LIABILITY OF DIRECTORS AND OFFICERS FOR CORPORATE TORTS

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Introduction

Over the last three years, the law concerning the liability of officers, directors and employees for conduct they engage in on behalf of the corporation that employed them, or on whose Board they sat, has changed markedly in ways that these potential defendants will find unappealing. Courts appear to have swept aside a line of cases that made such actions more difficult to maintain in favour of an approach that encourages the addition of such individuals as defendants and an approach that makes success against such defendants much easier.

A brief note of clarification before proceeding: This paper does not purport to deal with directors and officers liability for negligence in their capacities as directors or officers for failing to exercise the care, skill and diligence that a reasonably prudent person would exercise in comparable circumstances,¹ but deals only with their liability for torts committed by the corporation through their agency.

Historic Limitations on Tort Liability

Until 1999, Ontario courts had tended to characterize the availability of actions against directors and officers in terms favourable to the proposed defendants. Courts tended to use language that limited actions against directors and officers for corporate conduct. Some cases suggested that, for liability to attach, the plaintiff had to establish a degree and kind of personal

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¹ See for example the Canada Business Corporations Act, R.S.C. 1985, c.C-44 as amended, section 122.
involvement by the employee that, made the wrongful conduct the employee’s own.\textsuperscript{2} Other courts required that the conduct constitute a tort separate from the employee’s duty to the corporation.\textsuperscript{3} Still other courts required the directors to have acted “outside of their corporate character”\textsuperscript{4} for liability to attach. Whatever the precise formulation, it tended to be couched in language that protected employees.

This line of cases regarded the personal liability of officers and directors as a conflict between two fundamental legal principles: maintenance of the corporate veil which would tend to protect directors and officers from liability and the equally fundamental principle that everyone should answer for their own tortious acts.\textsuperscript{5} In these older cases, the corporate veil tended to win out.

**Court of Appeal Clarifies the Rules**

In 1999, the Ontario Court of Appeal handed down its decision in *ADGA Systems International Ltd. v. Valcom Ltd.*\textsuperscript{6} The decision marks a visible change in the approach to directors and officers liability. In *ADGA*, the Court of Appeal noted that the language used by lower courts in the years leading up to the decision had “smudged” the true principles governing directors and officers liability.\textsuperscript{7}


\textsuperscript{3} *Stern v. Imasco Ltd.* (1999), 1 D.L.R. (3d) 198 at 228.


\textsuperscript{7} *Ibid.* at p. 110.
The Court of Appeal went back to first principles and held that the concern about piercing the corporate veil did not conflict with the concept that everyone was liable for their own tortious conduct because, if the plaintiff establishes tortious conduct on behalf of an officer or director, the corporate veil is not threatened. The personal liability of officers and directors is merely a principle which coexists with the corporate veil, it does not compete with it.

As a result, any director, officer or employee is personally liable for tortious conduct they engage in on behalf of the corporation even where that conduct is carried out solely for the benefit of the corporation and in pursuit of the individual’s employment with the corporation except for the tort of inducing breach of contract.

The exception to personal liability for the tort of inducing breach of contract stems from the case of Said v. Butt. It effectively precludes a party who contracts with the corporation from asserting both a claim for breach of contract against the corporation and a claim for tortious conduct in which damages may be assessed on a different basis. Contractual damages are usually based on expectation damages (in essence profit) while tort damages tend to be broader and extend to all foreseeable losses. The Said v. Butt exception has also been justified on the basis that it ensures officers and directors are capable of terminating contracts of employment without fear of personal liability and that it is appropriate for corporations to terminate contracts that are no longer in its best interest to fulfil. Courts have safeguarded this exception vigilantly

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8 Ibid. at page 105.
9 [1920] 3 K.B. 497.
10 ADGA, at supra note 6 at page 106.
and have struck out actions against officers or directors based on the tort of conspiracy where the essence of the conspiracy is to breach a contract.\textsuperscript{11}

**What Type of Conduct Establishes Personal Liability?**

Before *ADGA*, courts had suggested that plaintiffs face a higher hurdle when establishing personal liability against officers and directors than they faced in other contexts. For example, in *Mentmore Manufacturing Co. Ltd. v. National Merchandising Co. Inc.*\textsuperscript{12} the Federal Court of Appeal held that a director or officer would be liable only for “knowing, deliberate, wilful” participation in the wrong doing.\textsuperscript{13} Justice Le Dain articulated the test as follows:

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\text{…in my opinion there must be circumstances from which it is reasonable to conclude that the purpose of the director or officer was not the direction of the manufacturing and selling activity of the company in the ordinary course of his relationship to it but the deliberate, wilful and knowing pursuit of a course of conduct which was likely to constitute infringement or reflected an indifference to the risk of it.}\textsuperscript{14}
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In *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd*\textsuperscript{15} the Ontario Court of Appeal articulated a test that echoed *Mentmore*:

Considering that a corporation is an inanimate piece of legal machinery incapable of thought or action, the court can only determine its legal liability by assessing the conduct of those who caused the company to act in the way that it did. This does not mean, however, that if the actions of the directing minds are found wanting, that personal liability will flow through the corporation to those whose caused it to act as it did. To hold the directors of People’s personally liable, there

\begin{itemize}
  \item \textsuperscript{11} *Normart Management Limited v. West Hill Redevelopment Company Limited* (1998) 37 O.R. 3(d) 97.
  \item \textsuperscript{12} (1978), 89 D.L.R. (3d) 195 (F.C.A.).
  \item \textsuperscript{13} *Ibid.* at page 203 speaking specifically of directors liability for breach of patent.
  \item \textsuperscript{14} *Ibid.* at page 204-205.
  \item \textsuperscript{15} (1995), 26 O.R. (3d) 481.
\end{itemize}
must be some activity on their part that takes them out of the role of directing minds of the corporation.\textsuperscript{16}

In \textit{ADGA} the Court of Appeal held open the possibility of higher liability thresholds for corporate employees. When concluding its reasons in that case, the court noted:

It may be that for policy reasons the law as to the allocation of responsibility for tortious conduct should be adjusted to provide some protection to employees, officers or directors, or all of them, in limited circumstances where, for instance, they are acting in the best interests of the corporation with parties who have voluntarily chosen to accept the ambit of risk of a limited liability company. However, the creation of such policy should not evolve from the facts of this case where the alleged conduct was intentional and the only relationship between the corporate parties was as competitors….Such a development would be in the direction indicated by La Forest J. in his dissenting reasons in \textit{London Drugs} and thus may have to await further consideration by the Supreme Court.\textsuperscript{17}

In \textit{London Drugs Ltd. v. Kuehne & Nagel International Ltd.}\textsuperscript{18} La Forest J. in dissenting reasons had drawn a distinction between voluntary and involuntary creditors of corporations and suggested that it may be appropriate to hold officers and directors personally liable to the latter but not to the former. In explaining the distinction, Justice La Forest noted:

The distinction between voluntary and involuntary creditors is also useful in this area. As commentators have pointed out (Halpern, Trebilcock and Turnbull, “An Economic Analysis of Limited Liability in Corporation Law” (1980), 30 \textit{U.T.L.J.} 117), different types of claimants against the corporation have differing abilities to benefit from being put on notice with respect to the impact of the limited liability regime. At one end, creditors like bond holders and banks are generally well situated to evaluate the risks of default and to contract accordingly. These “voluntary” creditors can be considered to be capable of protecting themselves from the consequences of a limited liability regime and the practically systematic recourse by banks to personal guarantees by the principals of small companies attests to that fact.

At the other end of the spectrum are classic involuntary tort creditors exemplified by a plaintiff who is injured when run down by an employee driving a motorcar.

\textsuperscript{16} \textit{Ibid.} at page 491.

\textsuperscript{17} \textit{ADGA Systems}, supra note 6 at page 113.

\textsuperscript{18} [1992] 3 S.C.R. 299.
These involuntary creditors are those who never chose to enter into a course of dealing with the company and correspond to what I have termed as the classic vicarious liability claimant.\textsuperscript{19}

To date, Courts have not pursued the possibility of such policy limitations. Indeed, in \textit{NBD Bank, Canada v. Dofasco Inc.}\textsuperscript{20} the Ontario Court of Appeal held the Chief Financial Officer of Algoma Steel personally liable to Algoma’s banker for negligent misrepresentation, even though the misrepresentations were made in the course of the CFO’s employment duties to Algoma and were made solely in the interest of Algoma and not for any personal gain by the employee. In \textit{NBD Bank}, the Court of Appeal dealt with the limitations on liability by referring to the standard negligence principles set out in \textit{Anns v. Merton London Borough Council}\textsuperscript{21} and \textit{Kamloops v. Nielsen}.\textsuperscript{22} That is to say, by first asking whether there was a sufficiently close relationship between the parties so that, in the reasonable contemplation of the defendant, carelessness on its part might cause damage to the plaintiff. If the answer to that question is yes, the next task is to determine whether there are any considerations that ought to negate or limit the scope of the duty. In \textit{NBD Bank} the Court of Appeal answered the first question in the affirmative and rejected any policy arguments for limiting the liability of the CFO. Although the plaintiff Bank could have protected itself against limited liability by obtaining security or guarantees from Algoma’s parent corporation Dofasco, it did not do so. The Court of Appeal dealt with this policy concern by noting that the CFO’s representations related to the degree of risk the Bank was assuming. It appears that Algoma had an agreement to advise the Bank if its available unused lines of credit fell below $20 million, thereby providing the Bank some

\textsuperscript{19} \textit{Ibid} at page 349.
\textsuperscript{21} [1978] A.C. 728.
\textsuperscript{22} [1984] 2 S.C.R. 2.
assurance that its unsecured debt could be paid by using Algoma’s secured lines of credit. The Court also dismissed the more common policy concern about indeterminate liability to an indeterminate class by noting that the class of plaintiffs to which the CFO was liable was narrow and foreseeable and that the CFO’s statements were used for the specific purpose and in the specific transaction in which they were made.

Subsequent cases have adopted a similar negligence analysis. In Abdi Jama v. Macdonald’s Restaurants for example, a number of officers and employees of Macdonald’s were named as personal defendants in a lawsuit in which the plaintiff alleged she had partially consumed a “Big Mac” before finding a severed rat’s head in it. The court dismissed the action at the pleadings stage against senior officers of Macdonald’s but permitted it to proceed against lower ranking employees such as the restaurant manager because there was a sufficient nexus between the alleged negligence of the lower ranking employees and the plaintiff’s claim while that nexus did not exist for the higher ranking employees.

The Impact of ADGA

The clarity with which the Ontario Court of Appeal has reaffirmed the availability of actions against directors, officers and employees for conduct undertaken in their corporate capacity is likely to have a significant impact on litigation against corporations. Courts have clearly recognized that corporations cannot act on their own but must act through human agents. As a result, each time a corporation engages in wrongful conduct, there will almost inevitably be


24 Supra note 23.
an employee who is personally liable for that conduct, or more likely, several employees who share responsibility for the conduct.

The clarification encourages plaintiffs to join as defendants, all employees with a connection to the conduct at issue thereby avoiding the usual rule that only one representative of a corporation may be examined for discovery. Joining employees as co-defendants is clearly appropriate given the Court of Appeal’s confirmation of a cause of action against them. More importantly from a plaintiff’s perspective, joining a number of corporate employees is likely to improve the chance of success either in court or in settlement because of the increased likelihood of inconsistent answers and inconsistent conduct among employees. If anything, the likelihood of plaintiff-friendly answers on discovery will increase the further down the chain of corporate command the plaintiff goes. A front line employee may well feel less loyalty and obligation to the corporate defendant than a senior officer or director.

In short, the clarification of rules about officers and directors liability is likely to make litigation more complex and costly because it encourages the addition to an action of all employees with responsibility for particular corporate conduct.