

Dispute Resolution Hotline

July 19, 2016

SUPREME COURT LIFTS THE CORPORATE VEIL AND CANCELS ALLOTMENT OF LAND

INTRODUCTION

The Supreme Court (the "Court"), in the case of The Estate Officer UT Chandigarh ("Estate Officer") v M/s Esys Information Technologies ("Respondent"), pierced the corporate veil in a share transfer between the Respondent and its associate company and a further transfer to a third party, holding that the transfer effectively transferred the immovable property owned and constituted a violation of the Allotment of Small Campus Site in Chandigarh Information Services Park, Rules 2002 ("Allotment Rules"). The Court ordered a resumption of the land by the Estate Officer.

FACTUAL MATRIX

The Respondent, a company incorporated in Singapore, was the parent of Esys Information Technology ("Esys India") registered under the Companies Act, 1956, having its registered office at Chandigarh. Esys India was allotted 6 acres of land in the Chandigarh Information Services Park, under the Allotment Rules in 2006. Rule 9 of the Allotment Rules prohibited the transfer of the allotted property for a period of 10 years or till full payment of dues, whichever is later. In 2008, the Director, Information Technology of Chandigarh sought clarification regarding the transfer of majority stake held by the Respondent in Esys India to Esys Global Holdings ("Esys Dubai"). Upon receiving an unsatisfactory response, a show cause notice was issued by the Estate Officer, pursuant to which an order of resumption of the land was passed. The order was appealed and was upheld before the Administrator, Chandigarh. It was also brought to the notice of the appellate authority that the stake acquired by Esys Dubai was further transferred to Teledata Informatics Ltd. ("Teledata"), a Chennai based company.

Aggrieved by the order of resumption of allotment, Esys India approached the Hon'ble High Court of Punjab and Haryana. The High Court, applying the theory of distinct legal personality, held that as the shareholders of Esys India are distinct from the company, a change in shareholding of the company would not amount to a transfer of the allotted land. Thus, the Hon'ble High Court, set aside the order of resumption passed by the Estate Officer. The present judgment arose out of the appeal preferred by the Estate Officer against the said judgment and order of the Hon'ble High Court.

The Court directed the Respondent to file a counter affidavit containing certain factual details.

ISSUES BEFORE THE COURT

The Supreme Court considered whether a transfer of shares of the Indian Subsidiary by the Respondent to Esys Dubai or a further transfer to Teledata resulted in transfer of, inter alia, the assets (including the allotted land) in violation of Rule 9 of the Allotment Rules.

ARGUMENTS RAISED

The Respondent argued that while there was a transfer to Esys Dubai, there was no further transfer to Teledata, as a shareholders agreement by which the shares of the Respondent were to be transferred was disputed and was the subject matter of various pending litigations. The Respondent further argued that the allottee remained the same. In addition it argued that the Esys India fulfilled all the allotment criteria and therefore, the order of resumption was not sustainable in law.

The Estate Officer argued that Rule 9 of the Allotment Rules placed a restriction on the transfer of the property for a period of 10 years from the date of allotment or till full payment of dues, whichever is later.

The Estate Officer argued that under the garb of transfer of shares, the Respondent had, in fact, transferred its assets and its liabilities. Hence, the said transaction amounted to a violation of the Allotment Rules.

It also argued that the Respondents have not come to the court with clean hands as there was a concealment of material facts regarding its transactions with Teledata. Teledata in its unaudited results published that it along with its subsidiary Esys Technologies, was setting up a TBO facility at the Rajiv Gandhi Information Technology Park at Chandigarh.

JUDGMENT OF THE COURT

The Court examined the arguments of both sides and at the outset recorded that the Respondent had not, despite the specific direction of the court, furnished all material facts of its transfers in its counter affidavit. It held that the Respondent had entered into such transactions with Esys Dubai and that it was prima facie apparent from the affidavit of the Respondent's promoter that there was a further right created in favour of Teledata though the dispute

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with Teledata has to be decided in pending cases. Upon perusal of two affidavits filed by the Respondent in connected proceedings before the High Court of Singapore and brought on record by the Estate Officer, the Court held that the Respondent had suppressed facts.

The Court observed that while it is empowered to pierce the corporate veil in instances of fraud and tax evasion¹, it could also do so when the promoter was acting in furtherance of his/her dishonest and fraudulent designs². The Court held that there was a case made out to lift the corporate veil. Holding the Respondent guilty of suppression of facts and suggestio falsi, the Court held that the transfer of the shares of the Esys India effectively sold the land allotted in violation of the Allotment Rules. Consequently, it set aside the order of the High Court and held that the order of resumption of land of the Estate Officer was legal and valid.

ANALYSIS

The judgment is in consonance with an earlier judgment of the court in State of Rajasthan v Gotan Lime Stone Khanji Udhyog³, where, the Court pierced the corporate veil, in a matter when a mining license was transferred under the guise of a transfer of the share capital of the licensee. In the present fact pattern, upon clear proof of suppression of facts, the Court lifted the corporate veil and further held that the transfer of majority shares of a company amounted to a transfer of the allotted land, which was in violation of law.

Development rights allotted under State and Municipal laws, contain, for the most part, a similar restriction on their transferability. Also, after allotment of land is made, subsequent transfers are commonplace. In each such situation, care must be taken to ensure compliance with applicable law failing which, such transfers will always remain vulnerable.

— **Mohammad Kamran, Sahil Kanuga & Vyapak Desai**
You can direct your queries or comments to the authors

¹Juggilal Kamlatpat v Commissioner of Income Tax, UP; AIR 1969 SC 932

²Jai Narain v Pushpa Saraf. 2006 (7) SCC 756; State of U.P. v Renuagar Power Co. AIR 1988 SC 1737.

³2016 SCC OnLine SC 62; SLP (Civil) 23311 of 2015.

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