

Behind the Curtain

Imposing personal liability on corporate officers, directors and shareholders

By Marvin J. Huberman

It's a fundamental, but not absolute, principle of corporate law that a corporation has a separate legal personality. Hence, a court should not "pierce the corporate veil" and impose personal liability on people, including officers, directors and shareholders, associated with a corporate entity, except in exceptional cases.

This well-established common law principle is reflected in modern day corporation statutes, such as the *Ontario Business Corporations Act, R.S.O. 1990, c.B-16*, which in section 15 provides that "a corporation has the capacity and the rights, powers and privileges of a natural person."

In many corporate veil cases, a plaintiff asks the court to look behind the corporate curtain and require the principals to personally pay for the obligations of the corporation. In other cases, the claimant looks to the corporation to pay the obligation of its principal and often sole officer, director or shareholder.

So what are the circumstances that justify going behind the company and attaching personal liability to associated persons? A brief summary of this important principle—a corporation has a highly-respected separate legal personality—and its limits is as follows:

The law relating to when the corporate veil may be pierced does not follow a consistent principle. That said, the court will not enforce the "separate personality" principle when:

- It would be flagrantly unjust or unfair not to go behind the company and impose personal liability;
- When the company is incorporated for an illegal, fraudulent or improper purpose;
- When the corporation is subject to the complete control of the shareholder and the company is being used to insulate the shareholder from responsibility from fraudulent or illegal conduct;
- If when incorporated, those in control of the corporation—not just shareholders but also officers and directors—expressly direct a wrongful act to be done; and
- When the corporation is "completely dominated and controlled and being used

as a shield for fraudulent or improper conduct" including fraud, deceit, dishonesty or lack of proper authority.

This is critically important to corporations that have only one officer, director and shareholder. In this case, there can be no doubt that the individual associated with the company, and acting as its agent/representative, would be in control of the corporation, directing and causing it to act, and perhaps justifying the piercing of the corporate veil. That's what happened in *Shoppers Drugmart Inc. v. 6470360 Canada Inc.*, a recent decision of the Court of Appeal for Ontario, which imposed personal liability on Michael Wayne Beamish ("Beamish"). The Court of Appeal clarified the test for piercing of the corporate veil as follows:

"Fleischer is the appropriate test to apply to piercing the corporate veil in Ontario. In *Fleischer*, Laskin J.A. stated that only exceptional cases that result in flagrant injustice warrant going behind the corporate veil. It can be pierced if those in control expressly direct a wrongful act to be done. At para. 68, he stated: 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.* 1996 CanLII 7979 (ON SC), (1996), 28 O.R. (3d) 423 at pp. 433-34 (Gen. Div.), *aff'd* [1997] O.J. No. 3754 (C.A.): "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 Court of Appeal then concluded that Beamish, as the sole officer, director and shareholder of a corporation, had sole signing authority of the accounts in question and had authorized the transfer of \$970,000 to an operating account in his own name and the name of a company of which he was the sole shareholder, instead of paying utility bills.

Because he directed and caused the misappropriation of funds, the Court of Appeal held that there was an unjust enrichment that justified piercing of the corporate veil and the imposition of personal liability on Beamish for over \$1,800,000, plus legal costs.

While it is true that courts should hesitate to ignore the corporate structure under which business is conducted, there is and will always be circumstances that warrant piercing the corporate veil. Be aware of these circumstances or run the risk of being personally liable. **B2B**



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