ABlawg.ca

April 28th, 2008

An Equity Rationale for the Enforcement of the Corporate Veil?: The Alberta Court of Appeal Considers a Joint Venture Agreement in the Shadow of Corporate Reorganization

By Michael Ilg

Cases Considered:

Apex Corporation v Ceco Developments Ltd., 2008 ABCA 125

Common law courts have demonstrated a willingness to 'pierce the corporate veil' in circumstances when upholding the assumption of separate corporate legal identity would, for example: endorse an instrument that appears simply a sham; would permit for behaviour "akin to fraud"(*Gilford Motor Company Ltd. v. Horne*, [1933] Ch. 935 (C.A.)); or lead to a result "too flagrantly opposed to justice"(*Kosmopolous v. Constitution Insurance Co. of Canada* [1987] 1 S.C.R. 2). This latter language of justice, authored by Madame Justice Bertha Wilson, in particular signals a potential equitable limit to the invocation of separate corporate legal identity. And so while there are rare, if established, instances for piercing the corporate veil based upon justice concerns, the instances of an equitable *enforcement* of corporate personality are rarer still, and indeed may be difficult to conceive of. Involved would be a court enforcement of separate legal entity despite the claims of a corporation's ownership. Yet, just such a curious result occurred in the Alberta Court of Appeal's recent decision in *Apex Corporation v. Ceco Developments Ltd.* (per Justice Jean Côté, Justices Ellen Picard and Peter Martin concurring).

At issue between the two commercial parties was a joint venture for a residential property development, which proved to be unworkable. While the parties' claims were made and resolved largely on the basis of contract law, the Court's reasons for who was held to be in breach (as well as how, and when) depended almost entirely on a determination of corporate identity.

The joint venture agreement contained two main clauses in dispute, both of which are common to such arrangements. The first mechanism was a 'shotgun' clause, by which one party could offer to buy out the other. The receiving party could in turn either accept the offer or be deemed automatically to make the same offer in response. Under such shotgun clauses, the initial offering party sets the price of sale and exit, while the receiving party has the ability to set the roles between the parties. The second mechanism was a right of first refusal, under which an offer intended for a third party must first be made available to the other partner. This gives the non-offering partner a potential veto over a new and replacing partner, and ensures that a valid market price is offered. If, for example, the offering partner tries to orchestrate a 'sweetheart'

deal to an aligned party, the other party can have the advantage of it if they utilize their right of first refusal. These mechanisms provide a protective symmetry, or reciprocity, in the definition of offer and acceptance as one partnership party may act on what is proposed or declined by the other.

The operation of the above mechanisms were complicated in the circumstances of the present case as the venture reached an impasse at a time that coincided with the corporate reorganization of the appellant Apex Corporation and its parent, the Bentall Corporation. After the appellant's "complicated corporate gymnastics" of the reorganization (*Apex* at para. 35), the original Apex Land Corporation (Apex 1) had been renamed as a numbered company with the purpose of eventual dissolution, while a new company named Apex Corporation (Apex 2) was created. Adding to the confusion, was the result that after "these transactions, the directors, officers, assets, liabilities, employees, management, and ultimate shareholder remained the same in Apex and the new company" (at para. 13). One would think that had such orchestrations been conducted with the primary aim of avoiding a previous legal obligation, whether private or regulatory, that this would certainly be an instance calling for a piercing of the corporate veil to assign liability through such a transfer between entities that differed in name alone.

While the respondent Ceco had been aware of Apex's reorganization plans, it was not aware of the actual culmination of the plan. After the reorganization had been completed, unbeknownst to Ceco, Ceco sent a purchase offer of $1.5 million to Apex Land Corporation. The responding acceptance by Apex 2 substituted the new company name for the previous name of Apex 1 addressed by Ceco – deleting 'Land' from the subject title in its response letter. Ceco, however, was not able to complete the purchase due to an inability to arrange financing. Apex claimed breach of the buy and sell agreement, which did not specify a release due to lack of financing. Ceco counterclaimed for breach of the right of first refusal.

Of utmost significance within the steps of reorganization was that legal title passed through and from Apex 1 - to Bentall - to Apex 2. This transfer of the partnership interest, claimed Ceco, was a violation of its right of first refusal. And one can readily see that the characterization of the reorganization was instrumental in assigning breach and its resultant damages. If, as Apex argued, the reorganization transactions were internal and within the same corporate family, then no right of refusal would have been denied as the ownership interest in the joint venture would have remained constant. However, and as the Court decided, if a transfer between distinct legal entities occurred, then Ceco's purchase offer was preceded by a core breach by Apex. And as a curious result from this determination, the later purchase offer by Ceco was then characterized by the Court as a reasonable act of mitigation in response to Apex's breach of providing first refusal; which Ceco was admittedly not even aware of at the time the purported act of mitigation took place (at para. 63).

The Court's strict application of the corporate veil may be seen as an equitable move, even though the Court did not use express language of equity. The decision not only makes repeated reference to the conduct of Apex in an unfavourable light, but also argues for an equality of application that is reminiscent of equity's requirement of clean hands on the part of those seeking

it. In a telling passage, the Court states that "[Apex] wishes the court to apply the corporate "veil" (separate personality) only when that benefits Apex. Quite possibly one could say to Apex "All they that take the sword shall perish with the sword (Matthew 26:52)."" (at para. 47).

There is much to favour in an approach that is premised upon consistency and fairness (even when unsupported by scripture). Unfortunately, it is not clear in the decision exactly how Apex attempted to have it both ways. Its claims and defences appear founded necessarily on the continued existence of Apex Corporation as a constituent part of a larger corporate enterprise. Though it may be easy to assume that Apex, or its parent Bentall, would have claimed the protection of the corporate veil had the situation been otherwise, the Court did not apparently consider the mutuality of its strict veil application. This leads to some lingering problems of logic, policy, and precedent.

Ideally, the Court would have inquired hypothetically into whether Apex would have been able to escape the obligation of first right of refusal had Ceco contested it for another, future transaction. The Court did observe perceptively that the right of first refusal "comes but once" (at para. 39). Supposing that Apex had attempted another transfer of the partnership interest, after the reorganization and to a third party wholly unaffiliated with Apex or Bentall, the pertinent question would be whether Ceco would have maintained a right of first refusal or whether it had expired with the first transfer between Apex and Bentall? It is difficult to envision that in such a circumstance Apex would be allowed to rely upon the reorganization, or change in name alone, to escape its obligations to Ceco. Such a scenario, or interpretation of the right of refusal, would have had the advantage of falling much more squarely within the enunciated exceptions to the corporate veil mentioned above, rather than promoting a fair result through a very technical reading and endorsement of corporate identity.

Similarly, a logical problem occurs with the Court's conclusion as to the damage award due to Ceco from the breach of the right of first refusal. The Court ruled that Ceco was entitled to purchase Apex's interest at the price of $425,616, the amount of the transfer from Bentall to Apex 2. While Apex objected to this price quantum as merely "the sale price from its new parent Bentall to the ultimate purchaser (so-called Apex Two)" (at para. 115), the Court held that this was the "effective sale. Bentall was a mere way station. The previous sale or transfer from Apex to Bentall was for one dollar… Ceco does not hold Apex to that small sum"(at para. 115). The previous statement appears almost irreconcilable with rational analysis. If the Court's reading of the reorganization is to uphold the barest corporate alteration as creating a new party capable of being recognized as an outside, third party for the purposes of the right to refusal clause, then such a technical interpretation should be applied consistently. The transfer that breached the clause, upon the Court's own reasoning, must have been the sale from Apex 1 to Bentall, not Bentall to Apex 2. It then follows that the purchase price Ceco was entitled to under the first refusal clause was for the first sale made by Apex – that between Apex 1 and Bentall, for the value of one dollar. It is hardly consistent for the Court to enforce the technicalities of the reorganization plan against Apex and then selectively identify only the first half of the Bentall role as being that of a mere 'way station.' The Court's language appears to imply a certain reasonableness, or even modesty, on the part of Ceco in seeking hundreds of thousands instead

of a single dollar as the entitled purchase price. And arguably the Court should be appreciative, if only for the sake of appearances; because the logic of its decision should entitle Ceco to the purchase price of $1 for the partnership interest that they voluntarily offered $1.5 million for.

While the Court's decision may impart a feeling of fair-mindedness, as it holds the unappealing behaviour of a corporation to the letter of its altered legal corporate identity, there may be a danger with the principles and precedent imparted by the Court's approach. Simply, the very technical recognition of corporate personality through a reorganization process may serve equity in one isolated instance and yet indicate against the more numerous instances when equity would be better served by parting the corporate veil to recognize a wider scheme or project. Perhaps the present decision is a demonstration of the potential pitfalls that may follow from deciding an appellate case upon the position of the parties rather than the principles involved.

BY NC ND