Focus BUSINESS LAW

Lifting the corporate veil a rare occurrence

Shareholders and directors have faced liability, but only in exceptional cases

Anna Wong

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Corporate law is by and large built on a legal fiction: the fiction of the corporation as an entity separate from its shareholders, directors and officers. This conferral of separate identity allows corporations to operate as people by owning properties, entering into contracts, suing and being sued.

Flowing from separate corporate personality is the concept of limited liability, one of the key advantages of incorporating. Simply stated, neither a company's shareholders nor directors acting in their corporate capacity are personally liable for its debts and obligations.

As to every rule there is an exception. Courts have the power to pierce the corporate veil and affix liability on a company's shareholders and directors when the circumstances warrant it. Precisely what circumstances warrant veil-piercing, other than when it is required by statute? See, for instance, the exceptions to shareholder immunity referenced in s. 45 of the *Canada Business Corporations Act* and directors' liability for back wages pursuant to s. 119 of the *Act*.

The starting point is *Constitution Insurance Co. of Canada v. Kosmopoulos* [1987] 1 SCR 2. In *Kosmopoulos*, our top court observed that the law on when a court may lift the corporate veil "follows no consistent principle" and "the best that it can be said" is that the corporate veil should be lifted when not to do so "would yield a result 'too flagrantly opposed to justice, convenience or the interest of the Revenue.' "

Building on the dictum in *Kosmopoulos*, the Court of Appeal made clear in *Shoppers Drug Mart Inc. v. 6470360 Canada Inc.* [2014] ONCA 85, leave to appeal to SCC refused [2014] SCCA No. 119, that "only exceptional cases that result in flagrant injustice warrant going behind the corporate veil." Such exceptional cases include:

- where those in control of the corporation have expressly directed a wrongful act to be done;
- when the company is incorporated for an illegal, fraudulent or improper purpose;
- where the company is completely dominated and controlled, and being used as a shield for fraudulent or improper conduct.

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A test based on consideration of justice is arguably vague, offering little guidance as to when the separate legal personality of a corporate entity might be disregarded. That said, certain insights can be gleaned from a survey of the jurisprudence.

Courts have been more willing to pierce the corporate veil in scenarios involving closely held corporations. In *Tarion Warranty Corp. v. 1518162 Ontario Inc.* [2015] ONSC 6532, Tarion sued an unregistered vendor of a new home, as well as the owner of the vendor company, for reimbursement of monies paid out of the guarantee fund to the purchasers of the home. Justice S.E. Firestone was persuaded to look behind the corporate veil to impose liability on the owner as he was the sole officer, director and controlling mind of the corporate defendant and knowingly concurred in his company's violation of the statutory warranty. Other examples of judicial veil-piercing of narrowly held companies can be found in *Shoppers*; *Spartek Systems Inc. v. Brown* [2014] ABQB 526; *Legace v. 7678347 Canada Inc.* [2015] O.J. No. 5370; and *Jin v. Ren* [2015] ABQB 115.

On occasion, it is the controlling mind of a company who seeks to have the corporate veil lifted, as was the case in *Kosmopoulos*. There, a company's assets were damaged in a fire. The fire insurance policy was issued in its sole shareholder's name. Madam Justice Bertha Wilson refused to pierce the corporate veil so as to permit the shareholder to assert an ownership interest in the company's damaged assets for the purposes of recovering under his insurance policy, remarking that: "Having chosen to receive the benefits of incorporation, he should not be allowed to escape its burdens. He should not be permitted to 'blow hot and cold' at the same time."

Parent companies can be liable for the obligations entered into by their subsidiaries by piercing the corporate veils of the related companies. Nonetheless, courts are loath to do so. As Justice Jon Sigurdson explained in *Emtwo Properties Inc. v. Cineplex (Western Canada) Inc.* [2011] BCSC 1072: "The circumstances in which the Court will lift the veil and impose the contractual liability of a subsidiary on a parent require more than the exercise of total control by the parent over the subsidiary. The corporate veil will not be pierced absent conduct akin to fraud."

Lifting the veil may be regarded as a means of last resort where liability cannot be fixed on the basis of some other principles. For example, in *B.G. Preeco I (Pacific Coast) Ltd. v. Bon Street Holdings Ltd.*, [1989] BCJ No. 1032 (CA), the plaintiff thought it was entering into an contract with Bon Street Developments Ltd., a company with assets, but the principals had changed the name of that company and incorporated a shell company with the original company's name. The shell company, which has no assets, breached the contract. In addition to suing the companies, the plaintiff sued the principals. After considering the law on corporate veil-piercing, Seaton J.A. ruled that "the proper remedy is not to lift the corporate veil, but to award damages for fraud against the individuals and the company that committed the fraud."

All in all, if there is any certainty to be found in the case law, it is that judicial discretion to pierce the corporate veil is exercised cautiously.

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Risk: Experienced funders can help counsel and plaintiff with due diligence

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of reasons: they lack the means to pursue complex litigation; they prefer to use their money for their own growth and projects rather than for litigation; they wish to transfer the risk of litigation to a financer; or they need to level the playing field against a well-funded defendant.

Control of the litigation remains with the plaintiff, but experienced funders can also assist counsel and the plaintiff in the due diligence for a case and with high level strategic planning. The fact that a claim is funded may also improve the prospects of settlement, as the defendant understands that an experienced, independent and objective commercial entity considers the claim to be of sufficient strength to merit funding and that the plaintiff cannot be outspent or worn down in a war of attrition. Interlocutory skirmishes may also become futile.

Litigation funding may be particularly helpful with intellectual property litigation, where there is often a disparity of resources preventing meritorious cases from being advanced, and where clients prefer to focus their resources on their own research and development. In addition, in-house counsel often tire of being "cost centres" and litigation funding enables them to take a turn as a "profit centre."

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Given recent developments of jurisprudence, including *Schenk*, international funders are turning their attention to Canada, and are likely to play a growing role in litigation in the future.

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