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Lifting the Corporate Veil v Personal Liability Under the Oppression Remedy: When Directors Behave Badly, When is Each Remedy Appropriate?

By: Jassmine Girgis

Case commented on: *FNF Enterprises Inc v Wag and Train Inc*, 2023 ONCA 92 (CanLII)

In *FNF Enterprises Inc v Wag and Train Inc*, 2023 ONCA 92 (CanLII), the sole shareholder and director of Wag and Train Inc (Wag and Train) had stripped assets from the corporation, causing the company to defeat its creditors. In an action brought by a commercial landlord, the Ontario Court of Appeal declined to lift the corporate veil because the director's improper conduct was not the source of the corporation's liability, but it did allow the appellants to pursue the oppression remedy against the director personally.

Facts

The appellants, FNF Enterprises Inc, were owners of commercial premises in Kitchener, Ontario. They leased the premises to the corporate respondent, Wag and Train, in 2015 for a six-year term. Wag and Train's sole shareholder, officer, and director, Linda Ross, was the other respondent.

The appellants alleged that Wag and Train "vacated the premises early and without cleaning up, stopped paying rent, gave no notice and declined to answer all communications". The appellants also claimed that the business that had been conducted by Wag and Train under the lease was moved to a different location under a different name. Finally, the appellants maintained that Ms. Ross "treated the amounts earned by Wag and Train, as well as its liabilities, as her own and benefited personally in respect of same" (statement of claim at para 13).

The Claims

The appellants brought three causes of action against the two respondents, alleging that:

1. Ms. Ross interfered with contractual relations because the decisions she made caused Wag and Train to breach its lease;
2. Ms. Ross conducted herself in a manner that would justify lifting the corporate veil and imposing Wag and Train's liabilities on her; and
3. Ms. Ross acted in a manner to entitle the appellants to claim relief against her under the corporate oppression remedy.

The Decision

Corporate Veil

For the corporate veil claim, the court relied on *Transamerica Life Insurance Co of Canada v Canada Life Assurance Co*, [1996 CanLII 7979 (ON SC),] 28 OR (3d) 423 (Gen Div), aff'd [1997] OJ No 3754 (CA) (*Transamerica*), which sets out the test for when the corporate veil ought to be lifted, and which is most frequently applied in the corporate context (*Aubin v Petrone*, 2020 ABCA 13 (CanLII) at para 26). The two-part test is: 1) "where [that separate legal identify] is completely dominated and controlled" and 2) it is "being used as a shield for fraudulent or improper conduct" (*Transamerica* at 433-34).

With regard to the first element, the court said that the test does not only require "ownership or control of a corporation" but also "complete domination or abuse of the corporate form" (at para 20). For the second element, the "fraudulent or improper conduct" that is required must also be "that conduct that has given rise to the liabilities the plaintiff seeks to enforce" (at para 20). It referred to *642947 Ontario Ltd v Fleischer*, 2001 CanLII 8623 (ON CA), 209 DLR (4th) 182, which noted that fraudulent or improper conduct will be found in two scenarios: 1) when a corporation is formed for an improper purpose and 2) when "those in control expressly direct a wrongful thing to be done" in an already incorporated corporation (at para 68).

In this case, the court held that in order to lift the corporate veil, "the wrongful conduct alleged against Ms. Ross must have given rise to those lease liabilities [incurred by Wag and Train for breaching its lease], such that it is appropriate to lift the corporate veil and consider those liabilities to be hers" (at para 22).

On the first allegation, that Ms. Ross as the director caused Wag and Train to breach its lease, the court maintained that pursuant to the doctrine in *Said v Butt*, [1920] 3 KB 497, a director and officer cannot be held liable for the tort of interference with contractual relations if they caused their corporation to breach its contract (at para 25).

The court also rejected the second allegation, that Ms. Ross stripped value from Wag and Train by treating the business and assets as her own when she knew of the company's lease liabilities. Here the court distinguished between the director stripping value from the company while knowing of the company's liabilities, and the director giving rise to those liabilities by removing value. In other words, it drew a distinction between a situation in which the fraudulent or improper conduct gave rise to the liabilities that are the subject of the claim, and one where, as here, the source of the liability is the breach of a contract entered into for valid business purposes. In this case, Wag and Train entered into a valid lease agreement and performed their obligations for approximately five years before breaching the lease.

Finding that the link between the wrongful conduct and the liability was missing, the court declined to lift the corporate veil. To do so, the liabilities incurred as a result of the lease and its breach would need to constitute misappropriation of the appellant's funds, and the liabilities themselves would need to have arisen from the wrongful conduct. Here, the "lease liabilities have a source other than, and independent of, any alleged value stripping" (at para 28).

The court concluded that although value stripping does prejudice creditors and hinders their ability to collect on their debt, the proper remedy for this is not to lift the corporate veil, but to address it under the oppression remedy.

Oppression Remedy

The court laid out the two part test for the oppression remedy: 1) there must be a breach of reasonable expectations that is 2) oppressive, unfairly prejudicial, or unfairly disregarding of the complainant's interests (*BCE Inc v 1976 Debentureholders*, 2008 SCC 69 (CanLII)). Particular to this case, the court had to determine whether liability for oppression could lie personally against a director (*Wilson v Alharayeri*, 2017 SCC 39 (CanLII)). The criteria for this issue are: 1) the director is directly involved in the oppressive conduct such that it can be attributed to them and 2) a finding of personal liability is fit in the circumstances.

Since the appellants, as creditors, did not have standing to pursue the oppression remedy as of right, the court relied on *JSM Corporation (Ontario) Ltd v The Brick Furniture Warehouse Ltd*, 2008 ONCA 183 (CanLII), which said that a creditor could get standing when its interest as a creditor is "compromised by unlawful and internal corporate manoeuvres against which the creditor cannot effectively protect itself" (at para 66). It found that the appellants fell within this situation, that the allegation of Ms. Ross having stripped value from Wag and Train while knowing of its liabilities qualified as these "internal corporate manoeuvres" against which creditors could not protect themselves.

The court found that Ms. Ross, as a sole shareholder or sole director, was not entitled to use Wag and Train's money as her own or to appropriate the business when the corporation had outstanding amounts owing to creditors. It also found that a shareholder has the right to the corporation's assets when it is wound up and the creditors have been paid; a shareholder does not have that right while the corporation is a going concern. Since Ms. Ross stripped value from the company in an effort to prevent Wag and Train from paying its lease obligations to the appellants, the court found that there was an arguable case for a personal remedy against Ms. Ross under the oppression remedy. The court permitted the appellants to amend their statement of claim to assert their claim for a personal remedy against Ms. Ross under the oppression remedy.

Commentary

Corporate Veil

In this case, the appellants attempted to have the corporate veil lifted. Lifting the corporate veil is an equitable exception to the statutory rules granting the corporation a legal identity separate from its shareholders (in Alberta, see the *Business Corporations Act*, RSA 2000, c B-9 at ss 16 and 46(1) (*ABCA*)). These rules also establish, subject to certain exceptions, that shareholders are not liable for any liability, act, or default of the corporation.

In order to lift the corporate veil, a shareholder must either have incorporated the company for an illegal or fraudulent purpose or used the company to carry out improper or fraudulent actions. In

other words, the wrongful conduct must have given rise to the liability for which the plaintiff seeks to recover.

In this case, the liabilities arose from Wag and Train's breach of the lease. There were no allegations that Wag and Train had abused the corporate form by entering into the lease or through its performance of it. Here, the decision by the corporation's directing mind, Ms. Ross, to breach the lease did not give rise to the liability for stripping value from Wag and Train, meaning there was no "nexus between the liability the plaintiff sought to recover by piercing the corporate veil and the wrongful conduct directed by the individual in control of the corporation that gave rise to that very liability" (at para 27).

Oppression Remedy

Stripping value was not without consequence, however; the appellant creditors were prejudiced, and their reasonable expectations were breached. As such, the court determined the appropriate claim was the corporate oppression remedy.

Creditors' Standing

In this case, the appellants were creditors of Wag and Train. Creditors do not have standing as of right to seek an oppression remedy; they must qualify as a "proper person" to make an application (in Ontario see the *Business Corporations Act*, RSO 1990, c B.16 (*OBCA*) at s 245 (*OBCA*), in Alberta see the *Business Corporations Act*, RSA 2000, c B-9 (*ABCA*) at s 240(1)). See my previous post about when creditors can pursue oppression).

The oppression remedy is a remedial cause of action. Parties can use it to protect their reasonable expectations when they have no other legal recourse available to them (*Brar v Brar et al*, 2018 MBCA 87 (CanLII) at para 28). As a matter of general policy, creditors cannot use the oppression remedy as a debt collection device, as in, to address breach of the debt contract. The reason is that they could have protected themselves in their contracts, and if they did not, they cannot use the oppression remedy to compensate later for their failure.

Creditors can, however, use the oppression remedy when the debtor compromises their interests by engaging in "unlawful and internal corporate maneuvers" (*JSM Corporation (Ontario) Ltd v The Brick Furniture Warehouse Ltd*, 2008 ONCA 183 (CanLII)). These situations typically fall into two categories. First, when a debtor engages in asset tunneling, or moves assets beyond the reach of creditors. Second, when a debtor knew the corporation could not fulfill its obligations but went ahead and entered into debt contracts, namely situations akin to trading while insolvent (see for example, *El Ashiri v Pembroke Residence Ltd*, 2015 ONSC 1172 (CanLII)).

BCE Test

Once a creditor obtains standing, the analysis turns to whether the applicant can meet the two-part test laid out in *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 (CanLII): were the creditor's reasonable expectations breached, and if so, was the breach oppressive, unfairly prejudicial, or unfairly disregarding of the complainant's interests.

The two situations that define when creditors can obtain standing also encompass the expectations creditors can reasonably hold of a debtor. These include the expectation that the debtor corporation will not be used as a vehicle for fraud, that the debtor will not convey away assets for no consideration, that the directors will manage the corporation in accordance with their legal obligations, and that the debtor will honour the understandings and expectations that the debtor has created (*Builders' Floor Centre Ltd v Thiessen*, 2012 ABQB 86 (CanLII) at para 43, aff'd 2013 ABQB 23 (CanLII) at para 89). These expectations do not extend to expecting the debtor to "be managed and operated in a way that would ensure that it was paid for its debt" (*Ndex Systems Inc v Acquino*, 2011 ONSC 6654 (CanLII) at para 15).

In this case, since Wag and Train had unpaid debt, Ms. Ross, as the sole shareholder, was not entitled to use the company's money as her own or to appropriate its business. As the sole director, Ms. Ross could not confer that right on herself as shareholder, as a director's power to declare dividends is subject to the corporation being able to pay its debts as they become due (*OBCA* at s 38; *ABCA* at s 43). Doing so breaches creditors' reasonable expectations that directors will not strip assets from the corporation and will adhere to statutory requirements (at paras 41-42).

The next question is whether the breach meets one of the statutory tests for oppression. The allegation was that Ms. Ross "stripped value from Wag and Train knowing of its liabilities" (at para 39). This arguably meets the oppression test, which requires conduct done with an improper motive. If it does not qualify as oppression, it would qualify as unfair prejudice. In this case, to meet the unfair prejudice test, Ms. Ross could have stripped value from the corporation in an effort to do something other than avoiding the company's liabilities, but in doing so, she was reckless or wilfully blind as to the effect of her actions on the company's creditors. (See my previous post about meeting the different oppression remedy tests.) In any event, the conduct in this case arguably meets one of the tests, thereby making out the claim for oppression.

Directors' Personal Liability for Oppression

Once the claim for oppression has been made out, the court has to determine whether a remedy for oppression may properly lie against the directors of the corporation personally, rather than the corporation. Drawing on the two-pronged approach developed in *Budd v Gentra Inc*, 1998 CanLII 5811 (ON CA), [1998] OJ No 3109 (QL) the Supreme Court of Canada in *Wilson v Alharayeri*, 2017 SCC 39 (CanLII), laid out the following factors to consider before imposing personal liability against directors: the oppressive conduct must be properly attributable to the director because they "exercised – or failed to have exercised – [their] powers so as to effect the oppressive conduct" and the imposition of personal liability must be fit in all the circumstances (at paras 47-48).

In this case, the court found that there was an arguable case that a personal remedy should lie against Ms. Ross for stripping value from the corporation for her own benefit and for breaching her statutory obligations (at para 41).

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