

A THESIS REGARDING THE CIVIL LIABILITY OF DIRECTORS FOR CRIMINALLY OR NEAR CRIMINALLY CULPABLE ACTS

By Bill McNally¹ and Barb Cotton²

Introduction

There is much academic³ and judicial⁴ discussion of the potential liability of directors for tortious and other acts, but little focus on the potential liability of directors for criminally or near criminally culpable acts. (These “near criminally culpable” acts are frequently in the nature of intentional torts.) This article will therefore seek to provide this focus.

A difficulty is that the case law does not articulate that a different standard is being applied to impose civil liability on directors when their conduct goes beyond that which is relatively benign and becomes criminally or near criminally culpable. A close reading of the case law indicates that many courts are applying different standards, however, and, in general, a lower threshold for liability for criminally or near criminally culpable behaviour.

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³ For example, David Goddard, “Corporate Personality – Limited Recourse and its Limits” in R. Grantham & C. Rickett, eds., *Corporate Personality in the 20th Century* (Oxford: Hart Publishing, 1998); Anne Marie Frauts and Adrien P. Cameron, “Officers’ and Directors’ Liability – Lessons From the Court” (2003), 27 *Advocates’ Quarterly* 155; David Debenham, “The Scylla of Motions Court and the Charybdis of the Court of Appeal: The Scope of Directors’ and Officers’ Common Law Liabilities in the Post-ADGA Era” (2001), 25 *Advocates’ Quarterly* 21; Robert Flannigan, “The Personal Tort Liability of Directors” (2002), 81 *Can. Bar Rev.* 247; Christopher C. Nicholls, “Liability of Corporate Officers and Directors to Third Parties” (2001), 35 *Can. Bus. L.J.* 1 and Janis Sarra, “The Corporate Veil Lifted: Director and Officer Liability to Third Parties” (2001), 35 *Can. Bus. L.J.* 55.

⁴ See *ADGA Systems International Ltd. v. Valcom Ltd.* (1999), 43 O.R. (3d) 101; *Jim Pattison Developments Ltd. v. Fudex International Inc.* (1996), 191 A.R. 282; *Hovsepian v. Westfair Foods Ltd.* (2001), 296 A.R. 283; *Blacklaws v. Morrow* (2000), 261 A.R. 28; *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.* (1995), 26 O.R. (3d) 481; *Normart Management Ltd. v. West Hill Redevelopment Co.* (1998), 37 O.R. (3d) 97.

Perhaps this is due to the underlying policy concern, recently expressed by the Supreme Court of Canada with respect to a defendant that was breaching the *Criminal Code*,⁵ that a criminal should not be permitted to keep the proceeds of his or her crime.

The starting point is the celebrated case of *Salomon v. Salomon*,⁶ in which it was held that a corporation is a separate entity distinct from its shareholders and that a legally incorporated company has rights and liabilities of its own. On the premise of this separate legal identity of a corporation a corporate veil is thus created in which the actions of the directors are held to be the actions of the corporation, and any liability arising from those acts attaches to the corporation and not the individual.⁷

Directors are frequently held liable for their tortious and other behavior, however, either directly or by “lifting the corporate veil.” The current bell-wether case for imposition of liability on directors appears to be *ADGA Systems International Ltd. v. Valcom Ltd.*,⁸ a 1999 decision of the Ontario Court of Appeal. Although this case did much to cut away some of the obfuscation that had been introduced into the law regarding directors’ liability,⁹ subsequent case law seems to retain a requirement that there be “ownership” of the offending act by the director, over and above the director acting in the ordinary course of his or her duties.¹⁰ This is illustrated by the 2000 Alberta Court of Appeal decision of *Blacklaws v. Morrow*¹¹ in which Fraser C.J.A., for the majority, stated that the acts of a director could attract liability “where those actions are themselves tortious or exhibit a

⁵ Per Iacobucci J., for the court, in *Garland v. Consumers’ Gas Co.*, [2004] 1 S.C.R. 629 at para. 57 [1895-9] All E.R. 33 (H.L.)

⁶ Paraphrasing Berger J.A. in *Blacklaws v. Morrow* (2000), 261 A.R. 28

⁷ (1999), 43 O.R. (3d) 101, leave to appeal to the Supreme Court of Canada dismissed at [1999] S.C.C.A 124

⁸ Robert Flannigan, “The Personal Liability of Directors” (2002), 81 *Can. Bar Rev.* 247 at 292, 293.

⁹ For example see: *Meditrust Healthcare Inc. v. Shoppers Drug Mart, a division of Imasco Retail Inc.* (1999), 124 O.A.C. 137; *Immocreek Corp. v. Pretiosa Enterprises Ltd.* (2000), 186 D.L.R. (4th) 36; *Kay Aviation b.v. v. Rofe* (2001), 199 Nfld. & P.E.I.R. 339; *Dorus v. Taylor* (2003), 11 B.C.L.R. (4th) 260; *Glenayre Manufacturing Ltd. v. Pilot Pacific Properties Inc.* (2003), 26 C.L.R. (3d) 112. For an implicit expansion on this theory of the requirement for “ownership” see David Debenham, “The Scylla of Motions Court and the Charybdis of the Court of Appeal: The Scope of Directors’ and Officers’ Common Law Liabilities in the Post-ADGA Era” (2001), 25 *Advocates’ Quarterly* 20.

¹⁰ (2000), 261 A.R. 28

separate identity of interest from that of the corporation so as to make the act or conduct complained of their own...”¹²

This higher threshold of “ownership”¹³ does not, in general, seem to be required when the conduct of the director approaches criminal or near criminal culpability. There have been judicial efforts to incorporate such a requirement of “ownership” with respect to criminal or near criminal culpability,¹⁴ but such efforts have been resiled from.¹⁵

The cases dealing with conduct amounting to criminal or near criminal culpability frequently frame the issue of a director’s liability as being one of “lifting the corporate veil”. A director can also be held to be directly liable, of course, if, as noted by David Debenham,¹⁶ “participation is in the first degree”. Debenham cites¹⁷ the early Canadian case of *Cline v. Mountainview Cheese Factory*¹⁸ as stating:

“It is perfectly novel to hear it discussed, whether or not a corporation may sanction the acts of their directors, who have undertaken, by their direction, to do something wholly illegal, such as the infringement of a patent....It is new to hear it said that, the directors who have been guilty of such an act and can be made responsible for it, are not to be made defendants to a suit-and can say they are answerable for the consequences of their acts in that suit; because, forsooth, they have done it by the direction of a limited company. If so, there would be no end to the mischief and injury that might be committed by individuals choosing to act under the sanction of a company who has given those orders. This

¹² At paragraph 41, applying the *ratio* of Finlayson J.A. in *ScotiaMcLeod Inc.v. Peoples Jewellers Ltd.* (1995), 26 O.R. (3d) 481.

This is sometimes referred to as the “identification” theory, but as there are several postulations of an “identification” theory, the authors will refrain from using this term.

¹⁴ *Mentmore Manufacturing Co. v. National Merchandise Manufacturing Co.* (1978), 89 D.L.R. (3d) 195; *Whitehorse Distillers Limited and others v. Gregson Associates Limited and others*, [1984] R.P.C. 61

¹⁵ *C. Evans & Sons Ltd. v. Spritebrand Ltd. and another*, [1985] 2 All. E.R. 415; *Kalamazoo (Aust) Pty Ltd. v. Compact Business Systems Pty Ltd. and others*, (1985), 5 I.P.R. 213; *MCA Records Inc. and another v. Charley Records Ltd. and others* [2001] EWCA Civ 1441; [2003] 1 BCLC 93; *Tschritter v. Rent Cash Inc.*, [2004] A.J. No. 900; *Bellows v. Quick Cash Ltd.*, [2004] N.J. No. 352

¹⁶ In “Return to the Beaten Path?: Directors’ and Employees’ Liability for Intellectual Property Torts after *Mentmore*” (2003), 16 I.P.J. 527

¹⁷ At p. 536

¹⁸ (1873) CarswellOnt 37; (1873) 20 Gr. 227 at 232, per Blake V.C. applying Lord Hatherley in *Betts v. De Vitre* 11 Jur. N.S., reheard L.R. 3 Ch. Ap. 429, in appeal L.R. 5 H.L. 1

Court has always been in the habit of holding that anybody who takes part in a wrong of this description, is liable to be restrained from committing the wrong... I apprehend that every one of those agents might, if doing an actual wrong, be made a defendant to the suit, and personally and individually be made to pay the costs of it; and it is no justification for him to say that his master ordered him to do it..."

It seems that it can be generalized that directors will be held to be directly liable or there will be a "lifting of the corporate veil" such as to impose civil liability on directors for criminally or near criminally culpable acts in the following circumstances: (1) where the corporation was formed for the express purpose of doing a wrongful or unlawful act; (2) when the director either expressly or impliedly directed or procured that a wrongful thing be done; (3) where the corporation is being used as a cloak to cover fraud or improper conduct; and (4) where it would be "flagrantly opposed to justice" not to lift the corporate veil and impose liability.¹⁹

Most of the jurisprudence regarding the first two circumstances stems from England and has been developed throughout the Commonwealth, although there is independent Canadian jurisprudence supporting these principles.²⁰ On the other hand, it seems that the circumstance of being "flagrantly opposed to justice" as a basis for lifting the corporate veil and imposing civil liability on directors is a uniquely Canadian approach.

Let us now take a closer look at the circumstances giving rise to the imposition of civil liability on directors for criminally or near criminally culpable acts.

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Canadian Encyclopedic Digest (Western) (3d) "Corporations" paragraph 84
See *Cline v. Mountain View Cheese Factory* 1873 CarswellOnt. 37; 20 Gr. 227; *Tschritter v. Rent Cash Inc.*, [2004] A.J. No. 900; *Bellows v. Quick Cash Ltd.*, [2004] N.J. No. 352; *Mackey v. Doyle*, [2004] N.J. No. 358

A corporation was formed for the express purpose of doing a wrongful or unlawful act, or the directors expressly or impliedly directed or procured that a wrongful thing be done

These two circumstances will be examined together as they are intertwined in the case law.

Professor Bruce Welling in *Corporate Law In Canada* has articulated that civil liability will accrue to directors in these circumstances in his statement that: “. . . there is a somewhat confused notion that judges can disregard corporate entity whenever a corporation was created or managed for nefarious purposes.”²¹

This principle has an early articulation in Canadian jurisprudence in *Cline v. Mountain View Cheese Factory*,²² a decision of Blake V.C. of the Court of Chancery of Ontario. In this case Blake V.C. stated: “I should most unwillingly have come to the conclusion that while a plaintiff is entitled to relief against the company, those persons who are responsible for the act, who set the machine in motion, – whereby the wrong complained of is accomplished, could not be reached by the proceedings in which the plaintiff succeeds in obtaining relief against the corporation, which without them, would have no existence. It would, to my mind, be a grievous wrong to enable these defendants, guilty of such acts as this bill complains of, to shelter themselves behind a company, because the liability under its charter is limited, . . .”

The seminal case articulating this principle, however, is *Rainham Chemical Works, Ltd. and others v. Belvedere Fish Guano Co., Ltd.*,²³ a decision of the House of Lords. In this case, by a contract dated August 24, 1915, Feldman and Partridge undertook to make picric acid for the Minister of Munitions. On September 10, 1915 they obtained from the landlords an agreement for the tenancy of certain land on which they built factories. On

²¹ B. Welling, *Corporate Law In Canada – The Governing Principles*, 2nd ed. (Toronto: Butterworths, 1991), pp. 124-25

²² 1873 CarswellOnt. 37; 20 Gr. 227 at 233

²³ [1921] All E.R. Rep. 48

March 17, 1916, a company was incorporated to acquire the business of manufacturing the picric acid from Feldman and Partridge, who became sole governing directors with “full control of the business of the company”. On March 22, 1916 an agreement was entered into between Feldman and Partridge and the company under which Feldman and Partridge agreed to sell to the company the benefit of the tenancy agreement and the buildings erected on the land, to provide materials and money for expenses until the company was in a position to manufacture picric acid commercially, and to allow the company to go into possession of the premises as tenants until the purchase price had been paid, but until that was done the company was deemed to be in possession of the premises as their agents. No consent to assign the premises to the company was obtained by Feldman and Partridge, and the company never paid the purchase price under the agreement of March 22, 1916.

To manufacture picric acid it was necessary that explosive material be brought onto the premises, and this was done with the knowledge of Feldman and Partridge, but neither of them interfered in any way in the manufacture of the picric acid or had any responsibility regarding the place or mode of storage of the explosive material. On September 14, 1916, an explosion occurred at the factory and adjoining land holders sued for damages.

In the result it was held that Feldman and Partridge were not personally liable as directors of the company, although they were liable under the doctrine of *Rylands v. Fletcher*.²⁴

In this oft-applied seminal passage²⁵ Lord Buckmaster stated:

“ . . . If the company was really trading independently on its own account, the fact that it was directed by Messrs Feldman and Partridge would not render them responsible for its tortious acts unless, indeed, they were acts expressly directed by them. **If a company is formed for the express purpose of doing a wrongful act, or if, when formed, those in control expressly directed a wrongful thing be done, the individuals as well as the company are responsible for the consequences, . . .**” (Emphasis added.)

²⁴ (1868) LR 3 HL 330

²⁵ At p. 52

Subsequently this principle was enlarged to incorporate implicit as well as express acts of directors. Thus in the leading case of *Performing Rights Society Limited v. Caryl Theatrical Syndicate Limited*,²⁶ Atkin L.J. stated: “. . . If the directors themselves directed or procured the commission of the act they would be liable in whatever sense they did so, whether expressly or impliedly . . .”²⁷

A case illustrating these principles is *T. Oertli A.G. v. E.J. Bowman (London) LD et al.*,²⁸ a decision of the English High Court of Justice – Chancery Division, which involved the intentional tort of patent infringement.

In this case T. Oertli A.G., a Swiss corporation, owned a patent for mixing machines known as “Turmix”. In 1948 the Swiss corporation granted to P. Ld. an exclusive license to sell the mixing machines in the United Kingdom. Owing to difficulties in arranging for the manufacture of the machines in the United Kingdom P. Ld. became unwilling to carry out the arrangement and it was informally agreed that E.J. Bowman (London) Ld. should take over the marketing of the machines. There were considerable sales of the machines in the United Kingdom but, in November, 1949, the Swiss corporation terminated the license agreement on the ground of non-payment of royalties.

E.J. Bowman (London) Ld. then commenced to sell the mixing machines under the name “Magimix” in a scheme held by the court to infringe the patent rights of the Swiss corporation. Some of the machines which had been made while the license was in force bore the mark “Turmix”, and this was simply pasted over and sold as a “Magimix” machine. E.J. Bowman (London) Ld., also sent out a circular suggesting that the Magimix machines were simply an improved version of the Turmix machines they had been selling under the license.

²⁶ [1924] 1 K.B. 1

²⁷ At p. 15

²⁸ [1956] R.P.C. 282

In 1952 the Swiss corporation commenced an action against E.J. Bowman (London) Ld. and the directors of E.J. Bowman (London) Ld., alleging that they had maliciously conspired to injure the plaintiff and that they had passed off and were passing off their goods as the goods of the Swiss corporation.

The plaintiffs were successful in their action and Roxburgh J. examined in some detail what acts of the directors had given rise to their civil liability. Roxburgh J. commenced by noting the authority of *Rainham* that the directors could be liable as joint tortfeasors if their company had been formed for the express purpose of doing a wrongful act or, if, when formed, those in control expressly directed that a wrongful thing be done. He noted that the E.J. Bowman (London) Ld. corporation had never carried on a legitimate business and that it had adopted and carried on a deliberate policy of wrongdoing, although not originally created for that purpose. The company was directed into a tortious policy and, for formulating the policy of the company, the directors were responsible. The company could not act on its own; its policy must be directed by its directors. Moreover, on the facts, it had been proven that the directors had acted in concert, although informally and without holding proper board meetings or keeping proper minutes. The instructions to infringe the patents must have come from the directors. As all three directors had taken part in formulating the company's deceptive marketing policy they were liable as joint tortfeasors.

Another case frequently referred to as imposing civil liability for culpable behaviour of directors is *Yuille v. B. & B. Fisheries (Leigh), Ltd. and Bates (The "Radiant")*.²⁹ In this case the skipper of a fishing vessel had his legs amputated when they were caught in a coil of wire while their vessel was being taken under tow. The skipper claimed against the ship owning company and against the managing director of the company, alleging that the accident was due to unseaworthiness of both the rescuing vessel and The Radiant. It was held that the defective condition of the vessels had led to the accident, and that the director was liable because he had sent the vessels to sea when he knew, or ought to have

²⁹ [1958] 2 Lloyd's Rep. 596

known, that they were not in a seaworthy condition. Thus his culpable behaviour led to the imposition of civil liability in the circumstances.

Another leading case is *Wah Tat Bank Ltd. and another v. Chan Cheng Kum*,³⁰ a decision of the Privy Council on appeal from the Court of Appeal of Singapore. In this case two banks brought an action in the High Court of Malaysia against a shipping company and the company's chairman and managing director, claiming damages jointly against them for the intentional tort of conversion. Judgment was entered against the company but the issue of the managing director's liability was remitted for retrial. The case is of significance in that it states that a tort may be committed through an officer or servant of a company without the chairman or managing director being in any way implicated; however, if the chairman or managing director procures or directs the commission of the tort he may be personally liable for the damage flowing from it. Each case depends on its own particular facts-it must be assessed whether the director has procured or directed the commission of the tort in such a fashion as to give rise to liability.

Just to recap, the early English authorities established that a director could be civilly liable for culpable behaviour: (1) if the company was formed for a wrongful or unlawful purpose; (2) or if the director expressly or impliedly directed or procured the commission of the culpable act. The Canadian case of *Mentmore Manufacturing Co. v. National Merchandise Manufacturing Co.*,³¹ a decision of the Federal Court of Appeal per Le Dain J., threw a spanner into the works, however, and seemingly elevated the threshold of liability such that the director must in some sense "own" the culpable act, in addition to directing or procuring its commission.

The *Mentmore* decision also involved the intentional tort of patent infringement, and it should be noted that the trial judge had applied the *Rainham* test. Le Dain J. fashioned a

³⁰ [1975] A.C. 507

³¹ (1978), 89 D.L.R. (3d) 195

new test, however, and the following passages are flagged in the subsequent jurisprudence as key:³²

“What is involved here is a very difficult question of policy. On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. On the other hand, there is the principle that everyone should answer for his tortious acts. The balancing of these two considerations in the field of patent infringement is particularly difficult. This arises from the fact that the acts of manufacture and sale which are ultimately held by a Court to constitute infringement are the general business activity of a corporation which its directors and officers may be presumed to have authorized or directed, at least in a general way. Questions of validity and infringement are often fraught with considerable uncertainty requiring long and expensive trials to resolve. It would render the offices of director or principal officer unduly hazardous if the degree of direction normally required in the management of a corporation’s manufacturing and selling activity could by itself make the director or officer personally liable for infringement by his company . . .

What, however, is the kind of participation in the acts of the company that should give rise to personal liability? It is an elusive question. It would appear to be **that degree in kind of personal involvement by which the director or officer makes the tortious act his own**. It is obviously a question of fact to be decided on the circumstances of each case. I have not found much assistance in the particular case in which Courts have concluded that the facts were such as to warrant personal liability. But there would appear to have been in these cases **a knowing, deliberate, willful quality to the participation; . . .**” (Emphasis added.)

There has been some academic challenge to Le Dain J’s conclusion that there was indeed a “very difficult question of policy”, at all.³³ But it is Le Dain J.’s comments that the director must “make the tortious act his own” and demonstrate a “knowing, deliberate, willful quality to the participation” that are cited as elevating the threshold test of liability.

³² At pp. 202, 203

³³ Robert Flannigan, “The Personal Liability of Directors” (2002), 81 *Can. Bar Rev.* 247 at 280, 281

In England Nourse J. in *Whitehorse Distillers Limited and others v. Gregson Associates Limited and others*,³⁴ extracted this higher threshold from *Mentmore*, and ran with it. The *Whitehorse Distillers* case also involved the intentional tort of patent infringement, and Nourse J. held that in order to impose personal liabilities on directors for a tort committed by the company, the director must not only commit or direct the tortious act or conduct but he must do so deliberately or recklessly and so as to make it his own, as distinct from the act or conduct of his company. It was unnecessary for him to know, or have the means of knowing, that the act or conduct was tortious; it was enough if he knew or ought to have known that it was likely to be tortious. In doing so Nourse J. recognized that he was raising the threshold of civil liability for directors from what it had been under the *Rainham* test.³⁵

The English courts have subsequently stepped back from these higher thresholds stipulated in *Mentmore* and *Whitehorse Distillers*. The first retreat was articulated in *C. Evans & Sons Ltd. v. Spritebrand Ltd. and another*,³⁶ a decision of the English Court of Appeal, Civil Division. This case also involved patent infringement. Slade L.J. first referred back to the decision of *Rainham* and articulated that a director could be personally liable for tortious acts of his company where he has ordered or procured them to be done. After referring to the higher threshold in *Mentmore*, Slade L.J. stated: "... but I am not, for my part, convinced that any of them would support a proposition that a knowing, deliberate, willful quality to the participation is in all cases an essential condition precedent to the personal liability under discussion". After then reviewing *Whitehorse Distillers*, Slade L.J. stated that Nourse J. had expressed the principles in terms that were not sufficiently qualified. He further stated that in every case where it was sought to make a director liable for his company's torts it was necessary to examine with care what part he played personally in regard to the act or acts complained of.

The retreat from the higher threshold in *Mentmore* and *Whitehorse Distillers* was clearly articulated in the Australian case of *Kalamazoo (Aust) Pty Ltd. v. Compact Business*

³⁴ [1984] R.P.C. 61

³⁵ At pp. 91-92

³⁶ [1985] 2 All. E.R. 415

Systems Pty Ltd. and others,³⁷ a decision of Thomas J. of the Supreme Court of Queensland. In this case, again involving patent infringement, the defendant company had clearly infringed the plaintiff's copyright in a number of business records systems over the course of a number of years by simply copying them and appropriating them for their own use. It was sought to make the directors of the defendant company liable as well. Thomas J. stated:

“ . . . A deal of English authority has held that a director is liable for those tortious acts of his company which he has ordered or procured to be done (*Performing Rights Society, Limited v. Ciry l Theatrical Syndicate Limited*, [1924] 1 KB 1 at 14; *Wah Tat Bank Limited v. Chan Cheng Kum*, [1975] A.C. 507 at 514-5). Recently, the Court of Appeal in *C. Evans Ltd. v. Spritebrand Ltd.*, [1985] 1 W.L.R. 317 had occasion to consider the propriety of the joinder of directors in an action for infringement of copyright. Whilst leaving open the degree of authorization, direction or procurement necessary before a director may properly be included as a defendant, the court expressly rejected the suggestion that it must be proved that a director knew that the acts authorized were wrongful or that he was reckless as to the possibility. It does not automatically follow that a director of a company will be guilty along with his company of any tort that the company commits, even though the company be small and his control over it effective (see *C. Evans Ltd. v. Spritebrand Ltd.*, *supra*, at p. 329). However, the discussion in that case suggests that in the usual course a director who procures or directs his company to perform a tortious act will be liable along with the company.

The evidence in the present case shows that Mr. Crossley and Mr. Spollen personally ran the company at all material times and that they were responsible for authorizing and directing the particular course which the company followed. I am therefore constrained to hold that they are equally liable with the defendant company.

And thus in *Kalamazoo* the test for liability of a director for a culpable act seems to have been taken back to the original articulation set out in *Rainham*.

In Canada, the Federal Court of Canada – Trial Division, shortly following the *Kalamazoo* case, had no difficulty in imposing personal liability on directors for a patent

³⁷ (1985), 5 I.P.R. 213

infringement.³⁸ The court did not take the opportunity to articulate the principles involved, however.

In England recently there has been another attempt to expand upon the basic *Rainham* test. The case of *MCA Records Inc. and another v. Charley Records Ltd. and others*,³⁹ a decision of the English Court of Appeal (Civil Division), again involved patent infringement. In this case it was alleged that the defendant company did not hold the right to publish certain recordings and it was sought to make the director liable. The trial judge had imposed liability on the director on the basis that in order to make a director personally liable for a company's torts it was necessary either to show that he himself was the person who committed or participated in the act constituting the tort or that he had directed or procured the tortious act to be done by others.

The English Court of Appeal per Chadwick L.J. reviewed the involvement of the director and found that there was no doubt that he was part of the corporate governance of the company and that he exercised the ultimate influence over it. The decisions as to strategy and policy and the overall ultimate control of the company were his, even though he did not carry out decisions on a day to day basis. He did not participate in the copying of the unauthorized recordings; this was done by others. His role was essentially a directorial one. He had fully supported the activities, however, and had intended that they should continue as long as possible. He had the authority to stop the infringing recordings, but he did not. Although he gave no express direction or any express resolution to the effect that the recordings should be made it was not necessary to prove the making of an express direction or procurement.

Chadwick L.J. referred to *Rainham* and its seminal test, as modified by *Performing Rights Society Ltd. v. Cyril Theatrical Syndicate Ltd.*, and the other leading authorities. He then concluded:

³⁸ *Apple Computer Inc. v. Macintosh Computers Ltd.* (1986), 10 C.P.R. (3d) 1; varied on another point at (1987), 18 C.P.R. (3d) 129; affirmed at [1990] 2 S.C.R. 209.

³⁹ [2001] EWCA Civ 1441; [2003] 1 BCLC 93

“First, a director will not be treated as liable with a company as a joint tortfeasor if he does no more than carry out his constitutional role in the governance of the company – that is to say, by voting at board meetings. That, I think, is what policy requires if a proper recognition is to be given to the identity of the company as a separate legal person. Nor, as it seems to me, will it be right to hold a controlling shareholder liable as a joint tortfeasor if he does no more than exercise his power of control through the constitutional organs of the company – for example by voting at general meetings and by exercising the powers to appoint directors . . . if all that a director is doing is carrying out the duties entrusted to him as such by the company under its constitution, the circumstances in which it would be right to hold him liable as a joint tortfeasor with a company would be rare indeed . . .

Second, there is no reason why a person who happens to be a director or controlling shareholder of a company should not be liable with the company as a joint tortfeasor if he is not exercising control through the constitutional organs of the company and the circumstances are such that he would be so liable if he were not a director or controlling shareholder. In other words, if, in relation to the wrongful acts which are the subject of complaint, the liability of the individual as a joint tortfeasor with a company arises from his participation or involvement in ways which go beyond the exercise of constitutional control, then there is no reason why the individual should escape liability because he could have procured those same acts through the exercise of constitutional control . . .

Third, the question whether the individual is liable with a company as a joint tortfeasor – at least in the field of intellectual property – is to be determined under principles identified in *CBS Songs Ltd. v. Amstrad Consumer Electronics plc* [1988] 2 All E.R. 484. . . In particular, liability as a joint tortfeasor may arise where . . . the individual “intends and procures and shares a common design that the infringement take place”.

Fourth, whether or not there is a separate tort of procuring an infringement of a statutory right, actionable at common law, an individual who does “intend, procure and share a common design” that the infringement should take place may be liable as a joint tortfeasor. As Mustill L.J. pointed out in *Unilever plc v. Gillette (U.K.) Ltd.* [[1989] RPC 583] procurement may lead to a common design and so give rise to liability under both heads.

In the light of the authorities which I have reviewed I am satisfied that no criticism can be made of the test which the judge applied. But, in my view, the test can, perhaps be expressed more accurately in these terms: in order to hold Mr. Young liable as a joint tortfeasor for acts of copying, and of issuing to the public, in respect of which CRL was the primary infringer and in circumstances in which he was not himself a person who committed

or participated directly in those acts, it was necessary and sufficient to find that he procured or induced those acts to be done by CRL or that, in some other way, he and CRL joined together in concerted action to secure that those acts were done.”

Thus it would seem that this case has, in effect, taken the test back to that of the original test in *Rainham*, subject to some refinements.

Rainham has been recently applied in Canada. In the case of *Tschritter v. Rent Cash Inc.*,⁴⁰ a decision of Hawco J. of the Alberta Court of Queen’s Bench, the defendant sought to strike out a statement of claim seeking damages within a class action context for charging a criminal rate of interest in their payday loan operation. Hawco J. took note of the seminal test in *Rainham*.⁴¹ The defendants had argued that as there were no facts directly pleaded to establish the personal liability of the directors the courts should not lift the corporate veil to assess liability as against them. Hawco J. referred to the basic jurisprudence governing the test for tortious behaviour of directors, but seems to have recognized that a different test applies for criminally culpable behaviour. He applied *Rainham*, and refused to strike out the statement of claim as against the directors.

This recognition that there is a different test for tortious as opposed to criminally or near criminally culpable behaviour in assessing civil liability as against directors was made in a similar context in the subsequent case of *Bellows v. Quick Cash Ltd.*⁴² In this case Goulding J. of the Newfoundland and Labrador Supreme Court – Trial Division also dealt with an application seeking to strike out a class action claim as against the directors of payday loan defendants. Goulding J. noted the defendant directors’ arguments that as there were no allegations of fraud, misrepresentations, or tortious conduct or individual acts by the individual directors, they could not be found personally liable for the acts of the corporate defendant, and he reviewed key cases on tortious liability of directors. He then also implicitly recognized that a different standard was imposed for criminally

⁴⁰ [2004] A.J. No. 900; 2004 ABQB 590

⁴¹ Quoted with approval in *Wawanesa Mutual Insurance Co. v. J.A. (Fred) Chalmers & Co.* (1969), 69 W.W.R. 612

⁴² [2004] N.J. No. 352; 2004 NLSCTD 191

culpable behaviour and applied the *Rainham* test and the uniquely Canadian approach which allows the corporate veil to be lifted if not to do so would be “flagrantly opposed to justice” to deny the application (to be discussed subsequently herein). He stated:

“Counsel for the Plaintiff has satisfied me that courts have found personal liability of the directors where to fail to do so would yield a result that is “flagrantly opposed to justice”. Further, if a company is formed for the express purpose of doing a wrongful act, or if, when formed, those in control expressly direct that a wrongful thing be done, the individuals as well as the company are responsible for the consequences.”

Not to Lift the Corporate Veil Would be “Flagrantly Opposed to Justice”

There seems to be a uniquely Canadian basis upon which civil liability can be imposed upon directors for criminally or near criminally culpable acts, that is, that it would be “flagrantly opposed to justice” not to be lift the corporate veil. This principle is not accepted throughout Canada and has been challenged in Ontario. However, there does appear to be sufficient *dicta* to suggest that it is a viable basis upon which directors can be found liable.

The root of this principle would appear to be the case of *Clarkson Co. Ltd. v. Zhelka et al.*,⁴³ a 1967 decision of Thompson J. of the Ontario High Court of Justice. In this case the court refused to lift the corporate veil to impose liability on a bankrupt who had conducted the affairs of a family of companies with a view to delaying and hindering his creditors. The application was brought not on behalf of the creditors but on behalf of the trustee for the benefit of the bankrupt’s personal creditors. Although it was held that the debtor’s affairs could not have been more complex and confusing if he had purposely set out to delay and hinder his own creditors, there was no evidence that the debtor transferred any assets to the companies at any time when he was insolvent or that he actually received any of the corporations’ income or assets, and thus there was no impropriety upon which the court could fasten, nor any sufficient reason to label any of the corporations an agent or alter ego of the debtor.

⁴³ [1967] 2 O.R. 565

Thompson J. did state, however, in an oft-applied dicta:⁴⁴

“The cases in which the Courts, both in this Province and in England, have seen fit to disregard the corporate entity or personality, and instead to consider the economic realities behind the legal façade, fall within a narrow compass. The Legislature, in the fields of revenue and taxation, and particularly with respect to true subsidiaries, has made much greater departure in this respect. Such cases as there are, illustrate no consistent principle. The only principle laid down is that in the leading case of *Saloman v. Saloman & Co., Ltd.*, [1897] A.C. 22; and in general such principle has been rigidly applied. Briefly stated, it is that the legal *persona* created by incorporation is an entity distinct from its shareholders and directors and that even in the case of a one-man company, the company is not an alias for the owner. **The exceptions would appear to represent refusals to apply the logic of the *Saloman* case where it would be flagrantly opposed to justice.** (Emphasis added.)

This *dicta* was echoed in *Kosmopoulos v. Constitution Insurance Co. of Canada*,⁴⁵ a decision of the Supreme Court of Canada. In this case the respondent Kosmopoulos incorporated his leather goods business and became sole shareholder and director of the company. Virtually all documentation required in the business continued to refer to the sole proprietorship and made no reference to the company and the lease continued in the respondent’s name. The fire insurance policy showed the insured as being a sole proprietorship even though the insurance agency was well aware of the fact that the business was being carried on by the incorporated company. A fire in the adjoining premises damaged the company’s assets and the rented premises. When the insurance company refused payment on proof of loss, an action was commenced. The issue in the case became whether Kosmopoulos, as sole shareholder, had an insurable interest in the assets of the corporation. The trial judge held that Mr. Kosmopoulos could not recover on the policy for the destruction of the assets of the business because these were owned by the company, and this was upheld on appeal.

⁴⁴ At pp. 577, 578

⁴⁵ [1987] 1 S.C.R. 2

With respect to “lifting the corporate veil”, Wilson J., for the majority of the Supreme Court of Canada, stated:⁴⁶

“As a general rule a corporation is a legal entity distinct from its shareholders: *Saloman v. Saloman & Co.* . . . The law on when a court may disregard this principle by “lifting the corporate veil” and regarding the company as a mere “agent” or a “puppet” of its controlling shareholder or a parent corporation follows no consistent principle. **The best that can be said is that the “separate entities” principle is not enforced when it would yield a result “too flagrantly opposed to justice, convenience or the interest of the Revenue”:** . . .” (Emphasis added.)

This “just and equitable test” seemed to also have been adopted by the Ontario Court of Appeal in *642947 Ontario Limited v. Fleischer*⁴⁷ This case involved an action over entitlement to land by commercial real estate developers. The owners of Dreams Delights Inc., Halasi and Krauss, were found personally liable by the trial judge. Laskin J.A., for the court, stated:⁴⁸

“Halasi and Krauss’s second argument is that the trial judge disregarded well-known principles of corporate law in holding them personally liable. In my opinion, however, the trial judge took the correct view in concluding...that “Krauss and Halasi cannot hide behind the corporate veil”. To pierce the corporate veil is to disregard the separate legal personality of a corporation, a fundamental principle of corporate law recognized in *Saloman v. Saloman & Co.* . . . **Only exceptional cases – cases where applying the *Saloman* principle would be “flagrantly” unjust – warrant going behind the company and imposing personal liability.** Thus, in *Clarkson Co. v. Zhelka* . . . Thompson J. held that instances in which the corporate veil has been pierced “represent refusals to apply the logic of the *Saloman* case where it would be flagrantly opposed to justice”. Similarly, Wilson J. observed in *Kosmopolous v. Constitution Insurance Co.* . . . that the law on when the corporate veil can be pierced “follows no consistent principle. The best that can be said is that the ‘separate entities’ principle is not enforced when it would yield a result ‘too flagrantly opposed to justice, convenience or the interests of the Revenue.’ L.C.B. Gower, *Modern Company Law* (4th ed. 1979), at 112”.

⁴⁶ At pp. 10, 11
⁴⁷ (2001), 56 O.R. (3d) 417
⁴⁸ At pp. 439, 440

Typically, the corporate veil is pierced when the company is incorporated for an illegal, fraudulent or improper purpose. But it can also be pierced if when incorporated “those in control expressly direct a wrongful thing to be done”: *Clarkson Co. v. Zhelka* at p. 578. Sharpe J. set out a useful statement of the guiding principle in *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.*...: “the courts will disregard the separate legal personality of a corporate entity where it is completely dominated and controlled and being used as a shield for fraudulent or improper conduct”.

These authorities indicate that the decision to pierce the corporate veil will depend on the context. They also indicate that the separate legal personality of the corporation cannot be lightly set aside . . . (Emphasis added.)

In this case it was found that Halasi and Krauss had made an undertaking to the court when they knew they had no assets to satisfy the undertaking. Halasi was a sophisticated developer and Krauss was a lawyer. They tendered a worthless undertaking to gain an advantage. When called on to honour the undertaking they tried to hide behind a shell company, which they controlled, to escape liability.

In view of this improper conduct, they were held liable.

The earlier Ontario case of *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.*,⁴⁹ referred to by Wilson J. in *642947 Ontario Limited v. Fleischer*, does not endorse the “flagrantly opposed to justice” “just and equitable test”. In this case the defendant Canada Life Mortgage Services Ltd. (“CLMS”) was a wholly owned subsidiary of the defendant Canada Life Assurance Company (“C Ltd.”). It was managed and operated independently of C Ltd. CLMS management exercised independent discretion in conducting the business of CLMS. A number of the mortgage loans made by the plaintiff which had been arranged by CLMS fell into default. The plaintiff claimed that CLMS owed it a duty to do the underwriting for these loans, that it failed in that regard, and that the plaintiff suffered loss as a consequence. The terms of the Master Agreement which governed the relationship of the plaintiff and CLMS did not

⁴⁹ (1996), 28 O.R. (3d) 423, affirmed at [1997] O.J. No. 3754

specifically provide that CLMS was to perform any underwriting function on the plaintiff's behalf, and CLMS took the position that the agreement excluded this duty. The plaintiff sued CLMS for damages for breach of contract etc. and also sued C Ltd., asserting that C Ltd. was liable for the wrongs of CLMS. C Ltd. moved for summary judgment dismissing the action against it, and was successful.

Sharpe J. stated that there was "far too much (read) into a dictum plainly not intended to constitute an in-depth analysis of an important area of the law or to reverse a legal principle which, for almost one hundred years, had served as a cornerstone of corporate law", in seeking to extend the principle that the corporate veil could be lifted if it was flagrantly opposed to justice. He noted that since *Kosmopolous* had applied the "just and equitable" test it had not been subsequently applied and, in that case Wilson J. had rejected the submission that the corporate veil be lifted. He noted the comment of Welling in *Corporate Law in Canada*⁵⁰ that there was not a general fairness test, as follows:

"Little need be said about this rationale, other than that it simply will not do. There are, so far as we know, no such broadly enforceable standards of "fair play and good conscience," at least in Canadian corporate law."

He further noted that the 5th edition of Gower, *Modern Company Law*,⁵¹ had put the test for lifting the corporate veil in much more stringent terms than the 4th edition, and quoted the conclusion in Gower, as follows:⁵²

"There seems to be three circumstances only in which the court can do so [lift the corporate veil]. These are:

- "(1) When the court is construing a statute, contract or other document.

⁵⁰ Bruce Welling, *Corporate Law In Canada: the Governing Principles* (Toronto: Butterworths, 1984), at p. 129

⁵¹ L.C.B. Gower, *Gower's Principles of Modern Company Law* (5thed.) (London: Sweet & Maxwell, 1992)

⁵² At p. 433

- (2) When the court is satisfied that a company is a “mere façade” construing the true facts.
- (3) When it can be established that the company is an authorized agent of its controllers or its members, corporate or human.”

Sharpe J. then concluded:⁵³

“There are undoubtedly situations where justice requires that the corporate veil be lifted. The cases and authorities already cited indicate that it will be difficult to define precisely when the corporate veil is to be lifted, but that lack of a precise test does not mean that a court is free to act as it pleases on some loosely defined “just and equitable” standard . . .

As just indicated, the courts will disregard the separate legal personality of a corporate entity where it is completely dominated and controlled and being used as a shield for fraudulent or improper conduct. The first element, “complete control”, requires more than ownership. It must be shown that there is complete domination and that the subsidiary company does not, in fact, function independently . . .

The second element relates to the nature of the conduct: is there “conduct akin to fraud that would otherwise unjustly deprive claimants of their rights”? . . .”

This retreat from the “flagrantly opposed to justice” just and equitable test is also reflected in other Ontario cases.⁵⁴ Nevertheless, Goulding J. of the Newfoundland and Labrador Supreme Court – Trial Division seemed ready to apply such a principle in the recent case of *Bellows v. Quick Cash Ltd.*⁵⁵ As has been noted, he refused to strike out a claim against directors of a payday loan company, notwithstanding there were no allegations of fraud, misrepresentations or tortious conduct against the individual defendants, holding: “Counsel for the Plaintiff has satisfied me that courts have found personal liability of the directors where to fail to do so would yield a result that is “flagrantly opposed to justice”.

⁵³ At pp. 433, 434

⁵⁴ *Clancy & Co. v. Church*, [1999] O.J. No. 23, (1999), 88 O.T.C. 248; *United Canadian Malt Ltd. v. Outboard Marine Corp. of Canada* (2000), 48 O.R. (3d) 352

⁵⁵ [2004] N.J. No. 352; 2004 NLSCTD 191

The Corporation is a Cloak for Fraud or Improper Conduct

A somewhat more traditional basis of liability of directors is based on the clearly culpable behaviour of fraud or improper conduct.

This basis has been recently applied in the Alberta Court of Queen's Bench case of *Halpern Investments Ltd. v. Sovereign General Insurance Co.*⁵⁶ In this case David Halpern was the sole shareholder and sole director of two corporations, Halpern Investments Ltd. and Regal Management Ltd., that respectively owned and managed various buildings in the downtown Calgary core. Mr. Halpern and the two corporations were all co-insured under a business protector insurance policy that insured the buildings against losses arising from fire. On July 25, 1994, a fire occurred at one of the insured apartment buildings and damage was sustained throughout the building. Subsequent to the fire six proofs of loss, all sworn by David Halpern, were presented to the insurers. One of the proofs of loss was determined to have been fraudulently submitted and David Halpern was personally charged with the fraud under the *Criminal Code of Canada*. The insurers therefore denied payment of coverage pursuant to one of the statutory conditions of the policy negating payment in the event of fraud. At issue in the case was whether the claim of Halpern Investments Ltd. was vitiated by the admitted criminal fraud of its co-insured Regal Management and of David Halpern.

The insurers argued that Mr. Halpern was the guiding hand behind the two corporations and that he and the companies were indistinguishable from each other at law. As such they submitted that the court should intervene to lift the corporate veil to find that the statutory condition applied to prevent payment.

Clark J. reviewed the principles in *Kosmopolous, Transamerica Life Insurance Co. of Canada* and *642947 Ontario Ltd. v. Fleischer* and concluded: "Thus, the law is clear – where fraud or improper conduct has been committed by a corporation's shareholders or

⁵⁶ [2004] A.J. No. 1376; 2004 ABQB 865

controlling minds, the corporate veil may be lifted.” The plaintiff’s action for payment of the insurance coverage was therefore dismissed.

Another Alberta case wherein the corporate veil was lifted because of fraud or improper conduct is *McCardell v. Tisi Holdings Co.*,⁵⁷ a decision of Master Quinn of the Alberta Court of Queen’s Bench. In this case the plaintiff sued for the return of the purchase price of a car, alleging misrepresentation by the vendor. It was held that it would be unjust in the circumstances to allow the plaintiff to have judgment against the corporate defendant alone, and the corporate veil was lifted.

For other illustrative cases see *Phillips v. 707739 Alberta*;⁵⁸ *Sturrock v. Antcona Petroleum Ltd.*;⁵⁹ *Shillingford v. Dalbridge Group Inc.*;⁶⁰ *Le Car GmbH v. Dusty Roads Holdings Ltd.*⁶¹ and *Triple Three Holdings Inc. v. Jan.*⁶²

One of the conceptual bases upon which liability of directors is imposed for fraud or improper conduct is because the acts of the directors are akin to aiding and abetting, similar to the criminal offense. David Debenham discusses this within the context of the directors being a “participant of the second degree” for the crime committed by the corporation.⁶³ Debenham notes that:

“To be a participant of the second degree, it is well established that the participant be aware of the common design and actively assist it. A person who merely facilitates the commission of the tort is not a participant unless their assistance is given pursuant to, and in furtherance of, the common design. As Professor Fleming puts it in his celebrated text on The Law of Torts [J.G. Fleming, *The Law of Torts*, 9th ed. (Sydney: Law Book Co., 1998)]:

⁵⁷ (1992), 133 A.R. 340

⁵⁸ (2000), 259 A.R. 201, application for leave to appeal to the Supreme Court of Canada dismissed at [2002] S.C.C.A. No. 64

⁵⁹ (1990), 111 A.R. 86

⁶⁰ (1996), 197 A.R. 56

⁶¹ (2004), 222 N.S.R. (2d) 279

⁶² [2004] O.J. No. 2749; [2004] O.T.C. 561

⁶³ David Debenham, “Return to the Beaten Path?: Directors’ and Employees’ Liability for Intellectual Property Torts After *Mentmore* (2003), 16 I.P.J. 527 at 531, 532

“While the requisite degree of participation has not been precisely defined in modern decisions, there is cogent support both in principle and ancient authority for the suggestion that it may well correspond with the description attached by the criminal law to principles in the first and second degree. This would include, besides the actual perpetrator, anyone who “aids and abets”, whether or not he actively intervenes. Knowingly assisting, encouraging or merely being present as a conspirator at the commission of the wrong would suffice.”

This approach of imposing civil liability on directors for “aiding and abetting” the corporation is illustrated in the case of *C.C. Petroleum Ltd. (c.o.d. Budget Petroleum) v. Allen*,⁶⁴ a decision of O’Driscoll J. of the Ontario Superior Court of Justice. This case dealt with a claim for damages that resulted from the fraudulent conduct of a company and its officers and shareholders. At trial it was established that the company Payrite had relied on creative accounting practices known as cheque kiting to shuffle money between accounts in order to fraudulently mispay Payrites’ account balances. The plaintiff was a creditor of Payrite that relied on the account information to its detriment. The corporate officers were shown to have knowingly made payments to relatives that were fraudulent. As of 1996 the company was actually insolvent, but the status was concealed from its creditors. As a result, they were able to make purchases from the plaintiff that they never intended to pay for.

At trial it was established that Payrite was a closely held corporation owned by the wives of the corporate officers and directors. In determining that the defendant directors were personally liable for the damages, O’Driscoll J. stated:⁶⁵

“The male Defendants, while witnesses, boast that they were the guiding minds of Payrite. The female Defendants held the shares of Payrite, were part-time employees of Payrite and were the wives of the “guiding minds”. It does not lie in the mouths of any of the Defendants that she/he did not know what the others were doing. It was one large fraud with full participation and mutual aiding and abetting by all four (4) Defendants.

⁶⁴ [2002] O.J. No. 2499

⁶⁵ at para. 65

The cheques may have been payable to Karen Allen and Yvette Allen but it cannot be argued that their husbands did not knowingly benefit because they engineered it.

O’Driscoll J. went on to find that the fraudulent conduct of all the Defendants was “planned and deliberate”. The Defendants knew what each other were doing was wrong. The Defendants all profited from the misconduct. The Defendants also each showed wanton and reckless disregard for the financial survival of the plaintiff.

In the result general damages of \$539,658.41 were awarded against all defendants, together with punitive damages in the amount of \$300,000.

This concept that a director can be liable for aiding and abetting the commission of a criminal offense by the corporation is also embodied in provincial legislation, as is illustrated by the *Fair Trading Act*,⁶⁶ which constitutes a director guilty of an offence committed by the corporation if the director acquiesces or participates in the act or omission of the corporation.⁶⁷

Conclusion

In summary then, it is the thesis of the authors that, although not expressly articulated in the jurisprudence, many courts are applying different standards for criminally or near criminally culpable behaviour of directors, as opposed to more benign behaviour. Although it is difficult to generalize from the current state of Canadian jurisprudence regarding the civil liability of directors for tortious acts and notwithstanding *ADGA Systems International Ltd. v. Valcom Ltd.*, the law has seemingly developed to impose a higher threshold to the extent that the director must “own” the act in a manner that is over and above the ordinary course of their duties. This higher threshold does not seem to be

⁶⁶ *Fair Trading Act*, R.S.A. 2000, c. F-2

⁶⁷ s. 165(1) When a corporation commits an offense under this Act or the regulations, every principal, director, manager, employee or agent of the corporation who authorized the act or omission that constitutes the offense or assented to or acquiesced or participated in the act or omission that constitutes the offense is guilty of the offense whether or not the corporation has been prosecuted for the offense.

strictly necessary with respect to criminally or near criminally culpable acts of directors. Rather, the courts seem to have consistently imposed civil liability on directors for criminally and near criminally culpable acts if: (1) the corporation has been expressly incorporated for an improper or unlawful purpose; (2) the directors have expressly or impliedly directed or procured a wrongful act; or (3) there is fraud or improper conduct on the part of the directors. Within a specifically Canadian context it can also be argued that there is a more fundamental “just and equitable” test such that the corporate veil will be lifted to impose civil liability on directors for culpable conduct if it is “flagrantly opposed to justice” not to do so. Thus, while there may indeed be other circumstances in which the courts will impose civil liability on directors for criminally or near criminally culpable acts, the test for civil liability of directors for such acts appears to be different than the test for liability for more benign behaviour, and, in general, presents a lower threshold.

