

## Identification Theory: A Continuum of Personal Liability

The increasingly complex and international nature of the business world has brought a concomitant increase in the risk facing directors and officers that they may be personally exposed to lawsuits brought by 3<sup>rd</sup> parties, governmental agencies or even the company itself.

This personal exposure comes under a myriad of different legal theories and statutory provisions. For directors of companies involved in inter-provincial or international transactions, particular care must be taken to analyse the non-home jurisdiction laws since what may be an acceptable risk “here” may not be acceptable risk “there”. A quick internet search of the Loewen Group gives full meaning to what “catastrophic lawsuit” in a foreign jurisdiction really can mean.

Unfortunately there is still not agreement in the Canadian common law regarding a principled approach to when directors, officers and employees (“DO&E”) will be personally liable for their actions ostensibly taken qua DO&E. This type of analysis is usually referred to as “piercing the corporate veil” and although there is some scholarly debate as to what actually constitutes “piercing the corporate veil”, for purposes of this article, I will use this terminology to describe when personal liability is attributed to DO&E.

This review does not delve into an analysis of potential personal liability arising from the application of private international law (being sued in another jurisdiction) or statutory requirements, both of which would require a separate analysis beyond the scope of this discussion.

It is the premise of this article that the lack of clarity can be attributed to trying to solve a corporate law issue by applying the common law developed for other purposes: trying to fit a square peg into a round hole. In order to develop a consistent and principled approach to piercing the corporate veil, a corporate legal solution is required. Fully embracing the *Salomon* principle of a separate corporate legal existence leads naturally to the identification theory. From this basis of corporate law, a corporate legal solution that is both principled and consistent can then be formulated to determine when one act of the natural person can result in two liabilities: one for the corporation and one for the natural person.

I propose to start by setting out a stepped framework, a “continuum of liability”, which can be used as an analytical tool that forms the basis of a consistent and principled approach to determining when the corporate veil can be pierced. I will then look at case law to determine how or whether it fits into this “continuum of liability.”

### The Analytical Framework

The proposed framework is divided into the following 4 analytical steps.

- 1) Step 1: Setting the Groundwork: What Is a Corporation?
  - a) Fully embracing that corporations are separate legal entities per *Salomon*; and
  - b) Identification Theory: Having a separate legal existence from the natural persons who make the corporation function means that the acts of the DO&E

are first and foremost the acts of the corporation and not the acts of the DO&E in their personal capacity.

- 2) Step 2: Is the Corporation Liable? The next step in the analysis is determining whether a particular act can be viewed in law as actionable, either in tort or contract or otherwise. If the answer is “yes”, then the corporation, not the DO&E, is potentially liable;
- 3) Step 3: Is the DO&E Also Liable? The next step in the analysis is determining whether those same actions which bring about potential liability to the corporation can also be viewed as bringing personal liability to the DO&E (one act: two liabilities). In order to attract personal liability, then those actions must themselves be torts of the DO&E separate and apart from the actions of the corporation, or they must exhibit a separate identity or interest from that of the corporation so as to make the act or conduct complained of that of the DO&E<sup>1</sup>. If the answer is yes, then both the corporation and the DO&E are potentially liable;
- 4) Step 4: Is the DO&E Solely Liable?: the corporation may be exonerated from liability arising from the acts of the DO&E based on the principle of vicarious liability.<sup>2</sup>

### **Step 1: Setting the Groundwork: What Is a Corporation?**

The first step is to look at what a corporation is. Although there is a technical difference between companies and corporations, I use the terms interchangeably but the reader needs to note that there is a legal difference between the two which may affect personal liability of DO&E.

In today's world, we are surrounded by corporations and generally give little thought to the fact that they are really legal fictions. Companies originally arose as groups of individuals who pooled their resources so that they could carry out a larger transaction which none of them individually had the financial capacity to do. However, these first adventures into pooling resources also brought with it the spectre of unlimited liability for each of the participants. Over time, the law came to recognise this concept called a “company” and that individuals could invest into them with only the amount of their investment at risk.

In the early times of companies, there was much confusion about what a company really was and how a legal fiction could own property or do acts that were separate and apart from the individuals who were actually engaged in the transactions undertaken by the company.

In 1897, *Salomon v. Salomon*<sup>3</sup> recognised in the common law that a company was a

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1. *Blacklaws v Morrow*, 2000 ABCA 175 at para 41; cited with approval in *Hogarth v Rockey Mountain Slate Inc.*, [2013] ABCA 57 at para 13.

2. e.g. see *Bazley v Curry*, 1999 SCC 692; *EDG v Hammer*, 2003 SCC 52; *Blackwater v Plint*, 2005 SCC 58; *EB v Oblates*, 2005 SCC 60;

3. *Salomon v Salomon & Company, Limited*, [1897] AC 22 (HL).

separate legal entity.

After *Salomon*, the issue of the corporate body having a separate legal identity was settled. However, what was not settled was to what extent the DO&E had personal liability for actions taken ostensibly in their capacity as DO&E for the corporate body.<sup>4</sup> After almost 120 years, this issue of personal liability of DO&E is still not definitively settled in Canadian corporate law.

#### Identification Theory: Whose act is it anyway - the Director's or the Corporation's?

In order to understand many of the legal theories imposing personal liability on DO&E, it is necessary to understand how Canadian law views the actions of DO&E when carrying out the business of the company. Court decisions that rely upon considerations of “justice” alone to justify piercing the corporate veil have been criticised<sup>5</sup> or rejected<sup>6</sup> which points to the requirement for a more principled approach to determining DO&E liability. One legal theory that provides a principled approach to this issue is the “identification theory.”

Although DO&E are often described as being the representative or agent<sup>7</sup> of the corporation, in legal theory, that is not an accurate description according to the identification theory. Pursuant to the identification theory, DO&E merge with the corporation for the purposes of giving the corporation a directing mind or will, that is, the act of the DO&E is the act of the corporation itself, not that of the DO&E.<sup>8</sup>

“...a corporation is an abstraction. ... If [Mr. L.] was the directing mind of the company, then his action must ... have been an action which was the action of the company itself”...<sup>9</sup>

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4. *Hogarth v Rocky Mountain Slate Inc.*, [2013] ABCA 57 at para 71 “After some early missteps, the common law recognized the corporation as a separate legal entity.... But was also recognized that the corporate business form was open to abuse, and that some limits on its attributes had to be imposed by the common law. This process came to be known as ‘piercing’ or ‘lifting the corporate veil’.”

5. See *Transamerica Life Insurance Co. of Canada v Canada Life Assurance Co.*, 1996 Can LII 7979 (OntSC) at para 13-19 (QL); *aff’d* [1997] OJ No. 3754.

6. *B.G. Preeco 1 (Pacific Coast) Ltd. v Bon Street Holdings Ltd.*, 1989 CanLII 230 (BCCA) per Seaton J.A. at para 37 rejecting the so called “Deep Rock” doctrine; but see *Globex Foreign Exchange Corp. v Launt* 2011 NSCA 67 at para 24.

7. Agency law requires a principal and an agent which leaves a conceptual hole in the analysis since ultimately, a natural person must be the directing mind of the corporation in order for it to be the principal. If it is only that one directing mind that is involved in the impugned act, the agency analogy falls apart.

8. *Scotia McLeod Inc. v People Jewellers Ltd.*, 1995 CanLII 1301 (ONCA) leave to appeal to SCC refused (1996) SCCA No. 40, “...officers or employees of limited companies are protected from personal liability unless it can be shown that their actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own.” per Finlayson, JA. at 497 19 D.L.R. (4th) 314; *H. L. Bolton (Engineering ) Co. v T. J. Graham & Sons Ltd.*, [1957] Q.B. 159 (CA). *cf* *Enterprises Sibeca Inc. v Frelighsburg* (Municipality), 2004 SCC 61 at para 35 applying the same principle to municipalities: “A legal person can only act through its agents, and can have no intention separate from this.”

9. *Lennard's Carrying Co. v Asiatic Petroleum Co.*, [1915] A.C. 705 at 713, [1914 - 15] All E.R. Rep 280 (HL) per Viscount Haldane

“... the person who acts is not speaking or acting for the company. He is acting as the company and his mind which directs his acts is the mind of the company. There is no question of the company being vicariously liable. He is not acting as a servant, representative, agent or delegate.”<sup>10</sup>

“The identity doctrine merges the board of directors, the managing director, the superintendent, the manager or anyone else delegated by the board of directors to whom is delegated the governing executive authority of the corporation, and the conduct of any of the merged entities is thereby attributed to the corporation.”<sup>11</sup>

Since the actions of the DO&E are those of the corporation, the general rule is that the DO&E will not be personally liable for tortious acts of the corporation<sup>12</sup> (that is, that DO&E acting qua DO&E).

The identification theory has been restated and applied by both the Alberta and Ontario Courts of Appeal:

“Where those actions are themselves tortious or exhibit a separate identity or interest from that of the corporation so as to make the act or conduct complained of their own, they may well attract personal liability.”<sup>13</sup>

The British Columbia courts have taken a slightly different approach. As stated in *XY, LLC v. Zhu*, the focus is on:

1) Whether the actions of DO&E are independent torts:

“...it appears to be the law in Canada that as long as tortious conduct on the part of any employee or agent of a corporation ... is properly pleaded and proven as an “independent” tort by the employee or agent, the wrongdoer can be held personally liable notwithstanding that he or she may have been acting in the best interest of (and at the behest of) the employer or principal.”<sup>14</sup>

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10. *Tesco Supermarkets Ltd. v Nattrass*, [1972] A.C. 153 at 170, [1971] 2 All E.R. 127 (HL).

11. *Canadian Dredge & Dock Co. v R.*, [1985] S.C.R. 662 per Estey at 693 in a corporate criminal context ; The issue of corporate criminal liability and the identification theory has now been addressed by amendments to the Criminal Code: see *Extending Corporate Criminal Liability?: Some Thoughts on Bill C-45*, Darcy L. MacPherson, *Manitoba Law Journal* (2004) 30 Man. L.J. 253 – 284; see s. 22.2 of Criminal Code.

12. *Wah Tat Bank Ltd. v Chan Cheng Kum* [1975] 2 All E R 257 (PC); *Scotia McLeod*, supra.

13. *Scotia McLeod* (ONCA), supra; *Hogarth* (ABCA) supra; *Blacklaws* (ABCA) supra.

14. *XY, LLC v Zhu*, 2013 BCCA 352 at para 73

2) Whether there is fraud or other similar type of deceitful actions<sup>15</sup>.

Focusing on the actions of DO&E to determine whether there is personal liability appears to emphasise the actions of DO&E as their own personal actions, rather than actions of the corporation, in particular since the Court brings in the concept of agency law. This is in line with the legal reasoning of some of the case law<sup>16</sup> which relies on theories of vicarious liability to attribute liability for actions of DO&E either on the DO&E or on the corporation. What this approach appears to do is to start by determining whether the actions are actionable per se, with the DO&E initially “owning” the actions,<sup>17</sup> then attempting to determine whether or how the corporation is involved in those actions. Although ultimately the court in the XY case relied on the fact that deceit of the DO&E had been proven to attribute personal liability, this analytical approach appears to subtly shift the psychological onus onto the defendant DO&E to prove that their actions are not independent torts once the courts have determined that their actions are otherwise actionable per se. There was little analysis in the XY case of how the corporation was liable for the same actions that brought personal liability to the DO&E, so the issue of how one action can bring liability to 2 entities remains an outstanding issue.

Whether this difference in approach translates in practice to greater risk to DO&E pursuant to BC law as opposed to Alberta law remains to be seen, but at the least, this difference illustrates that the law remains unclear as to what activity might bring down personal liability upon DO&E, and that the same activity may have different results depending upon the province in which they occur.

A question also arises whether it is only upper management, the directing mind of the corporation, that falls within the ambit of the identification theory. The SCC has held that it is only certain upper levels of management whose actions can be attributed to be those of the corporation under the “doctrine of corporate identification” for purposes of determining whether a corporation can limit liability under certain provisions of the Canada Shipping Act.<sup>18</sup> It is unclear whether this case is limited to its particular facts or whether it is only those DO&E who are the directing mind of the corporation that are included in the identification theory. If the latter, then we are cast into the situation of determining for lower level employees of corporations what the character of their actions are, what the legal basis is for the corporation to be responsible for those acts, when will these lower level employees be personally liable for those actions and who has the onus of proving what. It is a little like the natural persons who are the directing mind of the corporation are in the corporate house, but that mere employees are somewhere outside, perhaps on the welcome mat, maybe only on the front walk.

It is the premise of this article that these cases, if limited to only the directing mind of the

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15. “It is clear that fraud or fraudulent conduct has historically fallen into an established category in which personal liability has been imposed on agents and employees.” XY, *ibid* at para 73.

16. e.g. see *London Drugs Limited v Kuehne & Nagel International Ltd.*, [1992] 3 SCR 299

17. for example, whether or not the agent was acting under ostensible authority or actual authority, the analysis focuses on the actions of the agent as agent.

18. *Rhone (The) v “Peter A.B. Widener” (The)*, 1993 Can LII 163 (SCC).

corporation, create a false dichotomy that would treat senior management differently from lower level employees. The first step of analysis would be to determine what the position of the individual played in the corporation and then, based on that determination, apply a different set of rules as to whether the corporation is liable (with the acts of the senior management being that of the corporation so the corporation is automatically liable, with the acts of the lower level employees subject to some other analysis to determine corporate liability) as well as a different set of rules to determine when the senior management was personally liable as opposed to when the lower level employee was personally liable. Rather than clarity, such an approach would further muddy the legal waters by creating different rules to be applicable to senior management as opposed to lower level employees. This type of dichotomy would result in a legal analytical framework relating to “piercing the corporate veil” that is neither consistent nor principled, which is the very issue that courts are wrestling with.<sup>19</sup>

By fully recognising the *Salomon* principle of the separate legal existence of corporations and that corporations cannot act save through natural persons, then adopting the identification theory is a natural step in the analysis. Without differentiating between different types of employees (directors, officers, managers, or employees), it is possible to arrive at a consistent and principled approach to when the corporate veil can be pierced: “the act of the DO&E is the act of the corporation.”

### **Step 2: Is the Corporation Liable?**

By accepting that a corporation is a separate legal entity and that the acts of DO&E are the acts of the corporation and not the DO&E in their personal capacity, the analysis does not get tripped up in attempting to anthropomorphize the actions of the DO&E to the corporation.<sup>20</sup>

At this stage of the legal analysis, it is not necessary to attempt to distinguish between acts of the corporation and acts of the DO&E. All the impugned acts are those of the corporation at this stage of analysis. If the court determines that the impugned actions have sufficient nexus to the corporate purposes and are actionable per se, then the corporation is potentially liable, not the DO&E. Whether the DO&E is also personally liable for those same actions requires another step in the analysis.

### **Step 3: Is the DO&E Also Liable?**

If the actions are found to have sufficient nexus to the corporate purposes and are actionable per se so the corporation is potentially liable, then the analysis shifts to whether those self same actions are themselves tortious acts of the DO&E or exhibit a separate identity or interest from that of the corporation.

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19. For example see *Prest* (UKSC) infra; *VTB* (UKSC) infra; *XY* (BCCA), supra *Hogarth* (ABCA), supra

20. *Hogarth v Rocky Mountain Slate Inc.* supra per Slatter JA at para 85; see also *Queen v Cognos, Inc.*, 1993 CanLII 146 (SCC) where the court in its analysis referred to the corporation and its representative owing a duty of care to the plaintiff, going so far as to say that the misrepresentations were made by Mr. Johnston [the representative] in a negligent manner in order to base the finding that the corporation was liable but not the representative. This analytical fluidity adds to the lack of clarity since if, as the court found in the *Cognos* case, the representative employee also owed a duty of care to the plaintiff and it was the representative that made the misrepresentation, then it follows that the representative employee should have been personally liable.

The legal issue to be determined is when does an act of DO&E move from purely one of the corporation to one that brings on personal liability of the DO&E, and if it does attract personal liability of the DO&E, what is the principled reasoning to find that the same act can result in liability for 2 entities (the corporation and the individual DO&E). In other words, when can one act be attributed to both the corporation and the individual DO&E at the same time.

Something more than conduct that is actionable per se which is sufficient to affix liability to the corporation is required in order to affix personal liability on the DO&E. If the separate legal existence of the corporation is not recognised and if the analysis does not keep clear that the acts of the DO&E are those of the corporation, then the analysis runs a real danger of lacking a consistent and principled approach by conflating ordinary rules of determining liability of the corporation as applicable to determining liability of DO&E. Either the corporation is a separate legal entity or it is not.

If the corporation truly has a separate legal existence as stated in *Salomon*, then in order for the one act of the DO&E to result in two liabilities (corporate and personal), then there must be something more than the ordinary rules of determining liability. If an adult individual engages in actionable conduct, what would the principled reasoning be to also affix liability to their parent or their child. It is the position of this article that there would not be any principled reason to do so in law. There must be something more to implicate the liability of the parent or child. The same holds true for corporations, so long as we wish to adhere to the principle espoused in *Salomon*. In either case, one act should not result in two liabilities without something more.

The case law has had little difficulty in assessing liability where the fraud or deceit of DO&E has been involved. Returning to a pre-Hedley Byrne state of law where actionable conduct by DO&E needs to be accompanied by moral blameworthiness in order to support an action to pierce the corporate veil and affix personal liability on DO&E is that something more.

The act of the DO&E which brings liability to the corporation is exhausted or merges with the finding of corporate liability, without something more. The counter argument “but the corporation may not have assets necessary to satisfy a claim of the plaintiff” rings hollow since the fundamental purpose of corporations is to limit liability. If the law is to be applied in a consistent and principled fashion, liability should stop at the corporate level, unless there is “something more”.

Requiring an element of moral blameworthiness is consistent with the existing case law dealing with piercing the corporate veil, and as stated by Lord Denning: “... fraud unravels everything.”<sup>21</sup>

This common law principle is consistently applied in Canada. Where there is an element of wrongdoing or fraud involved, the courts have had little difficulty in finding personal liability for those personal defendants involved in the fraud.<sup>22</sup> For example,

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21. *Lazarus Estates Ltd. v Beasley*, [1956] 1 QB 702 (CA) per Lord Denning.

22. *BG Preeco I (Pacific Coast) Ltd. v Bon Street Holdings Ltd.* supra; *Shibamoto & Co. v Western Fish Producers Inc. (Trustee of)*, [1991] 3 F.C. 214 (Fed TD); aff'd (1992), 145 NR 91 (Fed CA); *XY*, supra at para 60

- 1) where DO&E use a company as his alter ego while the company is a shell without assets, and intentionally, willfully and deliberately incurs corporate liabilities, he may be found to be a joint tortfeasor;<sup>23</sup>
- 2) where the DO&E have agreed on the terms on which the company will continue to wrongfully convert goods, they will face personal liability;<sup>24</sup>
- 3) where it is clear that the DO&E knowingly pursued a course of action that would constitute infringement under the Copyright Act, the DO&E may be personally liable for damages,<sup>25</sup> or
- 4) where employees engaged in a conspiracy with upper management and the controlling mind of the corporation in a “concerted action between the defendants to a common end” and “falsely reporting and concealing material documents.”<sup>26</sup>

Actions running afoul of insolvency statutes (in Alberta such as the *Fraudulent Preferences Act*<sup>27</sup> or *Statute of Elizabeth: in British Columbia the Fraudulent Preference Act*<sup>28</sup>, the *Fraudulent Conveyance Act*<sup>29</sup> or the *Statute of Elizabeth: and in all provinces the Bankruptcy and Insolvency Act*<sup>30</sup>) would also appear to fall within the reasoning of these decisions, thereby not only nullifying the fraudulent or preferential conveyance, but also potentially bringing personal liability upon the heads of DO&E in the event that the fraudulent transaction cannot be completely undone.

Requiring corporations, private or public, to have in place safeguards to prevent fraudulent or deceitful activity of its DO&E is consistent with a policy of holding corporations responsible to society. Although corporations should not be held to a standard of guaranteeing that their DO&E do not engage in fraudulent or deceitful activities, it would seem to be well within public policy norms to have corporations ensure that they have a corporate governance structure in place that reduces the risk of such activities, to a level that is consonant with the reasonable expectations of society.<sup>31</sup>

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23. *Craig v North Shore Heli Logging Ltd.*, (1997) CanLII 2068 (BCSC).

24. *Wah Tat Bank Ltd. v Chan Cheng Kum*, supra, “In the instant case...the...chairman and managing Director of [the company]...agreed with [TSC] the terms on which [the company] would continue wrongfully to convert goods...just as they had done in the past.” at pg 260.

25. *Apple Computer Inc. v MacKintosh Computers Ltd.* (1987), 16 CIPR 15 (Fed CA).

26. XY, supra, where the personal defendants were liable both in tort of deceit (direct liability) and civil conspiracy.

27. RSA 1980 c. F-18.

28. RSBC 1996 c. 164.

29. RSBC 1996 c 163.

30. SC 1992 c. 27, s. 95.

31. The situation with environmental laws potentially “piercing the corporate veil” is an example of such societal

To this author, requiring corporations (and DO&E) to rely on a due diligence type of defence by ensuring that there are corporate governance safeguards in place to deal with fraudulent or deceitful acts of their DO&E is neither commercially unreasonable nor does it appear to grate as a policy consideration of the courts to require such safeguards. To the contrary, it makes clear to DO&E that the existence of such corporate governance safeguards means they must be individually vigilant not to engage in activity that can attach to them moral blameworthiness or suffer the personal consequences.

#### **Step 4: Is the DO&E Solely Liable:**

On this end of the continuum, the question of how the principle of vicarious liability comports with the identification theory still requires clarification. The Supreme Court of Canada wrestled with the issue of vicarious liability as it relates to sexual abuse of minors by employees of corporate bodies over a number of different cases. These types of cases are at the extreme end of the continuum as it is clear that no corporation would authorise or benefit from this type of aberrant activity. The rules as set out by the SCC would apply in this type of extreme situation to determine if there is corporate liability.

However, when the issue relates to activity which may indirectly benefit the corporation such as fraud, the issue becomes less clear. For example, if the fraudulent actions of the DO&E results in a financial benefit to the corporation, even though the corporation did not authorise such fraudulent actions, the interplay between the identification theory and vicarious liability would need to be clarified.

If there is to be a corporate solution to a corporate problem, then so long as the act of the DO&E has a sufficient nexus to the corporate purposes so as to potentially affix corporate liability in step #2 above, it seems appropriate that the issue of vicarious liability be dealt with at this end of the continuum, since once the plaintiff has satisfied its onus of proving a prima facie case against the corporation in Step #2 above, the corporation should then have the onus of proof to raise the vicarious liability as a defence.

This stepped framework as a tool to set out a consistent and principled approach to piercing the corporate veil provides both predictability and flexibility for all parties. Corporations will know that they require a corporate governance structure in place to be able to set up a due diligence defence which protects both the corporation and the DO&E, DO&E will know that they must avoid actions that can be interpreted to paint them with moral blameworthiness, and injured parties (or at least their legal counsel) will be better able to know when to sue DO&E in their personal capacity and when they should not. For unusual fact situations, the courts will not be put into an overly precise framework which serves as a straitjacket to the exercise of their judicial functions.

#### **The UK Approach: Concealment Principle and Evasion Principle**

This lack of clarity is not limited to Canadian law. The UK Supreme Court in 2 recent cases<sup>32</sup>

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expectations that have been reduced to legislation.

32. *VTB Capital Inc. v Nutritek International Corp.*, [2013] UKSC 3 ("VTB")

("VTB" and "Prest"), grappled with this issue and started with the premise that much of the confusion may arise from the overuse of the phrase "piercing the corporate veil". Although the legal analytical tools set out in *VTB* and *Prest* have not been incorporated into Canadian common law, a discussion of these cases is useful to illustrate a different approach used by the UK Supreme Court in the search for a principled theory of when DO&E are subject to personal liability.

*VTB* and *Prest* set out the theoretical basis on the law applicable to "piercing the corporate veil":

1. The concealment principle; and
2. The evasion principle.

The "concealment principle" does not involve piercing the corporate veil at all. This principle relates to the inquiry as to the legally relevant identity of the real actors. In other words, the "interposition of a company or perhaps several companies so as to conceal the identity of the real actors will not deter the courts from identifying them..."<sup>33</sup> This is a fact finding mission and the court is not disregarding the corporate "facade" but is merely looking behind it to discover the facts which the corporate structure is concealing. Even if this exercise shows that the individual is the "real actor", that in and of itself will not trigger a piercing of the corporate veil.

"The "evasion principle" is different."<sup>34</sup> After determining that there is a "concealment", the court then looks to determine if there exists "a legal right against the person in control of [the company] which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement."<sup>35</sup>

Although these theories have been discussed in Canadian jurisprudential articles<sup>36</sup>, it is not clear whether the "concealment principle" and "evasion principle" will be adopted by Canadian courts or whether they add any clarity to the approach currently used by the Canadian courts, in particular those that adhere to the identification theory.

### **Existing Legal Principles: How Do They Fit**

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*Prest v Petrodel Resources Limited*, [2013] UKSC 34 ("Prest") per Sumption L., "...piercing the corporate veil" is often indiscriminately applied to a range of situations in which the law attributes the acts or property of a corporation to those who control it, but without disregarding its separate legal personality (e.g., joint liability, trust law, equitable remedies or in certain statutory contexts)."

33. *Prest*, supra at para 28.

34. *Prest*, supra at para 28.

35. *Prest* supra at para 61 & 81 ..."a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control".

36. Through the Looking Glass: Recent Developments in Piercing the Corporate Veil; 13-09-29 Banking & Finance Law Review [28 B.F.L.R.] 525 Thomas G. Heintzman, Q.C. & Brandon Kain.

There are a number of other legal principles or theories that the courts in Canada have used to affix personal liability on DO&E. I will discuss these from the perspective of how they fit (or do not fit) into this stepped framework of analysis.

### Alter Ego

In Canada, the courts have used the doctrine of "alter ego" to affix liability to a parent corporation or individual DO&E. In general terms, the doctrine of alter ego applies if:

- 1) a subsidiary corporation is completely dominated and controlled by the parent corporation, so that the former does not function independently;<sup>37</sup> and
- 2) the subsidiary is nothing more than a conduit used by the parent to avoid liability.

This approach raises issues of potential over reach in today's complex society. It is not unusual for corporations involved in activities that are inherently risky such as construction, to structure their affairs by having a general manager or some other lower level manager become the sole director of a single purpose subsidiary corporation created to carry out the particular contract in question. The equipment is leased to this subsidiary by another wholly owned subsidiary of the common parent and it would be unusual that the subsidiary was not subject to the general direction and control of the parent. Although profits and losses would be nominally booked at the subsidiary level, on a consolidated accounting basis, eventually any profits would be directed up to the parent, in accordance with an overall plan set by the parent corporation. The purpose of such a structure implemented by the parent is to avoid liability. Such a corporate structure, which is relatively common in today's society, would fall afoul of a strict application of the alter ego doctrine which may not accord with commercial practices in today's society.<sup>38</sup> This would also apply to the situation where it is an individual that stands in the place of a parent corporation in such a corporate structure.

The additional requirement of finding moral blameworthiness in such a structure would provide a principled approach and clarity as to when the alter ego doctrine applies to pierce the corporate veil.<sup>39</sup> This approach has already been used by the courts to prevent conduct akin to fraud that would otherwise unjustly deprive claimants of their rights<sup>40</sup> so does not add

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37. Six part test for determining whether subsidiary is completely controlled from *Smith Stone and Knight Ltd. v Lord Mayor, Alderman and Citizens of the City of Birmingham*, (1939) 4 All E.R. 116 (KB)

- 1) were the profits treated as profits of the company
- 2) were the persons conducting the business appointed by the parent company
- 3) was the company the head and brain of the trading venture
- 4) did the company govern the adventure
- 5) did the company make the profits by its skill and direction
- 6) was the company in constant and effectual control

See also *Elbow River Marketing Limited Partnership v Canada Clean Fuels Inc.*, 2012 ABCA 328

38. For example see *Abakhan & Associates Inc. v Braydon Investments Ltd.*, 2009 BCCA 521 where adherence to one set of laws may put one afoul of another set of laws, even though there is no intent to deceive.

39. *Phillips v 707739 Alberta Ltd.* 2000 ABQB 139; application to restore appeal dismissed 2001 ABCA 219; leave to appeal dismissed [2002] S.C.C.A. No. 64; see trial decision which sets out that incorporating a corporation for a wrongful act or DO&E directing the corporation to do a wrongful act could result in piercing the corporate veil.

anything that the courts have not already added themselves.

It is foreseeable that there could be situations where a corporate structure is established whereby DO&E have personal liability by taking an interest that is viewed as being a separate identity or interest from that of the corporation without requiring moral blameworthiness, for example in a trust type of situation (see discussion below). In that type of scenario, there would not be a piercing of the corporate veil, rather it would be an attribution of personal liability based upon that separate interest of the DO&E.

### Breach of Trust

Trust law is a special area of the law in which parties are held to very high standards of conduct (*uberimmae fide* - utmost good faith).<sup>41</sup>

The Supreme Court of Canada<sup>42</sup> has held that DO&E who are strangers to a trust, can be personally liable if:

- 1) the DO&E are found to be a constructive trustee of the trust; or
- 2) the DO&E knowingly participated in a breach of trust, either by:
  - a) acting as trustee in receipt and chargeable with the trust property (constructive trusteeship described as "knowing receipt"); or
  - b) knowingly assisting in a dishonest and fraudulent design on the part of the trustees ("knowing assistance"), which is further broken into 2 parts:
    - i) degree of knowledge required:
      - actual, recklessness or willful blindness
      - deemed knowledge if trust is imposed by statute<sup>43</sup>, or if contractual, the knowledge is determined by looking at the familiarity or involvement with the contract
    - ii) nature of the breach - whether the breach of trust is fraudulent and dishonest, not whether the assistance of the stranger (DO&E) is so characterised (i.e. the DO&E will be subject to personal liability even if

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40. *Gregorio v Intrans-Corp et al.* [1994] 18 O.R. (3d) 527 (ONCA)  
see also *Aluminum Company of Canada Limited v The Corporation of the City of Toronto* [1944] SCR 267; *Hovsepian v Westfair Foods Ltd.*, 2001 ABQB 700 where the absence of fraud was a factor in not piercing the corporate veil; *Sun Sudan Oil Co. v Methanex Corp.*, 1992 Can LII 6194 (ABQB).

41. *Sanford v Keech*, 1 W. & T.L.C. 46.

42. *Air Canada v M&C Travel Ltd.* (1991), 2 O.R. (ed) 184 (CA); aff'd SCC [1993] 3 SCR 787; note: the SCC stated that this case did not raise general issues of the personal liability of Directors (i.e. piercing the corporate veil), rather it was resolved on trust principles.

43. e.g. where the Director knowingly participated in the breach of trust in a builders lien act trust, *Henry Electric Ltd. v Farwell* (1985) 29 DLR (4th) 481 (BCCA); *Scott v Riehl* (1958) 15 DLR (2d) 67 (BCSC); where the Director innocently participated in the breach of trust in a mechanics lien; *Horsman Bros. Holdings Ltd. et al v Panton and Panton*, [1976] 3 WWR 746 (BCSC); see also *Trilec Installations Ltd. v Bastion Construction Ltd.* (1982) 135 DLR (3d) 766 (BCCA) where the Director was found personally liable by failing to preserve the trust monies; cf. *Clarkson Co. Ltd. v Canadian Bank of Commerce* (1966), 57 DLR (2d) 193, [1966] SCR 513, a case under the Ontario Mechanics Lien Act where the court held that where a trust exists, the party asserting that the money is not subject to the trust has the onus of proving so.

they are not the constructive trustee so long as they knowingly assisted the trustee in the trustee's fraudulent and dishonest breach of trust).

A receipt of a benefit as a result of the breach is neither sufficient nor a necessary condition for finding personal liability. The SCC also stated that this case did not raise general issues of the personal liability of DO&E (i.e. piercing the corporate veil), rather it was resolved on trust principles.

Depending upon the specific fact situation, the *Air Canada* case falls within one or both of the tests of the identification theory: tort actionable in itself (coupled with moral blameworthiness) or the "separate identity or interest" of the DO&E.

### Duty to Speak

Where DO&E become aware of an actionable misrepresentation (e.g. a statement in a disclosure statement that subsequent to its issue, the DO&E become apprised of information which would make a statement in the disclosure statement untrue), those DO&E may have a duty to speak or risk personal liability for their silence.<sup>44</sup> In addition, DO&E may be required to divulge highly relevant information in order that their statements are not determined to be misrepresentations, even though the statement itself may be truthful to the knowledge of the DO&E.<sup>45</sup>

In order to result in personal liability, the failure to speak would need to be of such a character as to carry with it moral blameworthiness on the part of the DO&E, otherwise only the corporation should face potential liability if breach of the duty to speak rule is actionable per se.

### Tort of Conspiracy

The Supreme Court of Canada has commented that a separate tort of conspiracy may exist under which DO&E could be found to be personally liable.

"Although the law concerning the scope of the tort of conspiracy is far from clear, I am of the opinion that whereas the law of tort does not permit an action against an individual defendant who has caused injury to the plaintiff, the law of tort does recognize a claim against them in combination as the tort of conspiracy if:

- 1) whether the means used by the defendants are lawful or unlawful, the predominant purpose of the defendants conduct is to cause injury to the plaintiff; or

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44. *T-D Bank v Leigh Instruments Ltd.* (1993) 4 BLR (2d) 220 (Ont CJ); quaere whether the principles of actionable non-disclosure may be applicable - see *Alex Tunner et al v Zeljka Novak et al*, [1993] BCD Civ 2255.2-01 BCCA CA 014672; *The Law Relating to Actionable Non-Disclosure and Other Breaches of Duty in Relations of Confidence, Influence and Advantage*, original text by George Spencer Bower, 2d Ed., Sir A.K. Turner and Sutton, R.J., Butterworth, 1990 at page 5 and 36.

45. *Queen v Cognos*, supra "There are many reported cases in which a failure to divulge highly relevant information is a pertinent consideration in determining whether a misrepresentation was negligently made...".

- 2) where the conduct of the defendants is unlawful, the conduct is directed towards the plaintiff (alone or together with others), and the defendants should know in the circumstances that injury to the plaintiff is likely to and does result."<sup>46</sup>

This second test has been restated as follows:

"For the appellants to be liable for the tort of unlawful conduct conspiracy, the following elements must therefore be present: (a) they act in combination, that is, in concert by agreement or with a common design; (b) their conduct is unlawful; (c) their conduct is directed towards the respondents; (d) the appellants should know that, in the circumstances, injury to the respondents is likely to result; and (e) their conduct causes injury to the respondents."<sup>47</sup>

Since by definition "conspiracy" means the actions of 2 or more persons, the conduct of the DO&E must be such that it is a separate actionable conduct of the DO&E and not merely conduct occurring qua director, or even qua an employee.<sup>48</sup> Requiring moral blameworthiness on the actions of the DO&E in order to create 2 liabilities for one action would represent a consistent and principled approach to piercing the corporate veil based on a conspiracy theory.

#### Contract Law: Good Faith and Honesty

Requiring moral blameworthiness as a condition of finding personal liability of DO&E would also appear to fit within the contractual obligations for parties to adhere to a standard of good faith and honesty in fulfilling their contractual duties.<sup>49</sup> Even if a corporation is found to have breached its duty of good faith thereby bringing about corporate liability, unless the DO&E engaged in actions that the court finds have the stench of personal moral blameworthiness, then there should be no finding of personal liability of DO&E.<sup>50</sup> Indeed, requiring DO&E to avoid acts that are associated with moral blameworthiness is similar to requiring honesty in the performance of contractual obligations: "A rule of honest performance [or avoidance of moral blameworthiness] in my view will promote, not detract from, certainty in commercial dealings."<sup>51</sup>

#### Statutory Provisions: Environmental Liabilities

In addition to the common law theories which can invite personal liability upon the head of the

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46. *Canada Cement LaFarge Ltd. v British Columbia Lightweight Aggregate Ltd.* (1983), 145 DLR (3d) 385 at 398 (SCC) per Estey, J.

47. *Agribrands Purina v Kasamakos*, 2011 ONCA 450 at para 26; *HSBC Bank Canada v Fuss*, 2013 ABCA 235 at para 1.

48. *XY*, supra.

49. *Bhasin v Hrynew*, 2014 SCC 71.

50. It should be noted that in *Bhasin*, the court did not attribute personal liability under the legal theory of conspiracy since it ultimately found that there was no breach of contract.

51. *Bhasin*, op cit per Cromwell, J. at para 80

unwary DO&E, as can be expected, there is a myriad of statutory provisions, hundreds or thousands across Canada, under which DO&E can be pursued in their personal capacity. It is beyond the scope of this article to set out all the statutory requirements that must be met in order to avoid bringing personal liability down on the head of DO&E.

However, I will illustrate how statutory environmental considerations already play a role in DO&E personal liability planning in the form of creating a due diligence defence.

Most DO&E are aware of the potential personal liability arising out of environmental legislation. The reach of this type of legislation is long and may even catch occupiers of land which had no connection with the original pollution of the land, a version of “no-fault liability”. The following is an illustration of the differences between environmental statutory provisions that DO&E need to keep in mind when operating in different jurisdictions:

Alberta: DO&E may have personal liability if they "directed, authorized, assented to, acquiesced in or participate in the commission of the offence..."<sup>52</sup>

British Columbia: DO&E may have personal liability if they are the one who "authorizes, permits or acquiesces in the offence..."<sup>53</sup>

Ontario: DO&E may have personal liability if they do not take "all reasonable care" to prevent the corporation from committing the offence.<sup>54</sup>

In general terms, it would appear that DO&E under the Ontario legislation have the highest standard to meet ("all reasonable care"), next is BC ("permits" appears to encompass a lack of care rather than a positive action resulting in environmental damage) and next is Alberta (where a positive action or failure to act on actual knowledge which results in environmental damage appears to be required). What steps the DO&E would need to take in order to establish a due diligence defence differs for each province. Although it is beyond the scope of this article to delve into the nuances of how different legislative provisions affect the potential personal liability of DO&E, it is instructive that some existing statutory provisions require DO&E to consider how to create a corporate governance structure in the form of a corporate environmental audit, in order to reduce their risk of personal liability. Also, depending upon the province where their corporate activity is regulated, what is required by DO&E will differ, which is a fact of life and not contrary to public policy considerations. Therefore it is a relatively short policy step to require DO&E to consider a similar type of corporate governance structure to mitigate their risk of personal liability in the arena of “piercing the corporate veil” in the fashion that is suggested in this article. Ultimately, if they do not institute such a structure, that is their free choice.

## **Conclusion**

This discussion sets out some of the issues surrounding DO&E’s liability. The law is ever

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52. Environmental Protection and Enhancement Act SA 1992 c E-13.3 s.218.

53. Environmental Assessment Act, SBC 2002, c 43 s. 41 (4).

54. Environmental Protection Act RSO 1990, c E s. 194.

changing and sophisticated DO&E need to ensure that they keep up with these changes in order to avoid inadvertently exposing themselves to personal liability simply by acting as a DO&E of a corporation.

Although the courts are not to look for moral blameworthiness as the basis of determining liability in a negligence situation,<sup>55</sup> the case law indicates that many if not most cases of “piercing the corporate veil” rely upon a finding of fraud or deceit, even where the basis of such liability is founded on negligent misrepresentation. Perhaps it is time to revisit this notion of moral blameworthiness in the case of piercing the corporate veil. Since a corporation has a separate legal existence, for one act of the DO&E to result in 2 liabilities, requiring an extra level of proof is within the reasonable expectations of all parties in our modern society.

Starting with the *Salomon* principle that a corporation is a separate legal entity, the only way that that separate legal entity can act is through its DO&E. The DO&E making that phone call or picking up that pen or designing that building is the act of the corporation, not that of the DO&E in their personal capacity. It is the premise of this article that the current state of the common law still does not completely accept the *Salomon* principle of the separate legal existence of corporations. What this means from a practical point of view is that individual DO&E are swept up into lawsuits just for opposing counsel to be safe, for not to do so could mean a negligence suit against the plaintiff's lawyer in the future.

We live in a society where we deal with corporations on a daily basis. It is generally accepted that when we speak to the representative of the telephone company, or the bank, or the grocery store, that we do not believe that they are acting in their personal capacity. If something is not satisfactory, we want to speak to their supervisor. We understand that these representatives act for and are the corporation, and that the corporation is responsible for their actions.

By adhering to the identification theory, we accept the *Salomon* principle as the starting point – the action of the DO&E is the action of the corporation, not that of the DO&E. If there is to be further action against the DO&E personally, then there must be something more: an independent tort or a separate identify or interest.

It is where the “independent tort or separate identity or interest” hits the “personal liability” road that the common law remains unclear.

For corporate liability, the ordinary rules related to determining liability apply. For example, moral blameworthiness has little bearing on determining whether a corporation is negligent (as opposed to fraudulent).<sup>56</sup> Perhaps in the arena of piercing the corporate veil, we need to return to the pre-Hedley Byrne state of law where a misrepresentation or other actionable negligence by DO&E needs to be accompanied by moral blameworthiness in order to support an action to pierce the corporate veil and affix personal liability on DO&E.

In reviewing the case law, it appears that the courts have done just that. This approach, if articulated as the basis for piercing the corporate veil, rather than in a piecemeal fashion as

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55. *Queen v Cognos*, supra.

56. *Queen v Cognos*, supra “Although the representor's subjective belief in the accuracy of the representations and his moral blameworthiness, or lack thereof, are highly relevant when considering whether or not a misrepresentation was fraudulently made, they serve little, if any, purpose in an inquiry into negligence.”

currently appears to be the case, would provide the framework for a principled approach to the subject matter. For DO&E, it would provide a sensible policy statement which specifically clarifies that engaging in any actions that could be viewed as having an element of moral blameworthiness will result in personal liability for the DO&E. For society dealing with corporations, little changes except we will know that DO&E have been warned. For we lawyers, it will have the salutary effect of clarifying when it is appropriate to pursue DO&E in their personal capacities rather than a shotgun approach of naming the DO&E as defendants, just in case.

We live in a world of corporations which have become indispensable in our modern society. It is the premise of this article that the common law needs to fully recognise the separate legal existence of corporations and to stop attempting to anthropomorphize the actions of DO&E. The actions of DO&E are the actions of the corporation. If there is to be personal liability, if there is to be a finding of 2 liabilities for one act, then there must be something more than conduct that is actionable per se sufficient to affix liability on the corporation. Recognising the identification theory and requiring a finding of moral blameworthiness on the part of DO&E is that something more.

This approach creates a corporate law solution to a corporate law issue. It is time that we finally accept that corporations are here to stay and that they have a separate legal existence.



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