

Urban Myths About the Corporate Veil

Commonly Misunderstood Beliefs About Personal Liability Protection Following Incorporation

Corporate Veil Unveiled For Proper Understanding of Limited Liability Protection

By: Scott McEachern



Firstly, let me start this article with a little Background 101. Generally, who I hear from on this issue are small business owners that started out as sole proprietors and then somewhere along the way a lawyer or accountant or insurance broker or financial planner convinced the small business owner to get incorporated for tax advantages and/or personal liability protection from a 'corporate veil'. So, the small business owner does get incorporated but then takes the general information received about personal liability protection too literally and settles into a warm and soft cuddly blanket known as a false sense of security.

What is scary is that the small business owner likely paid the hundreds-of-dollars-per-hour-lawyer handling the incorporation for information regarding the corporate law concerns such as articles of incorporation, bylaws, quorum, issued shares, taxation and so forth, while only briefly touching on the benefits and limitations regarding limited personal liability. Unfortunately, the word "limited" goes in one ear and out the other. After all, we all know from myth spread around by the common know-it-all buddy that incorporation now means the owner-director of the business cannot be sued, right? WRONG!

As a corporate law lawyer can explain, the limited personal liability benefit for the owner-director of an incorporation relates to protection from liability for a breach of contract by the corporation or the tortious acts by others engaged by the corporation such as employees or subcontractors. Quite simply, once incorporated, if the employee or subcontractor does something wrong, and does so purely without cause or contribution by the owner-director, the corporation may be liable while the owner-director is protected.

Side Bar 1:

Please note that as a paralegal, the Law Society of Ontario governing rules state that I cannot provide corporate law services but that I may advise on tort law matters involving corporations - this article is about tort law personal liability risks faced, often unknowingly, by owner-directors of small contracting corporations.

Side Bar 2:

A tort is a legal wrongdoing, other than breach of contract, compensable in law by the payment of damages or other relief. Examples include: general negligence, negligent workmanship, negligent supervision, misrepresentation, misstatement, deceit, etc.

The myth that incorporation protects the director and officer owner of a corporation is multilayered and arises out of dramatic differences in practicality between large corporations and the small business corporation. The rules are the same for both but the reality is what changes between the big and the small. In the large corporation, the owners of the corporations are often millions of faceless shareholders. Decisions made for a large corporation are made by the board of directors and officers along with a management team (the "executives") who are primarily acting on behalf of the shareholders and for which the executives are also often major shareholders themselves,. These executives make various decisions and act in many other ways that may involve liability risks; however, these executives are very unlikely to grab a shovel or hammer and head out to do a 'real days work'. Accordingly, if these executives are not on a job site, chances are very good that the executive will never be hands-on in some incident that causes or contributes to some sort of accident. Quite simply, [Geoff Smith as the President and C.E.O. of EllisDon](#) is unlikely seen digging trenches, pouring concrete, or hot tarring roofs. Other than perhaps for a media photo shoot, I doubt that Mr. Smith ever dons a hardhat to attend a work site. As such, the personal liability potential

faced by Mr. Smith involves little more than the usual concerns as may arise from any boardroom wrongdoing. However, the owner-director of a small corporation will regularly step out of the boardroom and get their hands dirty in day-to-day operations. By doing so, the small corporation owner-director becomes personally exposed to a large gamut of tort liability risks that threaten bank accounts, investments, and the nearly paid off home; *ADGA Systems International Ltd. v. Valcom Ltd.*, [1999 CanLII 1527](#).

As above, the hands-on small corporation owner-director may become liable for tortious wrongdoings where the owner-director played a role in the wrongdoing. This was very recently confirmed in the case of *Khursheed v. Venedig Capital SAS*, [2019 ONSC 5190](#) wherein it was said:

[26] The case law makes clear that unless there is an independent cause of action against them, officers, directors and employees are protected from personal liability for acts carried out under a corporate name. As the Court of Appeal stated in *ScotiaMcLeod Inc. v. People's Jewellers Ltd. (1995)*, [1995 CanLII 1301](#) (ON CA), 26 O.R. (3d) 481 (C.A.), at pp. 490-491:

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 employees or officers, they are also rare. ... In every case, however, the facts giving rise to personal liability were specifically pleaded. Absent allegations which fit within the categories described above, officers or employees of limited companies are protected from personal liability unless it can be shown that their actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own.

[27] The Court of Appeal went on to say that a corporation's directors or officers may cause it to sign a contract, since a corporation can only operate through human agents. However, this does not mean that "*if the actions of the directing minds are found wanting, that personal liability will flow through the corporation to those who caused it to act as it did*": *Scotia McLeod v. People's Jewellers*, at p. 491.

[28] Directors and officers are responsible for their tortious conduct even though that conduct was directed in a bona fide manner to the best interests of the company, subject to the exception for liability for procuring a breach of contract: *Adga Systems International Ltd. v. Valcom Ltd. (1999)*, [1999 CanLII 1527](#) (ON CA), 43 O.R. (3d) 101 (C.A.), at para. 18. In order to properly plead a cause of action against the directors or officers of a corporation, a separate claim must be stated against the individuals in their personal capacity: *Scotia McLeod v. People's Jewellers*, at p. 491. The statement of claim must allege actions conducted by the individuals which are themselves tortious or exhibit a separate identity or interest from that of the corporation so as to make the act or conduct complained of their own: *Ibid.*

By frequently being hands-on, the small corporation owner-director is quite likely somewhat directly involved if some incident occurs involving general negligence, negligent hiring, negligent design, negligent workmanship, negligent supervision, misrepresentation, or misstatement. Stakeholders, such as client property owners, neighbours, employees, subcontractors, material suppliers, equipment operators, banks, governments, public-at-large, and others, whose wellbeing might be harmed or injured by a small corporation owners hands-on wrongdoing (whether intentional or unintentional) can, and often do, sue the small corporation owner-director.

Addressing principal owner directors of corporations, courts have ruled that, "Where those actions are themselves tortious or exhibit identity or interest from that of the corporation so as to make the act or conduct complained of their own, they may well attract personal liability."; *Blacklaws v. Morrow*, [2000 ABCA 175 at 41.](#) "... the Court of Appeal in *AGDA Systems* confirms that a breach of a duty of care owed by a director to a plaintiff can result in separate tortious liability"; *Pelliccione v. John F. Hughes Contracting and Development Company*, [2005 CanLII 24822](#).



So, what can the small corporation owner-director do? Well, firstly avoid being naive. Secondly, proactively manage your liability risks by:

-
- ▷ Speaking to a corporate law lawyer that also deeply understands tort law and civil litigation matters to learn more about how limited the limited personal liability benefits are when having your business incorporated;

 - ▷ Speaking to your financial planner for hints and tips on protecting your assets;

 - ▷ Speaking to your insurance broker about general liability insurance, directors' & officers' liability insurance and other insurances; and

 - ▷ Speaking to your trade association, advisors, consultants, educators, friendly competitors, and others for the purpose of learning, and using, risk management hints and tips that help to reduce the possibility of accidents and general business wrongdoing.

An exception to the general rule that a director of a corporation can be held liable when directly involved in a tortious act is when the director, as controlling mind of the corporation, makes decisions relating to breach of the corporation's contracts. While unlawful wrongdoing in tort law generally does include the wrong of inducing breach of contract or interference in contractual relations, *Lumley v. Gye*, (1853) 118 E.R. 749, an exception exists when a director makes such a decision within the scope of the director's duties and legal claims should not be brought in these situations. Accordingly, if the director-owner of a small business corporation 'decides' that the corporation is not paying certain bills for goods purchased by, or services rendered to, the corporation, litigation against the director remains off limits, *Said v. Butt*, [1920] 3 K.B. 497. This is true in most cases but there are exceptions to the exception such as when it can be shown that the director was culpable while wearing a personal identity rather than a director identity and made the decision for personal benefits rather than with the corporate welfare foremost in mind.

Additionally, sometimes a small business owner will fail to engage with the public or clients in a manner that clearly shows that the owner is engaging on behalf of the corporation. Where the owner fails to clearly identify the corporation to the public or clients, the owner is unable to hide beneath the corporate veil as the law will treat the owner as a personally liable sole-proprietor.

Lastly, I want to share with you the flip side - what if we were wronged by the owners, managers, or employees, of a small corporation while said were acting on behalf of a corporation - who can be sued?

The answer is the small corporation entity (i.e. ABC Contracting Inc. - "ABC") and all those persons tortiously connected to the wrong. As a very simple example, if employee 'Bob' of ABC negligently digs a hole resulting in a 'trip and fall' injury after being hired by 'Joe', trained by 'Jim', and supervised by 'John', a case may be made out for suing ABC corporately as well as Bob, Joe, Jim, and John personally. Of course, the practicality of who to sue in a given situation needs specific circumstances evaluation by a legal professional. If the injuries are relatively minor, a licensed paralegal can help assess the situation and potentially bring legal action in the Small Claims Court; however, if the injuries are serious, a lawyer's attention is required.