An Overview of Cases Suggestive of When the Courts Will Lift a Corporate Veil to Find an Individual Behind the Corporation Jointly and Severally Liable for a Plaintiff's Damages

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Plaintiff's counsel frequently find themselves in the situation where they would like to reach behind a corporate veil and impose liability on an individual as well as the corporation for the plaintiff's damages. When can this be successfully done?

In *Toronto Board of Education* v. *Brunel Construction 2000 Ltd.,* [1997] O.J. No. 3783 (Ont. Gen. Div.) Kiteley J. provides an instructive review of the development of the law respecting lifting a corporate veil.

Kiteley J. begins with the seminal cases of *Clarkson Co. Ltd.* v. *Zhelka et al*. (1967), 64 D.L.R. (2d) 457 (Ont. H.C.) and *Salomon* v. *Salomon,* [1897] A.C. 22 (H.L.).

Clarkson v. Zhelka is frequently cited as authority for the "just and equitable" dictum, a broad principle that a court can lift a corporate veil if it would be "flagrantly opposed to justice" not to do so. This statement of broad principle has been challenged, however.

In *Clarkson v. Zhelka,* the court refused to find that lands held by a family of companies under the control of the bankrupt belonged to the bankrupt. Thompson J. stated at p. 469-470:

> 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 facade, 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 Salomon v. Salomon & Co. Ltd., [1897] A.C. 22 and in general such principle has been rigidly applied .....

> **The exceptions would appear to represent refusals to apply the logic of the Salomon case where it would be flagrantly opposed to justice.**
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> ...in questions of property and capacity, of acts done and rights acquired or liabilities assumed, the company is always an entity distinct from its corporators. It is not an alias or a sham and the principle of the Salomon case stands unimpaired.
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> If a company is formed for the express purpose of doing a wrongful or unlawful act, or, if when formed, those in control expressly direct a wrongful thing to be done, the individuals as well as the company are responsible to those to whom liability is legally owed.
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> In such cases, or where the company is the mere agent of a controlling corporator, it may be said that the company is a sham, cloak or alter ego, but otherwise it should not be so termed.
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> Whether an individual has constituted the company his agent is a question of fact in each case. A controlling or total share interest does not in itself establish such agency. Due regard must be had to the law of principal and agent relating to the formation of the relationship. (Emphasis added.)

Next in the line of cases considered by Kiteley J. was *Constitution Insurance Co. of Canada et al.* v. *Kosmopoulos et al.,* [1987] 1 S.C.R. 2. In *Kosmopoulos,* the Supreme Court of Canada considered whether the sole shareholder and director of a company could recover on an insurance policy which the shareholder had obtained in his own name. Wilson J. stated:

> The law on when a court may disregard this principle by "lifting the corporate veil" and regarding the company as a mere "agent" or "puppet" of its controlling shareholder or 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 interests of the Revenue"**: L.C.B. Gower, Modern Company Law, 4th ed. (1979) at p. 112. I have no doubt that theoretically the veil could be lifted in this case to do justice, as was done in American Indemnity Co. v. Southern Missionary College, supra, cited by the Court of Appeal of Ontario. But a number of factors lead me to think it would be unwise to do so.
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> There is a persuasive argument that "those who have chosen the benefits

> of incorporation must bear the corresponding burdens, so that if the veil is to be lifted at all that should only be done in the interests of third parties who would otherwise suffer as a result of that choice": Gower, supra, at p. 138....
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> ... If the corporate veil were to be lifted in this case, then a very arbitrary and, in my view, indefensible distinction might emerge between companies with more than one shareholder and companies with only one shareholder....
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> ... In addition, it is my view that if the application of a rule leads to harsh justice, the proper course to follow is to examine the rule itself rather than affirm it and attempt to ameliorate its ill effects on a case-by-case basis. (Emphasis added.)

Kiteley J. next considered *Gregorio* v. *Intrans-Corp. et al.* (1994), 18 O.R. (3d) 527 (Ont. C.A.). In that case the Ontario Court of Appeal found that the trial judge had erred in finding liability of a defendant distributor on the basis that it was the alter ego of the defendant truck dealer. At p. 536 of *Gregorio,* the appellate court held:

> Generally, a subsidiary, even a wholly owned subsidiary, will not be found to be the alter ego of its parent unless the subsidiary is under the complete control of the parent and is nothing more than a conduit used by the parent to avoid liability. The alter ego principle is applied to prevent conduct akin to fraud that would otherwise unjustly deprive claimants of their rights....

Kiteley J. also discussed the decision of Sharpe J. in *Transamerica Life Insurance Company of Canada* v. *Canada Life Assurance Co. et al*. (1996), 28 O.R. (3d) 423 (Gen. Div.). Transamerica's submission was that the court should lift the corporate veil whenever it was "just and equitable" to do so, a submission based on the decision of *Kosmopoulos*.

The defendants in *Transamerica* were CLMS, a corporate mortgage correspondent and general financial agent which was a wholly owned subsidiary of Canada Life, and Canada Life. Both were sued by Transamerica for breach of contract, breach of fiduciary duty and misrepresentation in connection with certain mortgage transactions. Canada Life brought a motion for summary judgment to be excluded from the proceedings, which

required a consideration of the circumstances in which the court would lift the corporate veil.

In rejecting Transamerica's "just and equitable" submission, Sharpe J. made the following comments at page 431:

> If accepted, the argument advanced by Transamerica would represent a significant departure from the principle established in Salomon v. Salomon & Co., [1897] A.C. 22 at page 51....
>
> The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.

Sharpe J. also quoted from L.C.B. Gower**,** *Modern Company Law***,** 5th ed. (London: Sweet & Maxwell, 1992) where the test for piercing the corporate veil was articulated as follows:

> There seem to be three circumstances only in which the courts can [pierce the veil]. These are:
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> 1. When the court is construing a statute, contract or other document;
> 2. When the court is satisfied that a company is a "mere facade" concealing the true facts; and
> 3. When it can be established that the company is an authorized agent of its controllers or its members, corporate or human.

[Note: The 4th Edition of L.C.B. Gower**,** *Modern Company Law***,** 1979 provides seven conclusions respecting when the corporate veil can be lifted; caution is warranted in applying the earlier cases which rely on the authority of that edition; see *Ian J. Ward & Co. v. Gilbert,* [1990] B.C.J. No. 2398 (B.C.C.A.).]

Two cases were cited by Sharpe J. in *Transamerica* as examples of where the court refused to apply the "just and equitable" dictum: *W.D. Latimer Co.* v. *Dijon Investments Ltd.* (1992), 12 O.R. (3d) 415 and *801962 Ontario Inc.* v. *MacKenzie Trust Co.*, [1994] O.J. No. 2105.

Sharpe J. concluded at pages 433-434:

> ... 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?"

Transamerica's claim against Canada Life was dismissed.

Following this review of the law, Kiteley J. in *Toronto Board* concluded at para. 29-30 (QL):

> ... the protection afforded to the corporate entity 100 years ago remains intact. The jurisprudence does not suggest that the corporate veil will be pierced where it is "just and equitable" to do so. Rather, the court must examine the elements of control and conduct before taking that important step.

In a comprehensive decision of Rooke J. in *Phillips* v. *707739* (2000), 259 A.R. 201, appealed on separate grounds at (2001), 286 A.R. 367, and with application for leave to appeal to the Supreme Court of Canada dismissed at [2002] S.C.C.A. No. 64**,** opposing counsel agreed upon the applicable legal principles regarding when it was appropriate to lift the corporate veil. Counsel differed only as to whether the facts and available evidence in the case supported or negated the veil's lifting.

Rooke J. cited with approval the following principles from *The Canadian Encyclopaedic Digest (Western),* vol. 8, 3rd ed., (Scarborough: Carswell, 1998), "Corporations" at 83, and *Clarkson v. Zhelka* at pp. 577-78, which were put forth by the plaintiff:

> The separate legal personality of the corporation is often referred to as the "corporate veil", and only in exceptional circumstances will the "veil" be lifted, and officers or shareholders found personally liable. The veil may be lifted where:
>
> 1. ...a corporation is formed for the express purpose of doing a wrongful act;
> 2. ...once incorporated, those in control expressly direct a wrongful thing to be done;
> 3. ...there is fraud;
> 4. ...one [entity] acts as an agent of another;
> 5. ...two seemingly separate [entities] are in fact one enterprise; and
> 6. ...the corporation is a mere agent, or "alter ego', of the controlling shareholder.

Rooke J. also cited *Anderson Exploration Ltd.* v. *Pan-Alberta Gas Ltd*. (1998), 224 A.R. 109 at 112, wherein Chief Justice Moore referenced two older Supreme Court of Canada cases, *Palmolive Manufacturing Co.* v. *R.,* [1933] 2 D.L.R. 81 and *Aluminum Co. of Canada* v. *Toronto,* [1944] 3 D.L.R. 609, for the general principle that:

> ...when a corporation is a mere puppet of another corporation the business is actually that of the controlling corporation. In these cases the controlling corporation was held responsible for certain liabilities of the subsidiary company....

Stressing the importance of "...all the admissible and relevant evidence when considering piercing the corporate veil" Rooke J. stated:

> 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 the 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.

In considering whether 707739 was incorporated to perform a wrongful act, Rooke J. accepted the submissions of the plaintiff's counsel, which were in large part based upon the *Alberta Business Corporations Act.* The evidence in *Phillips* disclosed that no financial statements had been produced by the defendant corporation. Also, despite the fact that the individual behind the corporation, Habib, was an experienced bookkeeper, the company 707739 lacked a bank account, minutes of meetings, directors' resolutions or shareholders' resolutions with respect to the purchase and sale transaction at issue, or at all. No books of account existed, nor any annual returns sent to the registrar as required by statute. Nor were there filed tax returns, or any capitalization to perform the sales transaction. Furthermore, Rooke J. found that:

> Even more significantly, although Habib continues to operate the business that was the Company's, at the same location, and using the same trade name, "Croissant Company", Habib testified that the Company was defunct as of Oct 1997, a year after the transaction. There is no evidence that 707739 is in any way operating the business that was the Company.

It was also found that Habib had pledged his shares in 707739 to his brother-in-law. Taking all of this evidence into account, Rooke J. held that "...all of these arguments [are] supportive of a need to pierce the corporate veil of 707739."

In reaching this conclusion Rooke J. accepted the argument of plaintiff's counsel that it was not one or two but rather "...a series of actions by Habib, which...cumulatively demonstrated an intention by Habib to use 707739 for a fraudulent or improper purpose, and accordingly...Habib should be jointly and severally liable for the judgment herein, along with 707739".

McCardell v. *Tisi Holdings Co. Inc. and Aldo Tisi* (1992), 5 Alta. L.R. (3d) 87 is a frequently cited decision and Rooke J. discussed it in *Phillips*. Rooke J. stated:

> ...[in *McCardell* v. *Tisi*] the plaintiff thought the individual defendant was the owner of the vehicle he purchased, but it was only when signing the sale agreement that he noticed that the corporate defendant was the owner. Master Quinn granted summary judgment jointly and severally against both defendants. The headnote provides:
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> > Although the corporate defendant was the vendor, it might be judgment proof. The corporate veil may be lifted if it is established that not to do so would be flagrantly opposed to justice, due to improper conduct or fraud. In the present circumstances, it would be unjust to award the plaintiff judgment against the corporate defendant alone.

Rooke J. also reviewed the submissions of plaintiff's counsel respecting the law regarding "alter ego". He started with definitions of the doctrine of alter ego:

> Second self. Under doctrine of "alter ego", the court merely disregards corporate entity and holds individual responsible for act[s] knowingly and intentionally done in the name of the corporation ... To establish the "alter ego" doctrine, it must be shown that the stockholders disregarded the entity of the corporation, made corporation a mere conduit for the transaction of their own private business, and that the separate individualities of the corporation and its stockholders in fact ceased to exist ... The doctrine of "alter ego" does not create assets for or in the corporation, but it simply fastens liability on the individual who uses the corporation merely as an instrumentality in conducting his own personal business, and that liability springs from fraud perpetrated not in the corporation, but on third persons dealing with the corporation.
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> J.R. Nolan & J.M. Nolan-Haley, *Black's Law Dictionary*, 6th ed. (St. Paul: West Publishing, 1990), at 77-78.
>
> **...**
>
> If an individual knowingly and intentionally commits a wrongful or inequitable act in the name of the corporation, that individual may be held personally liable under the alter ego doctrine.
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> *Ivy v. Plyler*, 54 Cal. Rptr. 894 (C.A. 1966) at 897, 899

...

An individual who seeks to mask his activities behind the corporate fiction need not own every share in order for liability to be found. The court should consider whether the corporation is in the effective control of the individual and that preservation of separate corporate existence would work a fraud or an injustice. In deciding to disregard the corporate entity, the court will consider whether the corporation is adequately capitalized.

> *O'Donnell v. Weintraub*, 67 Cal. Rptr. 274 (C.A. 1968) at 277-78

...

The corporate veil may be lifted under the alter ego doctrine when the corporation is organized and operated as a mere tool or conduit of another corporation or individual. Courts will look to the total dealings of the corporation and individual in each case to determine whether the corporate veil should be lifted. Specific factors include: absence of corporate formalities; inadequate capitalization; degree to which corporate and individual property have been separated; amount of financial interest of the individual in the corporation; degree of control individual has over the corporation; and whether the individual has used the corporation for personal purposes.

> *U.S. v. Funds Held in the Name of Wetterer*, 899 F. Supp. 1013 (E.D.N.Y. 1995) at 1013-17, 1020, 1027

...

The leading case on the alter ego doctrine in Canada holds that a key factor in determining whether separate corporate personality should be disregarded is whether not to do so "would be flagrantly opposed to justice".

> *Clarkson* v. *Zhelka*, at 577-78

...

The courts in Alberta have also accepted that the corporate veil may be lifted if it can be established that not to do so would be "flagrantly opposed to justice".

> *McCardell* v. *Tisi Holding*

...

Alberta courts have similarly held that the corporate veil maybe lifted when the shareholder treats himself and the companies he controls as

being interchangeable.

> *Yang* v. *Overseas Investments* (1986) Ltd. (1995), 26 Alta. L.R. (3d) 223 (Q.B.) at 223-28, 248-49.

Rooke J. noted that with respect to the American authorities cited above, one had to mindful of the words of Hunt J. in *Sun Sudan Oil Co. v. Methanex Corp*. (1992), 134 A.R. 1 at 12-13 where she stated that:

> ... It can be said that, in general, the American courts have shown a greater willingness than have the courts in Canada to treat one company as a mere "instrumentality" of another, and thus, as responsible as the other.

However, Rooke J. found:

> I do not find the propositions stated in the argument of Counsel for the Vendor, based on American law, relating to an individual using a corporation to work a fraud or injustice, are an anathema to the law applicable to the subject as set out in the Canadian authorities referenced. In addition, the American authorities are of assistance in setting out some criteria that the Court may look at to determine if the purpose and/or result is to work a fraud or injustice.

Several submissions put forward by the plaintiff regarding the use of agency principles to find dual liability were also reviewed by Rooke J., as follows:

> In some cases, the principal of the corporation has been perceived as the true vendor or purchaser of property. These are not truly `corporate veil' cases but merely examples of individuals contracting in a personal capacity.
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> > H. Sutherland, ed., *Fraser & Stewart Company Law of Canada*, 6th ed., (Scarborough: Carswell, 1993), at 22
>
> **...**
>
> If there is misrepresentation and a corporation is created as a vehicle for deflection of monies to the personal benefit of an individual agent, that individual will be personally liable.

> *Shillingford* v. *Dalbridge Group Inc*. (1996), 28 B.L.R. (2d) 281 (Alta. Q.B.), at 286
>
> **...**
>
> I note from the headnote in *Shillingford* that Perras J. found that "... the individual defendants treated the companies and themselves as interchangeable in a scheme designed to obtain funds for their own purposes. They misrepresented themselves to the plaintiff's bank, an action which was indicative of their true intent ....I do not find that different from the circumstances before me in the case at bar.
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> **...**
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> An individual may be personally liable if he owned substantially all the shares of a corporation, and used this corporation as a vehicle for selling assets to another corporation of which he was the director. Such an individual may be ordered to surrender the shares representing the secret profit he makes.
>
> *Patton* v. *Yukon Consolidated Gold Corp*., [1934] O.W.N. 321 (C.A.), at 324.

Finally, at para. 217 in *Phillips* Rooke J. concluded:

> No one piece of evidence or one authority justifies piercing the corporate veil in this case - indeed many of the individual facts are equally consistent with lawful actions. However, the total effect of the facts I have found, as supported by the authorities, overwhelmingly require that Habib not escape personal liability from the fraudulent total of his actions, and he shall not. I find him jointly and severally liable, with 707739, to the judgment to which the Vendor is entitled.

In *Sylvan Lake Golf & Tennis Club Ltd.* v. *Performance Industries Ltd.* (1999), 246 A.R. 272, Wilkins J. found that the actions of the defendant O'Connor were calculated and underhanded. The plaintiff had entered into an agreement with the defendant regarding the development of certain lands. The written agreement did not accord with the oral agreement entered into between the parties. The court found the defendant knew this to be so and that his overall conduct with respect to the overall business dealing was fraught with deceit. The court lifted the corporate veil, stating:

> It is clear from the evidence that that corporation was an entity wholly controlled by Mr. O'Connor and set up by Mr. O'Connor expressly for the purpose of holding his interest in the Sylvan Lake joint venture. All and every action undertaken with respect to the formation of the Agreement and its enforcement was directed by Mr. O'Connor and the contract was formed between he and Mr. Bell as individuals on the understanding that their separate interests in the joint venture would be placed in the names of their nominee corporations. Every action taken to defeat the legitimate interest of Bell and each attempt to deceive this court and deny justice to Bell was that of O'Connor. Surely there could never be a clearer case in which the court must pierce the corporate veil and attribute to O'Connor personally full responsibility for any and all of the acts undertaken in the name of Performance. The judgment herein pronounced shall be against both Defendants jointly and severally.

The Court of Appeal agreed (at (2000), 255 A.R. 329, appeal dismissed at [2002] 1 S.C.R. 678) and stated:

> The trial judge found the actions of O'Connor to be "fraudulent, dishonest and deceitful". Those findings of fact require deference on appeal. They provide the necessary support for lifting the corporate veil. 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:…

In *Canada (Attorney General)* v. *Gardner*, [1998] O.J. No. 3201 (Ont. Gen. Div.) the defendant owed 1.8 million dollars to Revenue Canada, not having made a payment since 1977. Revenue Canada sought *inter alia* to seize assets in the hands of Gardner's son and Gardner's companies. With respect to the actions of Gardner and his relationship to his companies, the court reviewed the guiding principles and concluded:

> The facts of this case bring these principles into play. The companies 556co and 285co are under the complete domination of Bruce Gardner and are being used in a fraudulent scheme to enable him to evade payment of his taxes. To the extent that he does not hold all of the shares, those who do have totally yielded control to him. There is also the element of trust/agency in respect of the funds received to discharge the mortgage and misapplied. Finally, allowing him to shield his assets under the series of sham transactions and puppet companies described in the evidence would certainly yield a result `flagrantly opposed to justice, convenience or the

> interests of the Revenue'.

In *Goldman, Sachs & Co.* v. *Sessions*, [1999] B.C.J. No. 1226 (B.C.S.C.), affirmed at [2000] B.C.J. No. 998, the defendant Sessions decided to conduct his personal trading directly with Goldman rather than through Sessions' own company AW. Sessions became under-margined in his accounts, and Goldman liquidated them when Sessions was unable to provide further security. There was a large deficit after liquidation, and Goldman brought an action to recover the shortfall. Kerdos (another company of Sessions') and AW were added as defendants to the action on the basis that they were Sessions' alter egos.

The judge noted "[t]here is no plea of fraud or improper conduct by Sessions and no such conduct was suggested during submissions." In addition the plaintiff had "...not pled and does not argue that the real transacting party was the corporation, Kerdos. Rather, the plaintiff contends that Sessions, Kerdos, and AWS were really one person because Sessions controlled both and used both to advance his personal business interests."

Relying on *Kosmopoulos* counsel for the plaintiff argued that "...the doctrine is not confined by fact patterns and will be used when to fail to use it will produce a result 'flagrantly opposed to justice'..."

Replied the judge:

> ...the plaintiff has not pled that it relied on Sessions's representation that he owned 100% of Kerdos nor that the representation was false nor that it has suffered any loss by reason of the representation. Moreover, the plaintiff has not pled that Kerdos was a party to any misrepresentation or to any fraudulent or otherwise improper conduct, or any other material facts that would found a cause of action against Kerdos.
>
> Rather, the plaintiff's position is that, because Sessions, Kerdos, and AWS are "one economic unit", as counsel put it during his submission, the plaintiff should be entitled to execute on Kerdos's assets if it obtains a judgment on its claim against Sessions.
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> The plaintiff's position finds no support in the authorities cited. Moreover,

> Kerdos's assets are not the property of Sessions, and that the plaintiff should be left to execute on Sessions's assets if it should obtain judgment against him is not unjust nor is it so inconvenient as to require the wrenching of the concept of alter ego from its traditional roots and its application in the circumstances here. There is simply no basis in the pleadings, in evidence, or in law for the plea of alter ego in this case.

Thus, it seems that the existence of conflicting and inconsistent case law on lifting the corporate veil is largely caused by the decisions being fact driven. The broad parameters of the governing legal principles seem clear, and provide guidance for plaintiff's counsel seeking to hold the individual behind the corporation liable for the plaintiff's damages.