] Liability of Multinational Corporations under International Law edited by Menno t. Kaminga, Saman-Zia Zarifi, Kluwer Law 2000

The scope of this study is simply to suggest the test rather than to touch on the demons that it might have. The five point *Rubicon* revolves around a question oriented format. These questions are to be asked when the SECP officer has filed his report. The judge can put these five questions to each case. The judge will assess whether in the light of the report and the series of questions an abuse of the corporate form is apparent or not.

It is rather impossible to provide a very incisive and objective test. However, some form of objectivity can be provided in order to reach a more informed judgment. This approach to the lifting of the veil is not new. It has been explored before, as explained in the famous Indian case[77] in Part one of the essay. Furthermore, as already expounded different commentators have given their own rules and guidelines for lifting of the veil. The *Rubicon* test, therefore, draws from all the relevant sources to arrive at a test that is suitable for the jurisdiction of Pakistan. The test draws from the fountain of writings by famous commentators and judges who have provided the different instances for lifting of the veil over the years. Some have tried to have an exhaustive list of instances and some have asked concise questions. The precedents and situations where there is a unanimous opinion of the commentators and judges to lift the veil have been discussed in the previous parts of the essay.

If a judge finds after careful consideration and investigation that any of the five points establish significantly and convincingly then the judge should lift the veil. All the five points enumerate instances where abuse of the corporate form can be checked. The test has a broad approach so that it remains open for the unforeseen problems that the courts may face in the future.

The legislature can ask these questions and try to take legislative steps in their wake to arrive at some statutory solution. They have done so in the past and it is all the more required now that cases like *Adams*[78] bring the inconsistencies back to the fore: a precedent that leaves lifting of the veil for very exceptional circumstances. It will, inadvertently invite the abuse of the corporate form. The *Rubicon* test brings us to the original argument of the very purpose of courts of law. The very purpose of serving justice should not be defeated. Therefore, where the courts find out that there is some abuse of the corporate form then they should not hesitate to lift the veil.

This test provides a starting point for the jurisdiction of Pakistan. There is already a plethora of commentaries on the veil of incorporation. By relying on tests or preferably legislative guidelines the judges can base their reasoning on more solid grounds.

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[77] Deputy Commissioner CT v Cheran Transport Corp. LTD (1992) 74 com cases 563 MAD

[78] Adams V Cape Industries plc [1990] Ch 433,[1991] 1 All ER 929(Court of Appeal)

CONCLUSION

It is only fair to conclude that there is an essential requirement for the judges to cross the *Rubicon*. In the jurisdiction of Pakistan they have done so with the help of guiding precedents like *Justice Shaukat Ali.*[79]They have even cited *Union Council*[80] to reach the reality of the matters in question. With the passage of time judges have applied the reasoning of major English precedents. The very precedents that have provided rules that state disregard of the corporate form where an element of wrong is said to exist.

In the sphere of corporate law the two doctrines of separate corporate entity and lifting of the veil remain the subject of a constant progressive debate. From *Salomon*[81] to *Union Council*[82] the abuse of the corporate form has been brought to the notice of the court innumerable times. They are fraught with inconsistencies and cannot be enshrined in some easily understandable code or statute. New legal problems require judicial inroads and radical insights by the judges. The need for judicial discretion remains. It remains to be seen in the wake of the precedents and different legal proposals whether the two doctrines are ever able to reach a state of delicate balance. However, judges and commentators alike can try to move towards that balance or criterion. In every jurisdiction the rules and principles are there to establish tests that can help judges in arriving at a just and equitable decision. The *Rubicon* five point test offers just such a foundation for the jurisdiction of Pakistan.

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[79] The President –Referring Authority V Mr. Justice Shaukat Ali PLD [1971] SC 585
[80] Union Council, Ali Wahan, Sukkur V Associated Cement(pvt.) Limited [1993] SCMR 468
[81] Salomon V A Salomon & Co Ltd [1897] AC 22(House of Lords)
[82] ibid