

## Piercing the Corporate Veil – An Update



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As long ago as 1897, the principle was established that a corporation is a separate and distinct entity from its shareholders and, as such, shareholders are afforded limited liability. There are recognized exceptions to this general rule, where a corporation has been used as an instrument of fraud and improper conduct, if it is a “sham” or was incorporated for no valid business purpose. Another exception where the courts have visited liability on a corporation’s shareholders/directors is where the court views the corporation to be a mere agent or puppet of the controlling mind.

There are numerous cases where the plaintiff alleged the court should pierce the corporate veil.

For example, in the recent case of *2066209 Ontario Inc. v. Tannis*,<sup>2</sup> the plaintiff entered into negotiations with the defendant’s principal, Tannis, of defendant restaurant franchisor to provide services for putting on poker tournaments at one of the sports bars operating under the franchisor’s logo. When the plaintiff’s invoices were not paid, the plaintiff brought an action in the Small Claims Court against Tannis and five related corporate defendants. The action was allowed against the corporate defendant operating the bar (now bankrupt) and against Tannis personally. The trial judge decided that he did not need to pierce the corporate veil in order to find Tannis personally liable for the debt to the plaintiff, but found him personally liable on other grounds. On Appeal to the Divisional Court, Aitken J. reversed the trial judgment and went on to state the following:

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<sup>2</sup> 299 O.A.C. 190, 2012 CarswellOnt 14837, 224 A.C.W.S. (3d) 208, 2012 ONSC 6665 (Ont. Div. Ct. Nov 23, 2012).

30 To pierce the corporate veil, the actions of the defendant must be said to have been "fraudulent, dishonest and deceitful". "As the corporate veil cannot be used as a shield for misconduct or fraud, liability may be extended to the principals of a corporation where they have engaged in this type of conduct..." (*Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd.*, 2000 ABCA 116 (Alta. C.A.), at para. 23).

31 The Ontario Court of Appeal in *Montreal Trust Co. of Canada v. ScotiaMcLeod Inc.*(1995), 26 O.R. (3d) 481 (Ont. C.A.), at para. 25, provided a useful summary of the circumstances under which the corporate veil can be pierced to render directors and officers of a company liable:

The decided cases in which employees and officers of companies have been found personally liable for actions ostensibly carried out under a corporate name are fact-specific. In the absence of findings of **fraud, deceit, dishonesty or want of authority** on the part of employees or officers, they are also rare. Those cases in which the corporate veil has been pierced usually involve transactions where the use of the corporate structure was a sham from the outset or was an afterthought to a deal which had gone sour. There is also a considerable body of case-law wherein injured parties to actions for breach of contract have attempted to extend liability to the principals of the company by pleading that the principals were privy to the tort of inducing breach of contract between the company and the plaintiff: see *Ontario Store Fixtures Inc. v. Mmmuffins Inc.* (1989), 70 O.R. (2d) 42 (H.C.J.), and the cases referred to therein. Additionally there have been attempts by injured parties to attach liability to the principals of failed businesses through insolvency litigation. In every case, however, the facts giving rise to personal liability were specifically pleaded. Absent allegations which fit within the categories described above, 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.

[Emphasis added.]

The Court determined that the findings of the trial judge did not fit within the categories of "fraud, deceit, dishonesty or want of authority." The judgment against Tannis personally was set aside and replaced by a judgment in the same amount against the corporate franchisor.

In a recent British Columbia decision,<sup>3</sup> the Court held all of the directors of a defendant corporation personally liable. The defendant, Gabriel, engaged the claimant, SPC Holdings, to do extensive roofing work. Gabriel considered the work deficient and challenged SPC Holdings' invoices. SPC Holdings sued Gabriel to enforce payment of invoices, while Gabriel counterclaimed for the cost of having the roof repaired. SPC Holdings' claims were dismissed and Gabriel's claim was allowed. Gabriel applied for a

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<sup>3</sup> *SPC Holdings and Construction Ltd. v. Gabriel*, 2013 CarswellBC 495, 2013 BCPC 31.

declaration that SPC Holdings' directors and Ms. Zhou, the wife of one of the directors, should all be held personally liable for the amount of his counterclaim.

The claim was allowed in part:

12 ...SPC Holdings is an incorporated entity and it follows that the SPC Holdings Directors presumptively enjoy the protection of the corporate veil which distinguishes them from SPC Holdings itself and shields them from liabilities incurred by SPC Holdings. The presumption is a robust one. In the words of Lowry J.A. (Low and Chiasson, JJ.A. concurring), "[t]he separate legal personality of the corporation will not be lightly disregarded": *Edgington v. Mulek Estate* (2008), 86 B.C.L.R. (4th) 78 (B.C. C.A.). However, the protection from company liabilities that is afforded by the corporate veil to directors and shareholders is not absolute.

13 In the often-cited Ontario decision of *Clarkson Co. v. Zhelka*, [1967] 2 O.R. 565 (Ont. H.C.), Thomson J. observed that it would be "flagrantly opposed to justice" for a court to allow the corporate veil to protect a company's "corporators" where:

- (a) the company was formed for the express purpose of committing a wrongful act;
- (b) once the company was formed, those in control of it expressly directed a wrongful act;
- (c) the company is a sham — that is, a mere agent, or façade or alter ego, of a controlling corporator; or
- (d) clear and express statutory provisions permit the lifting of the corporate veil.

The Court decided that in the circumstances of this case, SPC Holdings was a sham and its directors' conduct warranted piercing the corporate veil. The directors were held jointly and severally liable, while Ms. Zhou was not a director and did not have the authority to guide the corporations activities, and was therefore not held liable.

In another recent decision,<sup>4</sup> the Provincial Court of Saskatchewan refused to pierce the corporate veil to hold individual employees of a corporation liable for the corporation's negligence. The individual defendants were employees of the corporate defendant, Evelet Home Improvements Ltd. The plaintiff contracted with the defendant to install tile and other related products. The plaintiff subsequently alleged that the corporation and its employees had performed the work negligently, suing the two employees as being the "guiding mind and will" of the corporation for damages.

The action was allowed in part, although the Court determined that piercing the corporate veil was not appropriate in this case. Plaintiff's contracts were specifically with the corporation. Even though the two employees were the "guiding mind", this is not uncommon in closely held corporations.

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<sup>4</sup> 617359 *Saskatchewan Ltd. v. Evelet Home Improvements Ltd.*, 2013 CarswellSask 136, 2013 SKPC 27.

As one can see, the law on when the corporate veil can be pierced “follows no consistent principle.” There are, however, some principles that have emerged from the cases that could assist those behind a corporation (often the sole shareholder, director, officer) in avoiding having the corporate veil being pierced:

1. Keep minutes of directors/shareholders meetings even where there are only 2 or 3 directors or shareholders. A number of U.S. cases use the keeping of minutes as an important criteria for maintaining separate existence.
2. Where possible, a corporation which has a sole shareholder, often another corporation, should make sure that directors and officers are not exactly the same in both corporations.
3. The corporation should be self-sufficient if possible and the parent or sole shareholder should not pay its bills. Taking security for loans made is permissible and encouraged.
4. Each of parent-subs should have its own separate telephone/fax numbers, and ideally separate offices or premises.
5. The shareholder/director should ensure there is not a perception that they are interchangeable with the corporation.

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