PERSONAL LIABILITY OF DIRECTORS AND OFFICERS IN TORT: SEARCHING FOR COHERENCE AND ACCOUNTABILITY

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INTRODUCTION

The 21st century has been marred by corporate scandal after scandal—including financial fraud,[1] pyramid schemes,[2] international bribery,[3] and decades of sexual harassment.[4] This raises a question regarding the role of corporate and tort law in reining in the behavior of corporate executives. It is clear that directors and officers should not be overexposed to tortious liability—doing so would make them ultimately insurers of the firm's obligations.[5] Yet, underexposure to liability has adverse consequences when directors and officers are not required to conduct themselves reasonably. This may embolden them to act without due care, not only with regard to their duties to shareholders, but also with respect to interactions with third parties.[6] Furthermore, underexposure works an injustice to third parties who would otherwise have broad access to the ordinary principles of tort law. That is, underexposure precipitates

1. Hugh Grove & Elisabetta Basilico, *Major Financial Reporting Frauds of the 21st Century: Corporate Governance and Risk Lessons Learned*, 3 J. FORENSIC & INVESTIGATIVE ACCT. 1 (Special Issue 2011).

2. *Chapter 7: MLM's Abysmal Numbers* in JON M. TAYLOR, THE CASE (FOR AND) AGAINST MULTI-LEVEL MARKETING, https://www.ftc.gov/sites/default/files/documents/public_comments/trade-regulation-rule-disclosure-requirements-and-prohibitions-concerning-business-opportunities-ftc.r511993-00008%C2%A0/00008-57281.pdf [https://perma.cc/MWV2-K4YW] (comparing multi-level marketing and traditional pyramid schemes).

3. Robbie Gramer, *Bribery Is on the Rise Worldwide, and It Costs A Lot More Than Just Money*, FP (Dec. 1, 2016), https://foreignpolicy.com/2016/12/01/global-bribery-corruption-scandal-worldwide-index-infographic/ [https://perma.cc/KL7D-8L2S].

4. Rhitu Chatterjee, *A New Survey Finds 81 Percent of Women Have Experienced Sexual Harassment*, NPR (Feb. 21, 2018), https://www.npr.org/sections/thetwo-way/2018/02/21/587671849/a-new-survey-finds-eighty-percent-of-women-have-experienced-sexual-harassment [https://perma.cc/77Q9-G4MH].

5. Frank Easterbook & Daniel Fischel, *Limited Liability and the Corporation,* 52 U. CHI. L. REV. 89, 93–94 (1985). For further discussion, see *infra* Part II.

6. Shannon O'Byrne, Katherine Fraser, & Yemi Philip, *The Tortious Liability of Directors and Officers to Third Parties in Common Law Canada,* 54 ALTA. L. REV. 878 (2017). *See also* Janis Sarra, *The Corporate Veil Lifted: Director and Officer Liability to Third Parties*, 35 CAN. BUS. L.J. 55, 66 (2001) (observing that if directors acting in the best interest of the corporation are exempt from tortuous conduct they will be encouraged to take risks that may harm third parties). In addition, empirical research is casting doubt on the efficacy of directors in fulfilling their gatekeeping role against corporate wrongdoing – and in some cases, the data suggest they may be participating in self-serving behaviors. *See generally* S. Burcu Avci, Cindy A. Schipani, & H. Nejat Seyhun, *Do Independent Directors Curb Financial Fraud?*, 93 IND. L. J. 757 (2018); S. Burcu Avci, Cindy A. Schipani, & H. Nejat Seyhun, *Manipulative Games of Gifts by Corporate Executives,* 18. U. PA. J. OF BUS. L. 1131 (2016); S. Burcu Avci, Cindy A. Schipani, & H. Nejat Seyhun, *Ending Executive Manipulations of Incentive Compensation*, 42 J. CORP. L. 277 (2016).

unfairness when, for example, the deserving third party plaintiff is denied judgment simply because the tort is committed by an exempted director or officer class.[7] And as evidenced by the scandals of late, underexposure presents a serious risk of decay to corporate culture.

The question of director and officer personal liability in tort to non-shareholder third parties poses a particular challenge because it involves a deep contest between tort law values and corporate law values.[8] Because pure tort law manifests strong notions of personal responsibility and accountability,[9] it draws this simple conclusion: if one has committed a tort, then one has personal liability. Corporate law, by way of contrast, moves in the opposite direction. Imposing personal liability on directors and officers acting in the course of their duties to the corporation would or could threaten the modern corporation as a separate legal entity.[10] In short,

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7. *See* Joan Loughrey, *Breaching the Accountability Firewall: Market Norms and the Reasonable Director,* 37 SEATTLE U. L. REV. 989, 1016 (2014) ("Holding market participants accountable to the law signals that they are not exempt from the demands of community morality. Markets are after all, embedded in society and exist to serve society's aims."); Jason M. Solomon, *Equal Accountability through Tort Law*, 103 NW. U. L. REV. 1765, 1809 (2009) ("[I]t is accountability as a constant social understanding that tort law serves to reinforce. By a constant social understanding, I mean that – as we go about our lives, make our choices and plan our activities – that we are *answerable* to one another. We understand if the pursuit of our own ends is not conducted with due care for others, we may be held to account by those we harm. By harming others, we incur a moral or social debt that may be translated into a financial one. And those we harm may call us into the legal system to settle our accounts.") (footnote omitted).

8. For discussion, see O'Byrne, Fraser & Philip, *supra* note 6. *See also* Christian Wittin, *The Small Company: Directors' Status and Liability in Negligence*, 24 KING'S L.J. 343 (2013) (discussing the competing interests of a company director).

9. *See* Solomon, *supra* note 7, at 1809. *See also* Thomas C. Galligan Jr., *Contortions Along the Boundary Between Contracts and Torts*, 69 TUL. L. REV. 457, 460 (1994) ("Tort law is more communitarian in nature and purpose. While contract law generally turns on the idea that people can do as they choose, as long as they do not step outside its very broad contours, tort law imposes more drastic limits on individual freedom . . . One may view the reasonable person standard as the symbolic point at which society arrests unfettered freedom of action."); LEWIS KLAR & CAMERON JEFFRIES, TORT LAW 14 (6th ed. 2017) ("Tort law operates as an important part of the Canadian society's civil *justice* system. Its theoretical underpinning – that a wrongdoer who injures another ought to be required to repair the damage and restore the victim – is clearly an integral part of our system of values.").

10. *See, e.g.,* Trustees of Dartmouth College v. Woodward, 17 U.S. 518, 667 (1819) ("An aggregate corporation at common law is a collection of individuals united into one collective body, under a special name, and possessing certain immunities, privileges, and capacities in its collective character, which do not belong to the natural persons composing it."); Donnell v. Herring-Hall-Marvin Safe Co., 208 U.S. 267, 273 (1908) ("A leading purpose of [corporation] statutes and of those who act under them is to interpose a non-conductor, through which, in matters of contract, it is impossible to see the men behind.").

making directors and officers broadly liable for torts committed in such circumstances amounts to a forced, personal guarantee of the corporation's tortious liabilities.[11] This would both undermine and overwhelm the principle of limited liability[12] and separate corporate personhood. Robert Rhee calls this tension "inter-doctrinal divergence" and summarizes the matter more broadly as follows: "[t]ort law finds fault; corporation law excuses it."[13]

The purpose of this Article is to measure the coherency and fairness of how various U.S. state courts attribute personal liability to directors and officers in actions by non-shareholder third parties. The Article's touchstone throughout is Professor Lewis Checchia's admonishment that the law must not "reward unreasonable and unethical conduct" nor "deny recovery to injured third parties with valid legal claims."[14]

Part I offers an assessment of U.S. common law with a focus on two main fronts: negligence causing personal injury or property loss and negligence causing pure economic loss. Analysis on the first front focuses on decisions from Delaware in light of its preeminence in corporate law, as well as contrasting approaches taken by California and New York courts. It concludes, *inter alia*, that the law of Delaware is deficient for too broadly shielding directors and officers in relation to negligence causing personal injury and property loss. Analysis on the second front focuses on several California decisions and one decision from the New York Court of Appeals while acknowledging that case law concerning negligence causing pure economic loss brought against directors and officers is relatively sparse. This Part concludes that courts are correct to require proof that the defendant officer or director owed a duty of care in his or her *personal* capacity, but not all courts are sufficiently careful in analyzing the duty

See also O'Byrne, Fraser & Philip, *supra* note 6, at 880–81.

11. Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57, para. 146.

12. *See* Anderson v. Abbott, 321 U.S. 349 (1944) ("Limited liability is the rule, not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted."); First Nat. City Bank v. Banco Para El Comercio Exterior de Cuba, 462 U.S. 611, 625 (1983) ("Separate legal personality has been described as 'an almost indispensable aspect of the public corporation."); Salomon v. Salomon & Co. [1897] AC 22 (HL).

13. Robert Rhee, *The Tort Foundation of Duty of Care and Business Judgment,* 88 NOTRE DAME L. REV. 1139, 1141-1157 (2013) (arguing for an understanding of director's liability to the corporation such that tort and corporate law converge).

14. We adopt these words from Lewis Checchia which were offered in the context of auditor liability to third parties. Lewis P. Checchia, *Accountants' Liability to Third Parties under Bily v. Arthur Young & (and) Company: Does a Watchdog Need Protection,* 38 VILL. L. REV. 249, 284 (1993).

question. In short, the economic loss doctrine in U.S. state law is harsh vis-à-vis the injured party, largely insulating directors and officers from personal liability.

Part II shifts gears and assesses Canadian law as a useful comparator. This Part concludes that Canada is correct to treat directors and officers as any other defendants in the context of personal injury and property loss but, in varying ways, may stumble when it comes to assessing liability for simple negligence causing pure economic loss. On the one hand, some courts have historically *underexposed* directors and officers to liability in relation to ordinary negligence causing pure economic loss by foreclosing recovery as a matter of course. On the other hand, certain courts have leaned toward *overexposing* directors and officers for this same kind of liability by too easily finding that the plaintiff was owed a *personal* duty of care by the individual defendant. Fortunately, a new line of authority in Alberta is largely successful in addressing these deficiencies.

Drawing on all the Article's jurisdictional sources, we offer some brief conclusions, including that the ideal liability regime is one that eschews special defenses for directors and officers.

I. DIRECTOR AND OFFICER LIABILITY TO NON-SHAREHOLDER THIRD PARTIES IN THE UNITED STATES

Prior to assessing director and officer liability to non-shareholder third parties, it is important to note that in Delaware, for example,[15] statutory law permits corporations to exculpate directors from monetary liability to the corporation for breach of fiduciary duty, excepting breach of the duty of loyalty, acts not in good faith, intentional misconduct and actions resulting in an improper personal benefit.[16] That is, Section 102(b)(7) of the

15. "Between 1985 and 1995, approximately forty other states followed Delaware's lead in authorizing the release of damage claims for breach of a duty of care." WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 246 (5th ed. 2016).

16. DEL. CODE ANN. tit. 8, §102(b)(7)(2017). See Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989) for a discussion of the impact of *Van Gorkom* resulting in the amendment to the Delaware Code. Other U.S. states followed Delaware's lead and similarly adopted legislation limiting or eliminating liability for directors for breach of the duty of care. *See* Roberta Romano*, Corporate Governance in the Aftermath of the Insurance Crisis,* 39 EMORY L.J. 1155, 1160–61 (1990) (reporting that over 90 percent of a sample of Delaware public corporations adopted exculpatory provisions); *see also* Lawrence A. Hamermesh, *Why I Do Not Teach* Van Gorkom, 34 GA. L. REV. 477, 479 (2000) ("Exculpatory charter provisions adopted pursuant to statutes, universally enacted since *Van Gorkom,* have

Delaware Code permits firms to eliminate monetary liability of directors to the corporation and its shareholders for damages ensuing from acts of gross negligence.[17] The amendment's appeal to freedom of contract helped to broadly quell the aftermath of the Delaware Supreme Court decision in *Smith v. Van Gorkom,*[18] which found the defendant directors grossly negligent and thus in breach of their duty of care. Concerns about this decision included the precipitous escalation of insurance costs for directors and fears that individuals qualified to serve as directors would otherwise exit the market,[19] making everyone worse off. For these kinds of reasons, the new provision permitted further degradation of the already low common law standard directors owed to shareholders and the corporation (that of gross negligence). One informing idea was that corporations and shareholders should be able to choose the foundation of their relationship, with freedom of contract as an established, albeit contested, value or rationale.[20] Though shareholders stand to lose by virtue of reduced director accountability on the duty of care front (including the risk of shirking), these risks are presumably offset by gains, including access to a strong pool of individuals willing to serve and the increased opportunity for "desirable entrepreneurial decision making."[21] As a result, the Delaware Code (and its

rendered the damages claim for the breach of duty of care essentially non-existent."); See John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989), for a discussion of the tension between innovative contractual freedom and mandatory enforcement of strict fiduciary duties. See also Gabriel Rauterberg & Eric Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers,* 117 COLUM. L. REV. 1075 (2017), for the same debate in the context of the "mandatory" fiduciary duty of loyalty and corporate opportunity waivers.

17. DEL. CODE ANN. tit. 8 § 102(b)(7) (2017).

18. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). "Before *Smith v. Van Gorkom,* the duty of care had been 'essentially unenforceable as a stand-alone concept,' but *Van Gorkom* made it into an enforceable duty that came to occupy a more central place on the corporate law stage." Stephen P. Lamb, *Duty Follows Function: Two Approaches to Curing the Mismatch between the Fiduciary Duties and Potential Personal Liability and Corporate Officers,* 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 45, 53 (2012) (quoting William T. Allen et. al, *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law,* 56 BUS. LAW. 1287, 1290 (2001)).

19. Edwards P. Welsh & Robert S. Saunders, *Freedom and its Limits in the Delaware General Corporate Law*, 33 DEL. J. CORP. L. 845 (2008).

20. Thomas Lee Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273 (1991).

21. *See* Welsh & Saunders, *supra* note 19, at 855 (quoting Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 793 (Del. Ch. 2004)) (identifying as the purpose of section 102(b)(7) to "encourage 'capable persons to serve as directors . . . by providing them with the freedom to make risky, good faith business decisions without fear of personal

counterparts in other states) empowers a departure from the common law in relation to the director-corporation and director-shareholder relationship.[22]

Accepting for the purposes of this Article that internal groups should be able to lower common law standards *inter se*, the question becomes whether directors should likewise owe a lower standard of accountability to those external to the corporation (such as creditors, customers, employees, and tenants). At the most general level, lowering the standard in relation to external groups collides with purposes of tort law, which include redressing injurious wrongs;[23] compensating innocent injured parties; shifting the costs to the appropriate parties; and deterring future wrongful conduct.[24] Tort law accomplishes these purposes, in part, "through the recognition of a duty to exercise reasonable care and the imposition of liability for the breach of such a duty."[25] With this context in mind, on what basis, if any, should the ordinary protection of tort law be reduced or eliminated when third parties interact with corporate directors and officers?

Concerning the tortious liability of directors and officers in the U.S., the law is clear that these individuals are not personally liable for torts based solely on their positions within a corporation.[26] This is entirely appropriate because directors and officers are not guarantors of corporate operations. Rather, directors and officers must have engaged in the tortious behavior at issue or otherwise have a connection to it in order to be liable.[27]

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liability'"); 57 DEL. CODE ANN. tit 8, § 122(17) (2001).

22. *See* Welsh & Saunders, *supra* note 19, at 850 (quoting *Sterling v. Mayflower Hotel Corp*., 33 Del. Ch. 293, 313 (1952) ("the stockholders of a Delaware corporation may by contract embody in the [certificate] a provision departing from the rules of the common law, provided that it does not transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself.")).

23. VA. PRAC. TORT AND PERSONAL INJURY LAW § 1:2 (Nov. 2018).

24. AMERICAN LAW OF TORTS § 1:3 (Mar. 2019).

25. *Id.*

26. Martin Petrin, *The Curious Case of Directors' and Officers' Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law*, 59 AM. U. L. REV. 1661, 1667 (2010); *see also* 19 C.J.S. Corporations § 640 ("A director, officer, or agent is not liable for torts of the corporation or of other officers or agents merely because of his or her office. He or she is liable for torts in which he or she has participated or which he or she has authorized or directed.").

27. *See Lobato v. Pay Less Drug Stores, Inc.,* 261 F.2d 406, 408–09 (10th Cir. 1958) ("It is the general rule that if an officer or agent of a corporation directs or participates actively in the commission of a tortious act or an act from which a tort necessarily follows or may reasonably be expected to follow, he is personally liable to a third person for injuries proximately resulting therefrom. But merely being an officer or an agent of a corporation does not render one personally liable for a tortious act of the corporation. Specific direction or sanction of, or active participation or cooperation in, a positively wrongful act of commission or omission which operates to the injury or prejudice of the complaining party

Following agency law principles, directors and officers are personally liable for torts they commit—even when the tort is committed in an official capacity[28] and even if a director or officer is acting for the benefit of the corporation rather than for personal gain.[29] However, as is discussed below, directors and officers in certain jurisdictions face considerably less liability, particularly in the cases of negligence, than would other defendants. This differential treatment is problematic because it raises the specters of unaccountability, a decline in corporate culture, and lack of justice for the plaintiff.

Personal liability of directors and officers for intentional torts such as fraud is relatively routine and non-controversial, given the extreme nature of the conduct involved.[30] Personal liability for negligence is more problematic and contested. Accordingly, it is the focus of the following section.

A. Negligence Causing Personal Injury or Property Damage

Courts have found that the type of injury caused by the defendant matters in determining culpability and thus broadly differentiate between personal injury and property damage, on the one hand, and pure economic loss, on the other. Outside a corporate context, tort law is quick to find a duty of care when the defendant has negligently caused personal injury or

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is necessary to generate individual liability in damages of an officer or agent of a corporation for the tort of the corporation.").

28. Petrin, *supra* note 26, at 1668; *see also* 19 C.J.S. Corporations § 640 ("A director, officer, or agent is not liable for torts of the corporation or of other officers or agents merely because of his or her office. He or she is liable for torts in which he or she has participated or which he or she has authorized or directed.").

29. Petrin, *supra* note 26, at 1668.

30. *See id.* at 1709 ("This deviation from an effort to limit personal liability is justified because, apart from moral hazard considerations, directors and officers, like any other person, remain under a duty not to commit intentional torts."). *See* PMC, Inc. v. Kadisha, 78 Cal. App. 4th 1368, 1382 (Cal. App. 2 Dist. 2000) ("All persons who are shown to have participated in an intentional tort are liable for the full amount of the damages suffered. This rule applies to intentional torts committed by shareholders and those acting in their official capacities as officers or directors of a corporation, even though the corporation is also liable" (citing Vacco Industries, Inc. v. Van Den Berg 5 Cal. App. 4th 34, 53, fn. 20 (1992)); Klein v. Oakland Raiders, Ltd. 211 Cal. App. 3d 67, 76–79 (1989) (general partner could be personally liable for conspiring to violate the Sherman Act on behalf of limited partnership); *see also* Am. Med. & Life Ins. Co. v. CrossSummit Enters., 910 N.Y.S.2d 403, 411 (2010) ("Corporate officers and directors may be held individually liable if they participated in or had knowledge of the fraud, even if they did not stand to gain personally." (quoting Pludeman v. Northern Leasing Sys., Inc., 10 N.Y.3d 486 (2008)).

property damage because of the nature of the interest involved. As noted in *Restatement (Third) of Torts*, when the defendant's conduct creates a risk of physical harm, the defendant owes a duty to act with due care.[31] Furthermore, as held by Justice Cardozo in *Palsgraf v. Long Island Railroad*, the defendant owes a duty of care to those whom a reasonable person would have foreseen a risk of harm—that is, the question is whether the injured party was within a "foreseeable zone of danger."[32] The scope of that duty is defined as the reasonable person standard: each person owes a duty to act as a reasonable person would under the same or similar circumstances.[33]

Within a corporate context, it is possible to reach the same result but courts tend to follow a different framework to get there. This framework requires the plaintiff to show acts by the individual defendants amounting to direct participation in the wrongful conduct.[34] In certain jurisdictions, the framework has afforded directors and officers an effective but unduly extensive shield from tortious liability. In Delaware, the requirement of participation in the personal participation doctrine excludes liability for "nonfeasance or the omission of an act which a person ought to do."[35] For example, in the Delaware Superior Court case of *Brandt v. Rokeby Realty Co.*, the tenant suffered personal injuries resulting from toxic mold in a

31. RESTATEMENT (THIRD) OF TORTS § 7(a) (2010).

32. Palsgraf v. Long Island Railroad, 248 N.Y. 339 (1928). The duty analysis however, is not without its challenges. According to Professor Leon Green, "both foreseeability and reasonableness imply conduct based on considered judgment, while the conduct in negligence cases is frequently instantaneous and rarely based on considered judgment." Leon Green, *Foreseeability in Negligence Law*, 61 COLUM. L. REV. 1401, 1420 (1961). Furthermore, the jury's decision on negligence "should not be based on the impossible foresight of some mythical person, but on the factual details made known to the jury, frequently long after the defendant's conduct occurred." *Id. See also* the dissenting opinion of Judge Andrews in *Palsgraf,* arguing that duty is not imposed on the basis of foreseeability, rather duty is imposed because one must refrain from unreasonably threatening the safety of others. Palsgraf v. Long Island Railroad, 248 N.Y. 339 (1928) (Andrews, J. dissenting opinion).

33. RESTATEMENT (THIRD) OF TORTS § 7(a) (2010); *see, e.g.,* Mansfield v. Circle K. Corp., 877 P.2d 1130 (Okla. 1994) ("[T]he standard of conduct is that of a reasonably prudent person under the same or similar circumstances.").

34. *See, e.g., Lobato v. Pay Less Drug Stores, Inc.*, 261 F.2d 406, 409 (10th Cir. 1958) (requiring plaintiff to show acts by the individual defendants amounting to an "affirmative direction, sanction, participation, or cooperation in the alleged tortious act of the corporate defendant"). *See also* cases cited *infra* notes 36-77 and accompanying text.

35. Yavar Rzayev, LLC v. Roffman, No. CV S14L-12-035 MJB, 2015 WL 5167930, at *6 (Del. Super. Ct. Aug. 31, 2015) (quoting *Heronemus v. Ulrick*, No. CIV.A.97C-03-168-JOH, 1997 WL 524127, at *2 (Del. Super. Ct. July 9, 1997)).

building owned by that corporate defendant.[36] The injured party sued both the corporate defendant and the president of the corporation, Mr. Copeland, among others, for negligence.[37] The court allowed Copeland's motion for summary judgment on the basis that he had not personally participated in the tort.[38] The court stated that "[t]he personal participation doctrine stands for the idea that an officer of a corporation can be held liable for his own wrongful acts."[39] Quoting the Delaware Superior Court decision in *Heronemus v. Ulrick*,[40] the court further stated that "[c]orporate officers cannot be shielded from tort liability by claiming the actions were done in the name of the corporation."[41] The court emphasized, however, that under the personal participation doctrine, *knowledge* of health complaints would not be sufficient.[42] Rather, the plaintiff "must show that the officer 'directed, ordered, ratified, approved, or consented to' the tortious act*,"* and that the officer was engaged in misfeasance or "active negligence."[43] In short, there is no liability for "nonfeasance or the omission of an act which a person ought to do."[44] The court went on to add that "[c]laims based on the failure to warn, inspect or repair, or implement and supervise indoor air quality programs for common areas affected by mold [are] acts of nonfeasance."[45] The court found that, at most, the president had knowledge of the health complaints, but took no action to harm the plaintiff, and thus could not be liable under the personal participation doctrine.[46]

In another negligence case, the Superior Court of Delaware in *Ayers v. Quillen* asked whether the alleged negligence amounted to "active" negligence or mere nonfeasance in the context of property loss.[47] The difference would be critical because courts following this line of authority would not hold directors liable for nonfeasance. In *Ayers,* two of plaintiff's dogs were injured by other dogs while being boarded at a kennel.[48] The

36. *Brandt v. Rokeby Realty Co.*, No. C.A. 97C-10-132-RFS, 2004 WL 2050519, at *8–10 (Del. 2004).

37. *Id.*

38. *Id.*

39. *Id.* at *9.

40. *Heronemus*, No. CIV.A.97C-03-168-JOH, 1997 WL 52427, at *2 (Del. Super. Ct.).

41. *Brandt*, 2004 WL 2050519, at *9 (quoting *Heronemus*, 1997 WL 524127, at *2).

42. *Id.* at * 10 (citing *Heronemus*, 1997 WL 524127, at *2).

43. *Id.* (citing *Heronemus*, 1997 WL 524127, at *2).

44. *Brandt,* 2004 WL 2050519, at *10.

45. *Id.*

46. *Id.*

47. Ayers v. Quillen, No. CIV.A.03C-02-004-RFS, 2004 WL 1965866, at *3 (Del. Super. Ct. June 30, 2004).

48. *Id.* at *1.

kennel itself was incorporated and Mr. Quillen was the sole owner of the corporation. After this incident, plaintiff brought a raft of claims against Mr. Quillen, as an individual, on various theories of negligence and fraud. One of Mr. Quillen's defenses was that "[the plaintiff] was dealing with the Kennel, which is a corporation," and thus the claims against him as an individual should be dismissed.[49] In responding to this defense, the court first decided that Mr. Quillen was essentially an agent with a managerial/directorial role because he had more control over this corporation than anyone else.[50] After referencing agency and corporate law,[51] the court turned to the personal participation doctrine.[52] It allowed the claim to proceed to trial because Mr. Quillen managed the business. The court left it to the plaintiff to prove the defendant's active misfeasance at trial, leaving no doubt that nothing less would do in order to find liability.[53]

Similarly, in another case involving property damage, the court required active involvement in the wrong. In *Washington House Condominium Association of Unit Owners v. Daystar Sills, Inc.*, Daystar Sills, Inc. (Daystar), the defendant corporation, was hired to build a condominium for the Washington House Project.[54] When constructing the building, the president and sole owner of Daystar, Mr. Sills, "approved the decision to use 'thin brick' veneer in place of the full brick for cost and time-saving purposes."[55] He also worked on finding a manufacturer for the thin brick product, and allegedly pushed to keep the construction on schedule despite concerns raised about this product.[56] Within several years after construction, this building began disintegrating in areas, with sections of it crumbling and creating water leakage problems, among other issues.[57] All this culminated in a lawsuit where Mr. Sills was named as one of the defendants.[58] Regarding whether Mr. Sills incurred personal liability, the

49. *Id.*
50. *Id.* at *3.
51. *Id.* The court cited the RESTATEMENT (SECOND) OF AGENCY § 343 (1958), 3A WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1135 (perm. ed. rev. vol. 2002), and 18B AM.JUR.2D CORPORATIONS § 1877 (1985); 19 C.J.S. Corporations § 544 (1990).
52. *Ayers*, 2004 WL 1965866, at *3.
53. *Id.*
54. Wash. H. Condominium Assn. of Unit Owners v. Daystar Sills, Inc., No. CVN15C01108WCCCCLD, 2017 WL 3412079, at *1 (Del. Super. Aug. 8, 2017).
55. *Id.* at *5.
56. *Id.*
57. *Id.* at *3–5.
58. *Id.* at 34.

court denied summary judgment.[59] According to the Delaware Superior Court, Mr. Sills could be personally liable because of his "'direct[ing], order[ing], ratif[ying], approv[ing], or consent[ing] to Daystar's negligent construction and repair of the Condominium" but not because of his in-depth involvement in the project.[60] His liability exposure was for choosing thin brick when he knew that there were concerns about this brick.[61] With regard to the personal participation doctrine, *Daystar* focused on active negligence: "[p]ersonal liability cannot be assessed absent 'active negligence' and a corporate agent's knowledge of defects and failure to warn or correct those defects will generally be considered acts of *nonfeasance*."[62]

The implication under Delaware law is that officers and directors are exonerated for simple negligence resulting from nonfeasance. Put another way, unless the negligence is "active," there is no liability. This is a problematic distinction and one which the courts do not seem to justify. Where personal injury and property damage are at issue, it is difficult to accept specialized protection of directors and officers—at least absent a compelling judicial account of why that should be the case and why the specialized rule is the only way to obtain the desired result. If ordinary (i.e.: non-director or officer) defendants can be found liable under tort law principles for failing to take steps to protect a foreseeable plaintiff from the very serious consequence of personal injury, it is difficult to see on what basis a director or officer be should be relieved of responsibility for the same omissions.

On a related front, the active personal participation approach is deficient because it does not systematically address the duty component of liability. Under the personal participation doctrine, the plaintiff must *also* presumably show that the individual defendant owes them an independent duty of care, but this ingredient can go unaddressed.[63] As Martin Petrin notes, certain courts:

> [D]o not explicitly discuss the requirement that the defendant director or officer breaches a duty that he personally owes to the injured party. Thus, it is unclear how these participation-based cases deal with the duty requirement, i.e.: whether they implicitly

59. *Id.*
60. *Id.* at 36.
61. *Id.*
62. Wash. H. Condominium Assn. of Unit Owners v. Daystar Sills, Inc., No. CVN15C01108WCCCCLD, 2017 WL 3412079, at *39 (Del. Super. Aug. 8, 2017).
63. Petrin, *supra* note 26, at 1671.

> assume that participation in a certain act or whether direct or foreseeable contact by itself creates the necessary duty, whether they work under the assumption that the corporation owed a duty which is then delegated to the individual director or officer, or whether they follow yet another approach.[64]

Given these uncertainties and deficiencies, the approach taken in California is a step in the right direction. As in Delaware, the California courts require the personal participation of corporate officers and directors in the tort before personal liability to third parties will ensue.[65] But, unlike in Delaware, nonfeasance may be enough to hold a corporate officer or director liable, provided a duty of care was owed to the third party. As the California Court of Appeal in *PMC, Inc. v. Kadisha* stated:

> To maintain a tort claim against a director in his or her personal capacity, a plaintiff must first show that the director specifically authorized, directed or participated in the allegedly tortious conduct [citation]; *or that although they specifically knew or reasonably should have known* that some hazardous condition or activity under their control could injure plaintiff, *they negligently failed to take or order appropriate action to avoid the harm* [citations]. The plaintiff must also allege and prove that an ordinary prudent person, knowing what the director knew at that time, would not have acted similarly under the circumstances.[66]

In this way, corporate directors and officers are held liable not just for malfeasance but also for negligence involving nonfeasance according to the ordinary rules of negligence.

The other aspect of the California approach that is superior is its express analysis of the duty of care question. In *Francis T. v. Village Green Owners Association,* for example, the personal liability of individual board members of a condominium owners association, among other defendants, was at issue for negligence related to an attack the plaintiff suffered in her

64. *Id*. at 1671 n.47.

65. Wyatt v. Union Mortg. Co., 24 Cal. 3d 773, 785 (1979) ("Directors and officers of a corporation are not rendered personally liable for its torts merely because of their official positions, but may become liable if they directly ordered, authorized or participated in the tortious conduct."). This rule can be traced back to a 1970 case, *United States Liab. Ins. Co. v. Haidinger v. Hayes, Inc.*, 1 Cal. 3d 586, 595 (1970), which cited a number of secondary sources as its authority. *See, e.g.,* 19 C.J.S. Corporations § 845.

66. PMC, Inc. v. Kadisha, 78 Cal. App. 4th 1368 (2000), *as modified on denial of reh'g* (Apr. 7, 2000) (quoting Frances T. v. Vill. Green Owners Assn., 42 Cal. 3d 490 (1986) (emphasis added)).

condominium unit from a criminal break-in.[67] The lighting around the condominium had been poor for some time.[68] To support her allegations of negligence, the plaintiff first claimed the directors took affirmative action by requiring her to remove the lighting she installed for self-protection against someone breaking into her unit, an incident that was foreseeable under the circumstances because the directors knew of a crime wave in the area.[69] The attack happened the same day she complied with the order.[70] Second, plaintiff alleged that the directors were negligent by being too slow to investigate and fix the lighting issues around the condominium—six months passed between the time when the directors first started investigating the lack of lighting and the incident in the plaintiff's unit.[71] Further, plaintiff claimed the directors knew of the high crime levels in the area, which meant they had knowledge of the risk the abysmal lighting created.[72] In holding that the facts pled by the plaintiff were sufficient to survive a demurrer, the California court stated "[d]irectors and officers have frequently been held liable for negligent nonfeasance where they knew that a condition or instrumentality under their control posed an unreasonable risk of injury to the plaintiff, but then failed to take action to prevent it."[73]

Beyond this, the *Frances T.* court engaged in discussions of the association's duty of care, as well as the individual directors' duties of care. The court noted:

> [L]ike any other employee, directors individually owe a duty of care, independent of the corporate entity's own duty, to refrain from acting in a manner that creates an unreasonable risk of personal injury to third parties. The reason for this rule is that otherwise, a director could inflict injuries upon others and then escape liability behind the shield of his or her representative character, even though the corporation might be insolvent or irresponsible.[74]

In the context of negligence causing property damage, the California court in *Michaelis v. Benavides* also engaged in a duty analysis such that the plaintiff was able to survive a motion for non-suit by the corporate

67. Frances T. v. Vill. Green Owners Assn., 42 Cal. 3d 490 (1986).
68. *Id.* at 509.
69. *Id.* at 510.
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.* at 505.

officer defendant.[75] At issue was liability relating to a poorly-constructed patio that developed multiple cracks that were caused by

> use of insubstantial wire screen, not steel rebar, as the reinforcement material, and [the president of the subcontractor who built the patio's] failure to install an expansion joint between the concrete and home's foundation. Also, the patio concrete was not thick enough at the outer edges and slid down the surrounding hill.[76]

The court considered the individual defendant's participation and also analyzed the duty question in relation to the plaintiff/appellant:

> Appellants' allegations here show that respondent did not merely make a corporate policy decision which was carried out by someone else. He personally participated in and directed the construction of appellants' patio and driveway. He personally bid for appellants' job and he personally negotiated with appellants for completion of the job. He personally made the decisions to use cheaper materials and construction methods which allegedly resulted in the patio's and driveway's structural inadequacies.[77]

Given that property damage was involved, the court's finding of a duty of care very much fits with mainstream tort law. Furthermore, the court also laid the foundation for its determinations on the duty front.

In sum, Delaware law correctly requires personal participation before holding officers and directors liable to third parties for torts. Requiring evidence of active malfeasance by the defendant is highly problematic however, particularly in the context of personal injury or property loss. By allowing exoneration in this context, the law is effectively permitting directors and officers to be unaccountable in cases where exercise of reasonable care would otherwise have avoided personal injury or property damage to another. Instead, California's approach is superior for calibrating tort law, corporate law, and agency law, rather than elevating corporate law values alone. This is because it permits liability for nonfeasance provided the plaintiff can establish a duty of care.

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75. Michaelis v. Benavides, 61 Cal. App. 4th 681, 684 (1998).
76. *Id.* at 683–84.
77. *Id.* at 686.

B. Torts Causing Pure Economic Loss

As a general principle, it is difficult to recover pure economic loss in tort. The genesis of this difficulty is the decision of the U.S. Supreme Court in *Robbins Dry Dock & Repair Co. v. Flint*.[78] In this case, the Court ruled against the plaintiff whose charter was delayed as a result of damage that the defendant's employee negligently caused to the ship's new propeller.[79] The foundation for this outcome was that the plaintiff had contracted with the owners of the boat and not the defendants;[80] it was not a third party beneficiary to the contract between defendant and vessel owner; it had had no property interest in the vessel; and the dry-dock had no reason to know of plaintiff's existence.[81] The Court found that a "tort to the person or property of one man does not make the tort-feasor liable to another merely because the injured person was under a contract with that other unknown to the doer of the wrong."[82] According to Justice Holmes, "[t]he law does not spread its protection so far."[83] Historically, economic damages were relegated to cases where pecuniary damages were also accompanied by physical injury.

The holding of *Robins Dry Dock & Repair* is essentially reiterated in section 776C of the *Restatement (Second) of Torts*, which reads:

> One is not liable to another for pecuniary harm not deriving from physical harm to the other, if that harm results from the actor's negligently:
>
> a. causing a third person not to perform a contract with the other, or
>
> b. interfering with the other's performance of his contract or making the performance more expensive or burdensome, or
>
> c. interfering with the other's acquiring a contractual relation with a third person.[84]

The section bars recovery for defendant's negligence absent physical

78. Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303 (1927). *See, e.g.*, David Gruning, *Pure Economic Loss in American Tort Law: An Unstable Consensus,* 54 AM. J. COMP. L. 187 (2006); Herbert Bernstein, *Civil Liability for Pure Economic Loss under American Tort Law,* 46 AM. J. COMP. L. 111 (1998).

79. *See Robins*, 275 U.S. at 309–10.

80. *Id.* at 303.

81. Gruning, *supra* note 78, at 189.

82. *Robins,* 275 U.S. at 309.

83. *Id.*

84. RESTATEMENT (SECOND) OF TORTS § 776C (1979), 23–24.

harm to either the person or property of the plaintiff.[85] The *Restatement (Second) of Agency* applies the rule to agents: "Liability imposed upon agents for active participation in tortious acts of the principal [has] been mostly restricted to cases involving physical injury, not pecuniary harm, to third persons."[86]

The economic loss doctrine is a judicially created doctrine "which prohibits a party from recovering in tort for economic losses, the entitlement to which flows only from a contract."[87] There are, however, exceptions to this doctrine regarding liability for intentional torts and liability for some claims of negligence when the connection between the tortfeasor and the plaintiff is foreseeable. This Part addresses these exceptions, beginning first with a brief discussion of intentional torts of officers and directors, followed by analysis of cases alleging negligence.

1. Fraudulent Misrepresentation

When individuals actively participate in fraudulent misrepresentations, on behalf of an entity, they may be found to be personally liable in tort. In *Yavar v. Roffman*, a case was brought against the company, an LLC, and the only principal of the company, Mr. Rzayev.[88] The defendants were sued for breach of contract after a contractor stopped working on a construction project, and the contractor counterclaimed, alleging, among other things, that the principal committed fraud. Here, it was alleged that Mr. Rzayev "made affirmative representations, meeting the requirement that liability only be imposed for 'misfeasance or active negligence' as opposed to 'nonfeasance or the omission of an act which a person ought to do.'"[89] The court asserted that "corporate officers *are not derivatively liable* for the torts of the corporation; however, corporate officers *are directly liable* for the torts they personally commit, whether on behalf of the corporation or otherwise."[90] The Delaware court allowed the claim to proceed.[91]

In addition, in 2018, the California Court of Appeal reversed a lower court's decision and held the owner and managing member of an LLC

85. Gruning, *supra* note 78, at 190.

86. RESTATEMENT (SECOND) OF AGENCY, § 352, 354 (1958).

87. Edelstein v. Goldstein, No. CIV.A.09C-05-034DCS, 2011 WL 721490, at *7 (Del. Super. Mar. 1, 2011).

88. Yavar v. Roffman, No. CV S14L-12-035 MJB, 2015 WL 5167930, at *6.

89. *Id.*

90. *Id.* at 6.

91. *Id.*

personally liable for failing to disclose the true condition of a residence that the LLC sold.[92] During a renovation of the property, "Geiser 'became aware of certain defects . . . , which included mold, mildew, current water intrusion, damage to the structure from prior water intrusion, and defects in the windows, roof and deck that gave rise to the mold and water damage'" and made "representations that concealed the problems."[93] The trial court concluded that the LLC, not the individual defendant, sold the residence and that appellants failed to allege a breach of statutory or fiduciary duty. The court stated that plaintiffs "failed to allege adequate facts to show that Geiser actively participated in the tortious conduct as an individual" and that personal liability could not be squared with the Complaint, which suggested that Geiser "signed the allegedly false disclosures 'as managing member'" of the LLC.[94] On appeal, plaintiffs argued that defendants were "attempting to escape liability by hiding behind the shield of their . . . characters" as members of the LLC.[95] The appellate court, in turn, relied on *People v. Pacific Landmark, LLC,*[96] to reverse the trial judge's decision, stating that "while managers of limited liability companies may not be held liable for conduct of their companies merely because of their corporate status, 'they may nonetheless be held accountable . . . for their personal participation in tortious or criminal conduct, even when performing their duties as manager.'"[97] The *Pacific Landmark* court had issued a preliminary injunction against the manager of the LLC for aiding and abetting a nuisance, by permitting prostitution on the property.[98] The manager "occupied a prominent and influential position at Pacific . . . [was] thoroughly familiar with all of its operations and business . . . [and] had full responsibility for and authority over the property where the nuisance occurred."[99]

Thus, in cases involving fraud, which by definition involves intentional misconduct, courts in the U.S. appear willing to hold individuals acting on behalf of a firm liable if they engaged in the tortious activity. In

92. Rungtiwa v. Geiser, No. B281329, 2018 WL 6303780 (Cal. Ct. App., Dec. 3, 2018).

93. *Id.* at *4.

94. *Id.* at *2.

95. Brief for Appellant at 33, Rungtiwa v. Geiser, No. B281329, 2018 WL 6303780 (Cal. Ct. App., Dec. 3, 2018).

96. People v. Pac. Landmark, LLC, 29 Cal. Rptr. 3d 193 (Cal. Ct. App. 2005).

97. Rungtiwa v. Geiser, No. B281329, 2018 WL 6303780, at *4 (Cal. Ct. App., Dec. 3, 2018).

98. *Pac. Landmark, LLC*, 29 Cal. Rptr. 3d at 193.

99. *Id.* at 202.

these cases, corporate law and tort law principles pair up well. Individuals are held accountable for the harms caused by their wrongful behavior – that they were acting as an agent is of no defense.

2. Negligence Causing Pure Economic Loss

As noted above and as a general principle, courts are reluctant to allow recovery of pure economic loss for negligence. There are a number of policy reasons for this reluctance. First, the rule prevents limitless, disproportionate, and often speculative liability for unforeseeable economic damages resulting from the negligence.[100] Justice Cardozo famously addressed this concern in *Ultramares v. Touche*, where he warned of extending "liability in an indeterminate amount for an indeterminate time to an indeterminate class."[101] The second rationale is the "deeply rooted jurisprudential belief that contract remedies are superior to tort remedies for dealing with issues of economic loss."[102] That is, "[a]pplication of the economic loss doctrine to tort actions between commercial parties is . . . [intended] to encourage the party best situated to assess the risk of economic loss, the commercial purchaser, to assume, allocate, or insure against that risk."[103] Burgeoning this principle is the argument that "the law of contract is better equipped than the law of tort to redress a buyer's financial disappointment when a deal turns out badly."[104]

A third less prominent argument for the rule concerns the normative value of the tort system. Cases involving economic loss, while perhaps resulting in unfair decisions where one party benefits at the other's expense, do not necessarily result in a social cost but "simply a transfer payment -- a private cost to one but an equal private benefit to another."[105] Furthermore, personal injury and property loss are qualitatively different. Courts are thus wary of over-deterring non-negligent activities or activities that are "otherwise efficiently deterred for the purpose of mitigating social

100. Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 542–43 (2009).

101. Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931).

102. Amanda K. Esquibel, *The Economic Loss Rule and Fiduciary Duty Claims: Nothing Stricter than the Morals of the Marketplace*, 42 VILL. L. REV. 789, 793 (1997).

103. Daanen & Janssen, Inc. v. Cedar Rapids, Inc., 573 N.W.2d 842, 846 (Wis. 1998); Johnson, *supra* note 100, at 545.

104. Ward Farnsworth, *The Economic Loss Rule*, 50 VAL. U. L. REV. 545, 553 (2016).

105. Robert J. Rhee, *A Production Theory of Pure Economic Loss*, 104 NW. U. L. REV. 49, 62 (2010).

cost."[106] This may be especially true where other areas of the law already provide adequate remedies.[107]

Perhaps, unsurprisingly, the rule against recovery for pure economic loss has faced widespread criticism. For example, scholars like Robert J. Rhee note that "the practice which, in many instances, denies recovery for pure economic loss in negligence cases is hard to reconcile with the recovery for potentially large economic losses resulting from negligently caused physical injury."[108] In the modern world, where physical injuries from a calamity or string of calamities can be staggering, drawing a distinction between physical and economic injury based on the scope of liability has become a tenuous position.[109] Furthermore, the argument against the rule has grown stronger as economic damages have become increasingly easier to foresee and, given the reliance of modern enterprise on computerized transactions, are increasingly the only damages available to injured parties.[110]

In part because of the competing views and scholarly debate, efforts to create a single general theory for the economic loss rules have failed. Rather, the "mass of precedent relating to tort liability for economic loss has yet to be disentangled and expressed with the clarity commonly found with respect to other tort law topics."[111] Instead, "courts usually proceed in the field of economic negligence by establishing discrete pockets of liability that are not connected to general principles."[112] The result is a highly fact-intensive and situation specific endeavor with an increased focus on the foreseeability of the damages, the intent and culpability of the parties involved, and the duty, if any, owed by the tortfeasor to the tort victim.[113]

The exceptions to the economic loss rule tend to involve cases of intentional misconduct[114] or, with regard to negligent misrepresentation, cases where the injured party is justified in relying on the provider of

106. *Id.*
107. *Id.*
108. Herbert Bernstein, *Civil Liability for Pure Economic Loss Under American Tort Law*, 46 AM. J. COMP. L. 111, 126 (1998).
109. *Id.*
110. Rhee, *supra* note 105, at 52.
111. Johnson, *supra* note 100, at 536.
112. Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749 (2006).
113. *Id.;* Johnson, *supra* note 100, at 555.
114. Johnson, *supra* note 100, at 529.

information.[115] An example would be where a tortfeasor provides information or services to a principal but knows that it will ultimately be used for the sake of the third party.[116] Thus, as a general matter, negligent misrepresentation effectively falls into an exception to the economic loss rule. According to §552 of the *Restatement (Second) of Torts*:[117]

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
> (2) . . . [T]he liability stated in Subsection (1) is limited to loss suffered
>> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.[118]

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115. RESTATEMENT (SECOND) OF TORTS: NEGLIGENT MISREPRESENTATION § 552 (AM. LAW INST. 1977).

116. *See, e.g.*, Bilt-Rite Contractors, Inc. v. The Architectural Studio, 866 A.2d 270, 287 (Pa. 2005) (holding the economic loss rule did not bar recovery where an architecture firm had provided inaccurate measurements to a contractor and reliance on such measurements caused foreseeable harm to the contractor's client).

117. Guardian Constr. Co. v. Tetra Tech Richardson, Inc., 583 A.2d 1378 (Del. Super. 1990).

118. RESTATEMENT (SECOND) OF TORTS: NEGLIGENT MISREPRESENTATION § 552 (AM. LAW INST. 1977). Some courts have further stated that he or she must establish: (1) "the defendant supplied the information to the plaintiff for use in business transactions with third parties" and (2) "the defendant is in the business of supplying information." Christana Marine Servs. Corp. v. Texaco Fuel and Marine Mktg. Inc, C.A. No. 98C-02-217WCC, 2002 WL 1335360, at *6 (Del. Super. June 13, 2002). *See also,* Milsboro Fire Co. v. Constr. Mgmt. Serv., C.A. No. 05C-06-137MMJ, 2006 WL 1867705, at *2 (Del. Super. June 7, 2006) (holding the defendant liable only if she is in the business of supplying information and supplied information for use in transactions with a third party). In *Delaware Art Museum v. Ann Beha Architects*, Inc., Civ. No 06-481, 2007 WL 2601472 (D. Del. Sept. 11, 2007), for example, recovery under the exception to the economic loss rule was barred because defendant engineers who had provided plans and specifications as a consultant for the renovation and expansion of the museum, were not in the business of supplying information within the scope of §522. "To determine whether a defendant is in the business of supplying information, a court must conduct a case-specific inquiry, looking into the

However, as demonstrated by the following decisions, it appears that even if the above requirements are met for establishing liability for negligent misrepresentation, courts are reluctant to hold corporate executives liable to third parties in their individual capacity for the economic damages incurred. Instead, courts tend to find the duty of the officer, director, or principal, runs to the entity for which they work, and not to the party harmed by their actions.

For example, in *United States Liability Insurance Co. v. Haidinger-Hayes*, an insurance company brought a negligence action against the corporation, Haidinger-Hayes, Inc., a licensed insurance agent and the corporation's president and principal executive officer, Mr. Haidinger, in California.[119] The defendant corporation had the authority to solicit and underwrite proposals for insurance, to determine the premium rate, and to issue contracts of insurance on plaintiff's behalf.[120] Plaintiff alleged negligence against both the corporation and the individual officer, V.M. Haidinger, in the computation of the premium rate of the policy. The trial court agreed. The California Supreme Court, however, found that although evidence was sufficient to allege the negligence of the defendants, the defendant officer could not be held personally liable. The court stated that "actionable negligence involves a legal duty to use due care, a breach of such legal duty, and the breach as the proximate or legal cause of the resulting injury."[121] Notably, the court remarked that "liability imposed upon agents for active participation in tortious acts of the principal have been mostly restricted to cases involving physical injury, not pecuniary harm, to third persons"[122] and thus found the only duty owed by Mr. Haidinger was to the corporation. It held:

> [M]ore must be shown than [the] breach of the officer's duty [t]o his corporation to impose personal liability [t]o a third person upon him. Neither the evidence nor the findings support the conclusion that defendant V.M. Haidinger was personally liable to plaintiff by reason of his negligent performance of his

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nature of the information and its relationship to the kind of business conducted." Delaware courts have found a defendant in the business of supplying information when "information is the end and aim product of a defendant's work." When, however, the "information supplied is merely ancillary to the sale of a product or service . . . defendant will not be found to be in the business of supplying information."

119. United States Liab. Ins. v. Haidinger-Hayes, Inc., 463 P.2d 770, 771 (Cal. 1970).

120. *Id.*

121. *Id.* at 594.

122. *Id.*

corporate duties.[123]

Another California case involving pecuniary (rather than physical) harm similarly highlights the critical distinction between duty to corporation and duty to third party. In *Self-Insurers' Security Fund v. Esis, Inc.*, plaintiff fund sued the former vice president of an insolvent employer, California Canners and Growers (CCG), alleging negligent misrepresentation to recover worker's compensation benefits.[124] The complaint alleged that the president (1) falsely estimated CCG's workers' liabilities, (2) knew that such estimates would be relied upon, (3) "actively ordered, participated in and authorized the tort" and (4) "knew or reasonably should have known that if CCG became insolvent CCG's employees would be injured" by the estimates.[125] Here, the court noted that there are:

> Two traditional limits on a corporate officer's personal liability for negligence as set forth in *United States Liab.*, namely (1) "the oft-stated disinclination to hold an agent personally liable for economic losses when, in the ordinary course of his duties to his own corporation, the agent incidentally harms the pecuniary interests of a third party" (Francis T. v. Village Green Owners Assn.) and (2) "the traditional rule that directors are not personally liable to third persons for negligence amounting merely to a breach of duty the officer owes to the corporation alone."[126]

The court concluded that the officer did not owe a duty of care to CCG's employees. Instead, it found that the president's conduct

> allegedly resulting in pecuniary harm to CCG employees, was not directed in any fashion towards, or in response to, the employees. By signing and submitting the Reports to the department, [the president] was acting solely in the scope and course of his employment for and on behalf of CCG in connection with its statutory reporting obligations. It was by virtue of his status as an officer of CCG, and for no other reason, that [the president] signed and attested to the Reports. . . . No cause of action for negligent misrepresentation lies against [the president] in his individual capacity.[127]

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123. *Id.*
124. Self-Insurers' Sec. Fund v. Esis, Inc., 204 Cal. App. 3d 1148 (1988).
125. *Id.* at 1161.
126. *Id.* at 1162.
127. *Id.* at 1163.

Similarly, in 2013, a California Court of Appeal ruled in favor of a corporate officer who argued that those in his position "are not personally liable for negligence when they make decisions in the course and scope of their duties to the corporation that incidentally cause economic harm to a third party but do not cause physical harm or property damage."[128] In this case, the plaintiff corporation, Omnel, sued Mr. Tanner, the chief executive officer and president of Tanner Industries, a California corporation and an owner involved in "the management and operation of Valpo-LLC,"[129] in his personal capacity, for negligence in a commercial lease agreement. Omnel alleged that Tanner "authorized, directed, and meaningfully participated in the construction of the build-out and the other actions which delayed timely completion," violated applicable laws and regulations, and caused Omnel to lose profits and business opportunities.[130] Further, Omnel alleged the defendant owed a personal duty "'to use ordinary care to prevent Omnel from being harmed as a result of his individual negligence in making the decisions and personally performing' the alleged harmful acts."[131]

During construction, Tanner had "falsely advised Omnel that no permits were required," continued to build without permits, did not complete the building to code, and relied on cost-cutting shortcuts.[132] Months later, after the City declined to issue a certificate of occupancy in the absence of required permits, "Tanner responded that he had friends with the City and that he would work it out."[133] Eventually, the construction failed to meet code and did not reach completion. The trial court reasoned that "any duty owed by Tanner regarding the management and operation of Tanner Industries and Valpo-LLC was owed to those entities, not to Omnel."[134] A result to the contrary would "eviscerate the protection against individual liability that incorporation would otherwise provide."[135] The appellate court affirmed and relied on the *Haidinger-Hayes* and *Francis T.* line of reasoning, distinguished negligence from intentional torts, and emphasized that the plaintiff did not own nor occupy the leasehold premises at any point. In considering Omnel's assertion of economic damages related to "lost profits and business opportunities," the

128. Omnel v. Tanner, No. C070907, 2013 WL 3357886, at *1 (Cal. Ct. App. July 3, 2013).
129. *Id.*
130. *Id.* at *3.
131. *Id.*
132. *Id.* at *2.
133. *Id.*
134. *Id.* at *3.
135. *Id.*

court declined to hold Tanner liable. The court noted that the claim was not for property damage or personal injury — instead, only economic damages, and found Tanner:

> [N]ot personally liable for economic damages caused by any negligent acts he committed in the course and scope of his corporate duties. To hold otherwise would defeat the purpose of limited liability and unravel the balance our high court has struck between shielding corporate officers from personal liability when their negligent decisions cause economic harm and protecting third parties who suffer physical injuries or property damage.[136]

Yet again, in *Mansha Consulting LLC v. Alakai*, a federal trial court in Hawaii considered a negligence claim for economic damages.[137] This claim alleging mishandling of invoice payments was brought against Hawaii Health Connector (HHC), the chairman of its board, and its interim executive director. Consistent with the rulings in California, the court distinguished between the duty owed to the corporation and a duty of care owed to a third party. In granting a motion to dismiss, the court noted that the plaintiff consulting agency failed to show that the individual defendants owed a duty to Mansha independently recognized by principles of tort law and independent of the contract between them. In the court's words, there must be an assertion of a "duty or obligation, recognized by law, requiring the actor to conform to a certain standard of conduct, for the protection of others against unreasonable risks."[138] The complaint asserted that the defendants owed certain duties given their roles at HHC, mainly to ensure proper operation of the connector and responsibility for the overall administration of the connector. The court cited the *Restatement (Third) of Agency* that "[a]n agent is subject to tort liability to a third party harmed by the agent's conduct only when the agent's conduct breaches a duty that the agent owes to the third party."[139] Finally, the court distinguished this case from *Frances T.*, which, "unlike the instant case, involved a duty of care to avoid an unreasonable risk of physical injury . . . [and] included specific allegations that directors were aware of a 'hazardous condition' that could cause 'physical injury' to the plaintiff."[140]

From these cases it is evident that where the allegations of negligence against corporate officers, directors, and principals involve pure economic

136. *Id.* at *6.
137. Mansha Consulting LLC v. Alakai, 236 F. Supp. 3d 1267 (D. Haw. 2017).
138. *Id.* at 1274.
139. *Id.* at 1275.
140. *Id.* at 1276.

loss, courts in the U.S. are highly unlikely to find that the individuals owe a duty of care to the third party, even when an exception to the economic loss rule might allow recovery. There is already considerably less likelihood of liability when the injury is economic as opposed to one involving personal injury or property damage, regardless of who the defendant is. But where the claim is for negligent misrepresentation, liability can be established where the economic loss was caused by justifiable reliance upon the information given in the context of a business transaction. Yet, this analysis is typically not considered in actions brought by third parties against officers, directors, or principals. Courts tend to foreclose analysis of whether the reliance was justifiable, and instead find that these individuals, effectively by virtue of their position within the firm, owe no duty to third parties for economic loss.

Consider, for example, the *Omnel* case, where the president of the company personally advised the plaintiff that no permits were required for the project, and that he would work out any problems on that front with friends he had in the city.[141] According to the court, these direct statements to plaintiff imposed no personal duty but the court offered little analysis on the point. The decision is questionable given that the facts appear to engage a claim for negligent misrepresentation based on justifiable reliance. That is, it would appear justifiable for the plaintiff to rely on the individual defendant's personal representations that he would solve any problems regarding permits. This omission in the court's analysis is particularly puzzling given the active steps that the president seemingly took to encourage the plaintiff to rely on him personally.

It is appropriate for courts to be wary of imposing undue liability on corporate officers and directors. At risk is the evisceration of corporate law principles and the danger that these individuals would otherwise be required to backstop or guarantee corporate operations. The problem with the cases discussed above, however, is that courts appear to be foreclosing even the possibility that the director or officer would owe an individual or personal duty to third parties. It is true that status alone should not result in liability but it is also important that courts advance accountability and reduce the problem of moral hazard. Tort law carves out an exception to the rather harsh economic loss rule for negligent misrepresentation where the harm caused to the plaintiff is foreseeable and where reliance on information is justified. Yet, in the corporate context, courts, even in California, appear not to consider foreseeability and justifiable reliance

141. Omnel v. Tanner, No. C070907, 2013 WL 3357886 (Cal. Ct. App. July 3, 2013).

when deciding whether corporate officers, directors, or principals may be held liable for negligence to third parties. Put another way, courts seem to have concluded that the duty of these individuals runs only to the firm. Furthermore, with regard to a duty to the firm, the potential liability of these individuals is practically non-existent. As discussed in Part I above, there is effectively no liability to the corporate entity for simple negligence, and where the tortfeasor is a director, it is unlikely liability will ensue for even acts of gross negligence.

Instead, rather than simply exonerating officers and directors from liability to third parties for negligent misrepresentation, essentially a corporate law framework, courts could instead apply general tort law. This would entail a consideration of whether the defendant failed to exercise due care when providing the information and whether the plaintiff was justified in relying on that information. An example is presented by the New York Court of Appeals case of *Kimmell v. Schaefer*.[142] In this case, plaintiffs invested in a partnership that "provid[ed] heat and electricity to industrial and commercial energy users through on-site gas-powered 'cogeneration' units."[143] In soliciting support, the defendant (a lawyer, certified public accountant, former chief financial officer of Pepsico for twenty-six years, and current board member of the limited partnership) misrepresented the "potential rate of return" on the investment, in a memo directed to the plaintiffs. The memo failed to account for "recent and substantial change in local utility rates."[144] Notably, the projections were "generated for the express purpose of providing investors with current information about potential returns on the project" and the defendant received a commission for his solicitation efforts.[145] The lower court found that the defendant "had negligently misrepresented, both directly and by encouraging plaintiffs to rely on the projections . . . that the . . . project would earn income, and that plaintiffs relied on this misrepresentation to their detriment."[146] It also found the "existence of a special relationship sufficiently resembling privity to justify holding [the] defendant liable."[147] The Appellate Division affirmed, holding the defendant liable for negligent misrepresentation. The Court of Appeals stated that under New York law, "liability for negligent misrepresentation has been imposed only on those persons who possess

142. Kimmell v. Schaefer, 675 N.E.2d 450, 452 (1996).
143. *Id.*
144. *Id.* at 453.
145. *Id.* at 454.
146. *Id.* at 453.
147. *Id.*

unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified."[148] Furthermore,

> [w]hether the nature and caliber of the relationship between the parties is such that the injured party's reliance on a negligent misrepresentation is justified generally raises an issue of fact. In determining whether justifiable reliance exists in a particular case, a fact finder should consider whether the person making the representation held or appeared to hold unique or special expertise; whether a special relationship of trust or confidence existed between the parties; and whether the speaker was aware of the use to which the information would be put and supplied it for that purpose. The record here contains ample support for the finding that defendant's relationship with plaintiffs gave rise to a duty to speak with care.[149]

This duty approach to negligence causing pure economic loss represented in *Kimmell*, and as articulated by Section 552 of the *Restatement (Second) of Torts*, offers a fair compromise between tort law and corporate law values. On one hand, it is important that directors and officers are not treated as backstopping corporate obligations via tort law. On the other hand, if the director or officer takes steps that establish justifiable reliance by the plaintiff on the director or officer, liability should follow. The *Kimmel* court's conclusion also resonates with a persuasive approach taken in a significant Canadian case on point, a matter explored in the next part.

II. CORPORATE DIRECTOR AND OFFICER LIABILITY TO NON-SHAREHOLDER THIRD PARTIES IN CANADA

Like American law, Canadian law faces a dilemma when tort law and corporate law collide in relation to director and officer tortious liability to third parties. According to Justice Le Dain in *Mentmore Manufacturing Co. v. National Merchandise Manufacturing Co.*:[150]

> What is involved here is a very difficult question of policy. On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and

148. *Id.* at 454.
149. *Id.*
150. Mentmore Mfg. Co. v. Nat'l Merch. Mfg. Co. (1978), 89 D.L.R. 3d 195 (Can. Fed. Ct.).

> officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. On the other hand, there is the principle that everyone should answer for his tortious acts.[151]

On a related front, the Alberta Court of Appeal has recently opined as follows: "Finding representatives of corporations personally liable for torts engages competing policy objectives. One policy objective of the law of torts is the compensation of injured persons. A competing policy objective of corporate law is the limitation of personal liability for corporate acts."[152]

As will be seen, Canadian law is united in finding directors and officers personally liable in relation to torts causing death, personal injury, or property loss. However, Canadian law is more divided in result when the tort at bar is simple negligence causing pure economic loss.

A. Torts Causing Death, Personal Injury, and Property Loss

Directors and officers are subject to ordinary tort law in relation to negligence causing death, personal injury, and property loss. In such serious circumstances, courts have rightly concluded that corporate law values have no residual influence.

For example, in *Lewis v. Boutilier*, a 1919 decision of the Supreme Court of Canada, at issue was the personal liability of the company president (Mr. Lewis) in negligence for the death of a fourteen-year-old boy whom he had instructed to work in a dangerous area of a sawmill.[153] The Supreme Court of Canada dismissed as irrelevant any controversy as to whether Mr. Lewis or Mr. Lewis's company was the child's employer. As Justice Mignault observed, even if the boy had been employed by Mr. Lewis's company (as opposed to by Mr. Lewis himself), an action would lie against Mr. Lewis personally for putting "the boy at a dangerous work without proper safeguards to protect him from mishap."[154] As Judge Idington wrote in the same decision: "The sooner presidents of companies realize that they have duties, the better for themselves and their fellow men."[155] *Lewis* was more recently cited with approval by the Ontario Court

151. *Id.* at 202.
152. Hall v. Stewart, 2019 ABCA 98, para. 13 (Can. Alta.).
153. Lewis v. Boutilier (1919), 52 D.L.R. 383, 389 (Can.). The boy slipped or was otherwise pulled into a cogwheel and was killed. *Id.* at 390.
154. *Id.* at 393.
155. *Id.* at 386.

of Appeal in *ADGA Systems International Ltd. v. Valcom Ltd.*[156] in 1999.

A similar analysis holds when the plaintiff sues an officer or director for personal injury. In *Berger v. Willowdale A.M.C.*,[157] at issue was the corporate president's personal liability to the plaintiff employee who slipped on ice and was injured. Though aspects of this case involved the law going to workers' compensation legislation, the court recognized more generally and based on *Lewis* that both the corporation *and* the executive officer can owe a duty of care to the plaintiff in such circumstances. That the relevant legislation permitted such concurrency of actions in turn reflected important policy considerations including: that the corporate president has "great power over his employees;"[158] that there is "a natural desire on the part of an employee to please persons in authority in the employer corporation,"[159] particularly in a small corporation;[160] and that to the employee "the president is the symbol of job security and the source of possible promotion."[161] Taken together, this means that the corporate officer has a personal duty to show "due regard"[162] for employee safety as employees might be too wary to complain about various circumstances. In short, such an officer "cannot ignore a dangerous condition of which he is aware or should be. This is true particularly if he is in control of the situation and has available the means to rectify it."[163] In coming to this conclusion, that court rejected defendant counsel's floodgates argument as being *in terrorem* and without foundation,[164] stating that executive liability will depend on factors including:

> [T]he size of the company, particularly the number of employees and the nature of the business; whether or not the danger or risk was or should have been readily apparent to the executive officer; the length of time the dangerous situation was or should have been apparent to the executive officer; whether that officer had the authority and ability to control the situation and whether he had ready access to the means to rectify the danger.[165]

156. ADGA Sys. Int'l Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 19 (Can. Ont. C.A.).
157. Berger v. Willowdale A.M.C. (1983), 41 O.R. 2d 89 (Can. Ont. C.A.).
158. *Id.* at para. 42.
159. *Id.* at para. 40.
160. *Id.*
161. *Id.*
162. *Id.* at para. 42.
163. *Id.*
164. *Id.* at para. 44.
165. *Id.*

Berger has more recently been cited with approval by the Ontario Court of Appeal.[166]

Other Canadian jurisdictions follow an identical analysis. In a 2019 decision, the Alberta Court of Appeal in *Hall v. Stewart* determined that the defendant director was liable for negligently causing personal injury to the plaintiff-employee on a work site.[167] Noting that there is clearly a duty of care to avoid injuring one's co-workers and no policy basis for excluding that duty, the court concluded that "the modern corporation was not designed to be a method of providing immunity to corporate actors for this sort of loss. There are strong public policy reasons to ensure that physically injured plaintiffs are compensated. Claims for pure economic loss raise different issues."[168]

In a similar vein, directors and officers face personal liability for negligence causing property damage, as confirmed by the Supreme Court of Canada as recently as 2014. In *Peracomo Inc. v. TELUS Communications Co.*,[169] Canada's highest court very clearly adopted the principle that corporate personality matters not when assessing duty in such a context. Put another way, "corporate officers and directors may be held liable in their personal capacity where they negligently cause property damage in the course of their corporate duties."[170] As a result, the individual defendant's status as an officer of the corporate defendant could not dislodge his personal liability for recklessly cutting a fiber-optic cable and causing almost $1 million in damages to the plaintiff.[171] He was found to owe personally a duty of care to the plaintiff which was breached when he cut the cable.[172]

The same judicial perspective is present in the context of personal liability for nuisance. In the *New Brunswick Court of Appeal of Desrosiers*

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166. *ADGA*, 43 O.R. at para. 20.

167. Hall v. Stewart, 2019 ABCA 98, para. 25 (Can. Alta.). Note that this case involved workers' compensation legislation but the legislative context did not change the court's reasoning on this particular point.

168. *Id.* at para. 23. See also *Nielsen Estate v. Epton*, 2006 ABCA 382, para. 21 (Can. Alta.), wherein the Court of Appeal affirmed the trial judge's finding that the corporate director owed a personal duty of care in the context of extreme director misconduct causing a worksite death. Note that this case engaged, *inter alia*, occupational health and safety legislation.

169. *Peracomo Inc. v. TELUS Communications Co*., [2014] 1 S.C.R. 621 (Can.). Note that this case also involved application of the Marine Insurance Act, SC 1993, c 22 and the Convention on Limitation of Liability for Maritime Claims, 1976.

170. *Id.* at para. 16.

171. *Id.* at para. 2, 17.

172. *Id.* at para. 17.

v. Sullivan,[173] the plaintiff sued both the corporate owner of a hog farm operation *and* Mr. Sullivan, its shareholder/manager/principal employee. At issue was liability for odors on the plaintiff's land caused by a manure lagoon on the hog farm.[174] The court found both the corporation and the individual liable in nuisance, stating as follows:

> Nor am I attracted to the submission that Mr. Sullivan is protected by reason of the rule in *Salomon v. Salomon & Co*., [1897] A.C. 22. The question here, as I have pointed out, is not whether Mr. Sullivan was acting on behalf of or even if he "was" the company, but whether a legal barrier, here a company, can be erected between a person found to be a wrongdoer and an injured party thereby relieving the wrongdoer of his liability. In my opinion, once it is determined that a person breaches a duty owed to neighbouring landowners not to interfere with their reasonable enjoyment of their property, liability may be imposed on him and he may not escape by saying that as well as being a wrongdoer he is also a company manager or employee.[175]

Sullivan, too, has more recently been cited by the Ontario Court of Appeal.[176]

In sum, corporate law has no mitigating influence on personal liability in the context of tort actions involving death, personal injury, as well as damage to property or its reasonable enjoyment. On the contrary, Canadian law recognizes that individuals have certain foundational and mandatory legal obligations which the corporate vehicle does not absorb or otherwise annul.

B. Torts Causing Pure Economic Loss

It is beyond the scope of this Article to discuss all possible torts which may cause pure economic loss. Instead, three more common examples are selected for discussion, namely fraudulent misrepresentation, the tort of inducing breach of contract, and negligence causing pure economic loss.

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173. *Desrosiers v. Sullivan* (1986), 76 N.B.R. 2d 271 (Can.), leave to appeal to the SCC denied (S.C.C. 4 June 1987).
174. *Id.* at para 2.
175. *Id.*
176. *ADGA*, 43 O.R. at para. 21.

1. Fraudulent Misrepresentation

Directors and officers in Canada are personally liable to third parties for fraud,[177] with the presence of a corporation being irrelevant to the analysis. In *Midwest Amusement Park, LLC v. Cameron Motorsports Inc.*,[178] for example, the individual director was found personally liable, *inter alia,* for fraudulent misrepresentation, with the court simply applying ordinary tort law principles to reach this uncontroversial conclusion.[179] On the same footing, the corporation behind which the director stood was also found responsible. Though some courts also go on to discuss the corporate veil in situations involving fraud or other improper purpose[180] the result is the same—personal liability on the director or officer. Accordingly, this Article does not discuss the corporate veil cases and their complexities.[181] The point is that—directly or indirectly—tort law values justifiably prevail in relation to fraud and other forms of improper conduct. The importance of personal accountability is paramount and the involvement, in addition, of a corporation does not change that analysis.

177. The test for civil fraud has recently been described as follows by the Supreme Court of Canada in *Bruno Appliance & Furniture, Inc. v. Hryniak*, [2014] 1 S.C.R 126 (Can.), para 21: "(1) [A] false representation made by the defendant; (2) some level of knowledge of the falsehood of the representation on the part of the defendant (whether through knowledge or recklessness); (3) the false representation caused the plaintiff to act; and (4) the plaintiff's actions resulted in a loss."

178. Midwest Amusement Park, LLC v. Cameron Motorsports Inc., [2018] ONSC 4549 Can.). A director's or officer's personal liability for fraud is also expressly recognized in *Scotia McLeod v. Peoples Jewelers Ltd.*, [1995] 26 O.R. 3d 481, 490–91 (Can. Ont. C.A.).

179. Midwest Amusement Park, LLC v. Cameron Motorsports Inc., [2018] ONSC 4549 (Can.), para. 87.

180. For example, in *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club,* 2000 ABCA 116, *aff'd* [2002] 1 S.C.R 678 (Can.), the Alberta Court of Appeal accepted the trial judge's finding that the individual defendant had been "fraudulent, dishonest, and deceitful" and went on to note that such findings "provide the necessary support for lifting the corporate veil. As the corporate veil cannot be used as a shield for misconduct, or fraud, liability may be extended to the principals of the corporation where they have engaged in this type of conduct . . . ." *Id.* at para. 93. *See also* Jin v. Ren, [2015] ABQB 115 (Can.), para. 71–81, *aff'd* 2016 ABCA 80 (Can.), leave to appeal to SCC denied 37023 (13 October 2016).

181. See *Spring Garden Holdings Ltd. v. Ryan Duffy's Restaurants Ltd.*, [2010] NSSC 71 (Can.) for a comprehensive discussion of the corporate veil; *see also* Mohamed Khimji & Christopher Nicholls, *Piercing the Corporate Veil in Canadian Common Law Courts – An Empirical Study,* 14 QUEEN'S L.J. 207 (2015).

2. Inducing Breach of Contract (or Interference with Contractual Relations)

Directors and officers can be personally liable for the tort of inducing breach of contract,[182] which typically involves the director or officer inducing her own corporation to breach its contract with a third party by, for example, wrongfully terminating an employee.[183] Importantly, this tort is subject to what is called the defense of *Said v. Butt.*[184] *Said v. Butt* concludes that a director or officer has no personal liability for inducing the corporation's breach of contract provided that the director (or officer or other agent) is acting "*bona fide* within the scope of his authority."[185] In this way, the agency roots of the rule in *Said v. Butt* come to the fore as corporate law values, giving recognition to the fact that corporations must act through directors and officers who, ordinarily, are not parties to the contract at issue. If the tort of inducing breach of contract were too easily established, the plaintiff would be permitted to wrongfully escape the confines of contract and have an extra party to sue. The defense of *Said v. Butt* therefore protects the director or officer for reasons of public policy. And as the Ontario Court of Appeal expresses the matter, the *Said v. Butt* defense:

> [A]ssures that persons who deal with a limited company and accept the imposition of limited liability will not have available to them both a claim for breach of contract against a company and a claim for tortious conduct against the director with damages assessed on a different basis. The exception also assures that officers and directors, in the process of carrying on business, are capable of directing that a contract of employment be terminated or that a business contract not be performed on the assumed basis that the company's best interest is to pay the

182. *ADGA*, 43 O.R. at para. 34–35.

183. The tort is comprised of the following elements according to *369413 Alberta Ltd v. Pocklington*, 2000 ABCA 307, para.13(Can.): i) the existence of a contract; ii) knowledge or awareness by the defendant of the contract; iii) a breach of the contract by a contracting party; iv) the defendant induced the breach; v) the defendant, by his conduct, intended to cause the breach; vi) the defendant acted without justification; and vii) the plaintiff suffered damages. *See also* Super-Save Enterprises Ltd. v. 249513 B.C. Ltd. (c.o.b. Mike's Auto Towing), [2004] BCCA 183, para.2 (Can.).

184. Said v. Butt, [1920] 3 KB 487 (Eng.).

185. As the English court stated in *Said v. Butt*: "if a servant acting *bona fide* within the scope of his authority procures or causes the breach of a contract between his employer and a third person, he does not thereby become liable to an action of tort at the suit of the person whose contract has thereby been broken." *Id.* at 506.

> damages for failure to perform. By carving out the exception for these policy reasons, the court has emphasized and left intact the general liability of any individual for personal conduct.[186]

On the other side of the coin, the defense of *Said v. Butt* cannot apply when directors have used their powers "for an improper purpose."[187] An illustrative decision is *McFadyen v. 481782 Ontario Ltd.*[188] wherein the plaintiff successfully sued the corporate directors personally for inducing the corporate employer to wrongfully dismiss him.[189] The entire context was suspect, including that -- just prior to firing the plaintiff -- the directors transferred the contents of the corporation's bank account to themselves personally.[190] The court found that the directors, via the wrongful dismissal, had induced the corporation to breach of contract with the plaintiff.[191] It found no justification or availability of the defense in *Said v. Butt*. The directors were *not* acting *bona fide* with a view to the best interests of the corporate defendant but were, rather, in the words of the trial judge, seeking to "feather their own nest," not fulfill their duty to serve the corporate defendant.[192] This kind of misconduct (including asset stripping) is an example of the personal advantage-seeking which regularly features in the relevant case law.[193]

Thus far, discussion of Canadian law regarding the personal liability of directors and officers shows that directors and officers are personally liable for negligence causing death and injury as well as property loss. They are also personally liable for committing intentional torts like fraud and inducing breach of contract subject to the defense of *Said v. Butt.* In many of the cases explored in this section, the court assessed corporate law arguments by which directors and officers sought to be sheltered from the consequences of tort law. The cases conclude, however, that corporate law principles have no influence where the plaintiff has been killed, injured or had her property damaged due to the actions of the director/officer defendant. In such circumstances, the director's *personal* duties survive *Salomon v. Salomon & Co.* Likewise, when the director commits a fraud or induces breach of contract without justification, corporate law values also

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186. *ADGA*, 43 O.R. at para. 15.
187. KEVIN MCGUINNESS, 2 CANADIAN BUSINESS CORPORATIONS LAW 737-38 (3rd ed. 2017).
188. McFadden v. 481782 Ontario Ltd, [1984], 47 O.R. 2d 134 (Can. Ont. S.C.).
189. *Id.* at para. 1.
190. *Id.* at para. 22.
191. *Id.* at para. 42.
192. *Id.*
193. MCGUINNESS, *supra* note 187, at 739.

justifiably fade. This is because the director has been acting self-interestedly and even corruptly and should have personal liability for such conduct.

3. Negligence Causing Pure Economic Loss

Unlike the law discussed above, directors' and officers' personal liability for simple (or ordinary) negligence causing pure economic loss is considerably less settled in Canada. As Slatter J.A. of the Alberta Court of Appeal observed more generally in *Hogarth v Rocky Mountain Slate*:

> The law respecting the liability of directors and officers for torts committed while conducting corporate business is not entirely consistent. Some cases approach the problem from the perspective of the "duty of care", whereas others approach it from the perspective of "piercing the corporate veil." Some exceptions to general liability for tort have been recognized, and others have been rejected, without any clear principle emerging.[194]

Indeed, the law appears to split into two established, competing lines of authority, a very new third line, and possibly even a fourth. As will be discussed, the first line of authority seems to favor corporate law values, the second line seems to favor tort law values, while a new line is located somewhere in between. To add to the complexity, an apparent fourth line of authority reinterprets how the first line of authority should be understood. While it is beyond the scope of this Article to give a thorough, multi-jurisdictional account of how this area of law is regarded across Canada, it does select a number of important cases for discussion and illumination.

a. The First Line of Authority: ScotiaMcLeod Inc. v. Peoples Jewelers Ltd. *and the Corporate Veil Approach*

The first line of authority appears to support the conclusion that directors and officers are not liable for simple negligence causing pure economic loss and is represented by *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.,* a 1995 decision from the Ontario Court of Appeal.[195] In

194. Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57, para. 73 (Can. Alta. C.A.), *leave to appeal to the S.C.C. denied* (S.C.C. Apr. 16, 2013).

195. ScotiaMcLeod Inc. v. Montreal Trust Co. of Canada (1995), 26 O.R. 3d 481 (Can. Ont. C.A.), leave *denied*, 205 N.R. 314 (S.C.C.A. No. 40 1996).

ScotiaMcLeod, the plaintiff investor purchased senior unsecured debentures issued by the defendant corporation, Peoples Jewelers. Disappointed with the investment, the plaintiff sued the defendant underwriters (ScotiaMcLeod) for negligent misrepresentation, alleging that the prospectus and other documents related to the investment were deficient. At the heart of the matter for our purposes was that the underwriters brought a third party claim against the board of Peoples, alleging *personal* liability for negligent misstatement in relation to the impugned documentation.[196] In reply to being third partied, the directors brought a motion to dismiss the claim against them as disclosing no reasonable cause of action.[197] What follows is the Court of Appeal's most important and often quoted pronouncement regarding personal liability of directors and officers in tort:

> 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* (emphasis added).[198]

In referencing fraud, deceit, and dishonesty, the court appears to reach for the corporate veil cases alluded to by Slatter J.A. in *Hogarth* above as the touchstone for director and officer liability. Understanding *ScotiaMcLeod* in relation to the corporate veil cases is expositive because it explains why *ScotiaMcLeod* identifies fraud, deceit, dishonesty, and lack of authority as hallmarks of liability to begin with. If *all* torts committed by directors and officers were *per se* actionable, there would be no obvious reason for the court to single out fraud, deceit and dishonesty at all.

In fact, *ScotiaMcLeod* appears to double-down on the notion that

196. *Id.* at para. 24.
197. *Id.* at para. 1.
198. *Id.* at para. 25 (emphasis added). This passage has most recently been cited with approval by the Ontario Court of Appeal in *McDowell v. Fortress Real Capital Inc.*, 2019 ONCA 71, para. 55, though the law in Ontario remains divided. *See* discussion *infra* pp. 36-47.

directors and officers have special protection in relation to torts committed against third parties by invoking the directing mind theory. To do so, the court relied, *inter alia*, on Lord Reid in *Tesco Supermarkets Ltd. v. Nattrass.*[199] According to Lord Reid, the director does not simply act as agent in conducting corporate business. Rather, he is "an embodiment of the company . . . within his appropriate sphere."[200] In the ordinary case, therefore, the director acts for the corporation and his identity merges with the corporation. Any tortious conduct by the director is attributed to the corporation who has primary liability for the tort.[201] Crucially, however, this tortious conduct does not place personal liability on directors unless they step outside of their role and, for example, act fraudulently or dishonestly. As the court in *ScotiaMcLeod* states:

> 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 who caused it to act as it did. To hold the directors . . . personally liable, there must be some activity on their part that takes them out of the role of directing minds of the corporation.[202]

ScotiaMcLeod's reasonably extreme conditions for personal liability would appear, on their face, to foreclose liability for ordinary negligence causing economic loss—a conclusion that court itself indirectly endorses. That is, in applying the law to the application to dismiss the claims against the individual directors, the court in *ScotiaMcLeod* permitted claims in simple negligence against two of the defendant directors to proceed but only because the particulars against them had been pleaded. The court expressed severe reservations as to the viability of the negligence action itself but permitted it to continue on the basis that an action should not be summarily dismissed at this early stage only because it is "novel"[203] and "attempting to stretch the envelope of available jurisprudence."[204] The

199. *Id.* at para. 29 (citing Tesco Supermarkets Ltd. v. Nattrass, [1972] AC 153, 170 (HL)).
200. *Id.*
201. *See* R. v. Canadian Dredge & Dock Co., [1985] 1 S.C.R. 662 (Can.) (holding that the conduct of a primary corporate representative is attributed to the company).
202. *ScotiaMcLeod Inc.*, 26 O.R. at para. 26.
203. *Id.* at para. 39.
204. *Id.*

court's very clear implication is the claims for ordinary negligence were seen as unlikely to pass the test posited by *ScotiaMcLeod* itself.

That said, the cases applying *ScotiaMcLeod* are numerous, inconsistent, and difficult to organize. What immediately follows is an analysis of certain cases which interpret *ScotiaMcLeod* as standing for the proposition that director and officer liability to third parties is rare and tied to more extreme misconduct. Subsection (b) below assesses examples of cases which take a contrary view, namely that director and officer liability to third parties is common and widely encompassing.

Craik v. Aetna Life Insurance Co. of Canada,[205] is an Ontario decision which came out soon after *ScotiaMcLeod* and sought to apply it. Therein, the court stated:

> Qualifications or exceptions are necessary to the general approach of corporate directors and officers not being responsible for corporate actions. When an individual commits a fraud or acts with malice, then the individual cannot hide behind a corporation. There are many instances where the law allows a piercing of the corporate veil. . . .When the director or officer is acting outside the scope of his/her authority in being motivated by advancing a personal interest contrary to the interest of his/her corporation or when the director or officer is committing a fraud or doing something with malice, the individual can be subject to personal liability. Unless the claim against the director or officer alleges fraud, bad faith, absence of authority, or a deliberate and intentional act constituting an intentional tort or some other exceptional circumstance whereby it can be said that the director or officer has made the act complained of his own distinct, personal act rather than the act of the operation, the claim should be struck out at the pleading stage.[206]

The judicial language here is centered on exceptional and egregious misconduct as would permit lifting the corporate veil, such as the director or officer committing fraud, acting maliciously, or acting in bad faith.

In *Blacklaws* v. *Morrow,*[207] the majority decision of the Alberta Court of Appeal likewise appeared to take a restrictive approach to the question of liability. It cited *ScotiaMcLeod*'s test regarding liability, quoted above,

205. Craik v. Aetna Life Insurance Co. of Canada, [1995] O.J. 3286 (Gen. Div.), *aff'd* [1996] O.J. 2377 (Can.).

206. *Id.* at paras. 18–19 (citation omitted) (emphasis added).

207. Blacklaws v. Morrow, 2000 ABCA 175, 187 D.L.R (4th) 614 (Can.), *leave to appeal to the SCC refused*, 28126 (Apr. 19, 2001).

with approval[208] and, significantly for our purposes, described *ScotiaMcLeod* as concerning "whether someone has *an immunity from what would otherwise be a tort* because he is an employee or director of a company when he acts, or is doing the very essence of his employer's contractual duties" (emphasis added).[209] The Court of Appeal went on to dismiss the negligence claim against the officer in question, however, because, crucially, "we never get to the stage of discussing *immunity* from tort because we find the elements to *create* personal tort are absent in the circumstances of this case."[210] In short, unless and until the plaintiff can demonstrate a tort by the defendant, the question of whether the defendant has an immunity from that tort is moot. But otherwise, the exercise continues, with the test moving on to ask whether the director who has committed the tort may nonetheless escape personal liability. The court is to apply *ScotiaMcLeod* such that immunity is lost and liability flows if it is established that the director's 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. . . ."[211]

Following this interpretation, *ScotiaMcLeod* would seem to exclude liability for a director's simple negligence causing pure economic loss because negligence does not exhibit a separateness (at least not in the way that fraud, dishonesty, or want of authority does). See, for example, the assessment by Justice Martin (now of the Supreme Court of Canada) in *Stewart v Enterprise Universal Inc.*, writing in the context of a case involving personal injury allegedly arising from asbestos removal. [212] In her decision, Justice Martin relied on *ScotiaMcLeod* (a case involving pure economic loss) and the Alberta Court of Appeal's assessment in *Blacklaws v. Morrow* (a case involving pure economic loss) to conclude as follows:

> The most fundamental principle of corporate law is that of limited liability; see *Salomon v. Salomon*, [1897] A.C. 22. It is clear that a corporation like Enterprise [a corporate defendant] can only operate through its human agents, or what has become known as its "directing mind". However, the converse is not true; meaning that the liability of Enterprise does not necessarily

208. *Id.* at para. 41. The majority decision of the Court of Appeal did not cite this competing authority, namely *ADGA Systems International Ltd. v. Valcom Ltd.* (1999), 43 O.R. 3d 101 (Ont. C.A.). *See infra Part III.B.3.b* for discussion of *ADGA*.

209. *Id.* at para. 37 (emphasis added).

210. *Id.*

211. *Id.* at para. 41.

212. Stewart v. Enterprise Universal Inc., 2010 ABQB 259 (Can.). Note that *Nielsen Estate v. Epton*, 2006 ABCA 382, cited in *Stewart*, involved a workplace fatality.

> flow through to its human agents, like the Directors. At law there is a very strong presumption that a director in his/her personal capacity is not responsible for harms done by his/her corporation. The point is made well by the Ontario Court of Appeal in [*ScotiaMcLeod*]. . . .
> However, in extreme cases the corporate veil can be lifted to impose personal liability on a director; see *Kosmopoulos v. Constitution Ins. Co. of Canada*, (1987)[*1987 CanLII 75 (SCC)*] 1 S.C.R. 2, 34 D.L.R. (4th) 208. In *Nielsen Estate v. Epton*, *2006 ABCA 382 [(CanLII)*,] the Alberta Court of Appeal acknowledged at para. 20 that, "[i]t is settled law that a corporate director may have a personal duty of care and may be liable for acts that are in themselves tortious.". . . .Therefore, the legal test is clear. The Directors in this case must either have done something that is tortious in itself or have done something that is independently tortious, such that they exhibited a separate interest from Enterprise and in doing so made the tort their own. . . .[213]

In short, these cases and others[214] conclude that not all torts committed by a director or officer are actionable, a conclusion seemingly shared by the majority decision in the appellate case of *Hogarth* though this interpretation is not without doubt. *Hogarth* concerned the liability, *inter alia*, of an individual officer (Mr. Simonson) for negligent misstatement to investors who claim to have lost their investment as a result of relying on Simonson's words.[215] The trial judge determined that Simonson owed a duty of care based on there being a special relationship with the plaintiffs and he was therefore personally liable according to the law of negligent misstatement.[216] The Court of Appeal reversed, splitting into a majority

213. *Stewart,* 2010 ABQB 259 at paras. 59–60 and 63.

214. *See* Cherkas v. Shell Energy North America (Canada) Inc., 2019 ABQB 400, para. 26 (Can.) ("To summarize, companies can only act through people, and those people are not personally liable for their acts on behalf of the companies they represent unless their acts are so outside the ambit of their work and role that they are seen to be their personal acts and not those of the company."); McDonald & Bychkowski Ltd. (CMB Insurance Brokers) v. Lougheed, 2015 ABQB 792, para. 29 (Can.) ("What must be alleged, is an overt act; something that takes the owner or employee outside identification with the company. Circumstances that might permit lifting the corporate veil or imposing joint liability might also suffice. The Officer or Director has to exhibit a separate character or identity. . . .").

215. *Hogarth*, 2013 ABCA at para. 16.

216. *Id.* at paras. 23–28. Note that in its most recent statement of the law, the SCC does not use the language of "special relationship" in relation to the tort of negligent misstatement (though it had done so in the past). Rather, it refers to whether or not a duty of care exists. This is a point largely going to terminology and has no importance for the

and concurring judgment. As will be discussed in more depth later, the concurring judgment found that Simonson was not liable to the plaintiffs because he did not owe them a duty of care.[217] Put another way, the individual defendant had not committed a tort to begin with. The majority, however, followed more complicated terrain. It applied the Alberta Court of Appeal decision in *Blacklaws* (discussed earlier) which itself had applied *ScotiaMcLeod* (also discussed earlier). The majority concluded that Simonson was not liable for negligent misstatement because, echoing S*cotiaMcLeod*'s language, Simonson's conduct was not "tortious in itself" nor did it exhibit "a separate identity or interest from that of . . . the corporation."[218] This is where a lack of clarity creeps in. Does the majority mean that a tort was committed but it was not sufficiently separate within the meaning of *ScotiaMcLeod* to ultimately be actionable *or* does it mean that no tort was committed at all? Following *Blacklaws*, it apparently means the former. This is because, and as *Blacklaws* instructs, before one gets to the *ScotiaMcLeod* test of separateness, the court must determine whether a tort has even taken place. Only if a tort has been established, would the court *then* move to the question of "immunity" by applying *ScotiaMcLeod*. That is, and as transpired in *Blacklaws*, the court never reaches the stage of discussing immunity from tort unless the elements of a personal tort are in place.[219] (Note that the concurring decision in *Hogarth* is discussed in more depth in the following section of this Article.)

Regardless of its precise scope, however, *ScotiaMcLeod* clearly manifests a judicial fear that, absent exculpating provisos to the application of ordinary tort law principles, directors would be overexposed to liability, at least in the context of pure economic loss. As Janis Sarra observes, overexposure to tortious liability would be concerning on a number of grounds, including: trenching on the principle that the corporation is a separate legal entity;[220] eroding the benefits of incorporation by offering the plaintiff a backdoor to personal liability;[221] and reducing the pool of individuals willing to serve as a director.[222] Another concern is more generally identified by the Ontario Court of Appeal in the case of *ADGA*,

purposes of this Article. *See* Deloitte & Touche v. Livent Inc., [2017] 2 S.C.R. 855 (Can.) (conducting a duty of care analysis in evaluating the case).

217. *Hogarth*, 2013 ABCA 57 at para. 134.

218. *Id.* at para. 14.

219. Blacklaws v. Morrow, 2000 ABCA 175, para. 37 (Can.).

220. Sarra, *supra* note 6, at 67.

221. *Id.* at 67.

222. *Id. See also ADGA*, 43 O.R. at para. 9 (stating that directors may be driven away from involvement in corporate business due to exposure to potential lawsuits).

namely that directors and officers would be exposed to "ill-founded" litigation and that such a concern merits attention "because business cannot function efficiently if corporate officers and directors are inhibited in carrying on a corporate business because of a fear of being inappropriately swept into lawsuits. . . ."[223]

The *ScotiaMcLeod* view of liability can be cast as generally consistent in outcome with case law described in Part II A, including: *Midwest Amusement Park*[224] (personal liability for fraud); *McFadden*[225] (personal liability for the tort of inducing breach of contract); *Lewis*[226] (personal liability for negligence causing death); *Berger*[227] (personal liability for negligence causing personal injury); *Peracomo*[228] (personal liability for negligence causing property loss) and *Desrosiers*[229] (personal liability for nuisance). Using the language of *ScotiaMcLeod,* misconduct in these cases can be understood or characterized as taking the director outside her role as a directing mind and, in this specific sense, making the tort her own. Based on case law referenced in this section, it would appear that simple negligence causing pure economic loss is not captured, or at least not easily captured by *ScotiaMcLeod.*

If this is true, the *ScotiaMcLeod* line of authority is arguably problematic for being under-inclusive. By offering a broad shield of protection to directors and officers in relation to ordinary negligence causing pure economic loss, the decision creates moral hazard[230] and thereby condones poor corporate culture. Put another way, directors who have no accountability to third parties for ordinary negligence therefore lack the ordinary incentives to be careful. In this way, the case runs afoul of Checchia's warning quoted in the introduction to this Article, namely that the law not "reward unreasonable and unethical conduct and . . . deny recovery to injured third parties with valid legal claims."[231] Though *ScotiaMcLeod* does not necessarily reward unethical conduct, it does reward unreasonable conduct because unreasonable conduct is the very definition of negligence. And it denies recovery to injured third parties

223. *ADGA*, 43 O.R. at para. 9.

224. Midwest Amusement Park, LLC v. Cameron Motorsports Inc., 2018 ONSC 4549 (Can. Ont.).

225. McFadden v. 481782 Ontario Ltd. (1984), 47 O.R. 2d 134 (Can. Ont. S.C.).

226. Lewis v. Boutilier, 1919 CanLII 535 (Can. S.C.).

227. Berger v. Willowdale A.M.C., 1983 CanLII 1820 (Can. Ont. C.A.).

228. Peracomo Inc. v. TELUS Communications Co,. [2014] 1 S.C.R. 621 (Can.).

229. Desrosiers v. Sullivan, [1986] N.B.J. No. 156 (Can. N.B. C.A.) (QL).

230. O'Byrne, Fraser & Philip, *supra* note 6, at 878.

231. Checchia, *supra* note 14, at 284.

because—but for the *ScotiaMcLeod* caveats describe above—such plaintiffs would otherwise succeed against the culpable director. In short, *ScotiaMcLeod* elevates corporate law values at the expense of tort law values going to accountability. And most seriously, *ScotiaMcLeod* is problematic because it fails to align with the Supreme Court of Canada's subsequent pronouncement that directors *can* owe a duty of care to third parties such as creditors.[232]

b. The Second Line of Authority: ADGA Systems International Ltd. v. Valcom Ltd. *and the Uncontextualized Duty of Care Approach*

The appellate court decision of *ADGA Systems International Ltd. v. Valcom Ltd.*[233] appears to offer a second line of authority out of Ontario. Whereas *ScotiaMcLeod* stated the director and officer tortious liability to third parties would be "rare,"[234] and that there must be some activity that takes directors and officers outside their role as a directing mind, *ADGA* stated the opposite. Carthy J.A. in *ADGA* regarded director and officer liability as being entirely common, stating that the

> consistent line of authority in Canada holds simply that, in all events, officers, directors and employees of corporations are responsible for their tortious conduct even though that conduct was directed in a bona fide manner to the best interests of the company, always subject to the *Said v. Butt* exception.[235]

In short, under *ADGA*, directors and officers are *always* personally responsible for the torts they commit—whether as the directing mind or outside that scope—with one exception. That exception occurs when the director or officer is able to successfully raise the defense of *Said v. Butt,* which, in turn, only applies to the tort of inducing breach of contract.[236]

At issue in *ADGA* was the personal liability of the director and senior employees of Valcom Ltd. These individuals facilitated the commission of a tort by their own corporation by convincing virtually all the employees of ADGA, a competitor, to breach their contracts of employment and move to

232. Peoples Dep't Stores Inc. v. Wise, [2004] 3 S.C.R. 461, 487–93 (Can.). For further discussion, see O'Byrne, Fraser & Philip, *supra* note 6, at 885–87.
233. *ADGA*, 43 O.R. at para. 9.
234. *ScotiaMcLeod,* 26 O.R. at para. 25.
235. *ADGA*, 43 O.R. at para. 18.
236. *Id.* For a discussion of this tort, see *supra* notes 182–193 and accompanying text.

Valcom Ltd. for employment there.[237] This constituted the tort of inducing breach of contract by the corporation and was therefore actionable as against the corporate defendant. In addition, the Court of Appeal found the individual defendants personally liable for the same tort even though they were indisputably acting for a corporate purpose.[238]

It is very difficult to accept *ADGA*'s assertion that there is a consistent line of authority in this area and that it was merely following *ScotiaMcLeod* in ruling against the individual defendants. Indeed, *ADGA*'s claim has been directly challenged both by scholars,[239] and members of the judiciary.[240] Most recently, for example, Justice Marriott of the Alberta Court of Queen's Bench flatly rejected *ADGA*'s assessment on this point, observing, instead, that *ADGA* "establishes a broader scope of personal liability of corporate directors than *ScotiaMcLeod* because it does not call for the 'separate identity' requirement."[241] Fortunately for our immediate purposes, this debate is not central. What does matter is that *ADGA* most certainly posits an approach to personal liability that is expansive and virtually without exception.

By making directors and officers broadly liable, the Ontario Court of Appeal in *ADGA* sought to enforce the general principle that "individuals are responsible for their own conduct."[242] With little hesitation, the court stated an all-encompassing rule of personal liability that includes liability for ordinary negligence causing pure economic loss. Indeed, as Christopher Nicholls observes with implicit concern, the rule stated in in *ADGA* "could effectively insulate third parties from what ought properly to be the practical consequences of their decision to deal with a limited liability entity."[243] More generally, *ADGA* is subject to the criticism that it did not take proper account of corporate law values, focusing exclusively on tort. Its pronouncement that that a broad rule of liability did not

237. *Id.* at para. 3.

238. *Id.* at para. 6. Note that the defense of *Said v. Butt* had no application since the individuals were not inducing their *own* corporation to breach a contract; they were inducing employees of another corporation to do so.

239. *See, e.g.*, Christopher Nicholls, *Liability of Corporate Officers and Directors to Third Parties*, 35 CAN. BUS. L.J. 1, 19 (2001); Sarra, *supra* note 6, at 64; O'Byrne, Fraser & Philip, *supra* note 6, at 872–73.

240. *Hogarth*, 2013 ABCA at para. 73 (("The law respecting the liability of directors and officers for torts committed while conducting corporate business is not entirely consistent."). *See also* Hall v. Stewart, 2019 ABCA 98, para. 18 (Can.) (stating that a "comprehensive and integrated test remains elusive" regarding director and officer liability).

241. Rudichuk v. Genesis Land Dev. Corp., 2019 ABQB 132, para 18 (Can.).

242. *See Hogarth,* 2013 ABCA at para. 101.

243. Nicholls, *supra* note 239, at 37.

compromise the *Salomon* principle rings particularly hollow. True, *ADGA* insisted that it was merely holding directors liable for their own torts and accordingly, "the corporate veil is not threatened and the *Salomon* principle remains intact."[244] However, as Justice Slatter of the Alberta Court of Appeal states in the subsequent decision of *Hogarth,* such a pronouncement

> may be true, but it is hardly a helpful distinction. Whether it is done directly or indirectly, a finding of personal liability has an impact on the limited liability features of corporations, and the policy concerns are the same. . . . Holding an individual liable for a tort committed directly in pursuit of the company's business amounts to requiring that individual to grant a personal guarantee for the tort liabilities of the company.[245]

ADGA is also problematic for incentivizing directors and officers to act with undue caution out of fear for personal liability,[246] thereby jeopardizing the best interests of the corporation. In sum, *AGDA* extracts personal accountability at too high a price.

The difficulties posed by *ADGA* are manifest in the subsequent Ontario Court of Appeal decision of *NBD Bank, Canada v. Dofasco Inc*.[247] In this case, the VP of Finance, Mr. Melville, described the credit worthiness of the Algoma Steel Corporation (Algoma) in the form of "egregious, serious mis-statements."[248] The loan was made but Algoma quickly defaulted. In response, the bank sued Melville personally in negligence, *inter alia*. In finding that Melville owed the bank a personal duty of care (or was in a special relationship), neither the trial judge nor the appellate court took into account corporate law values that may militate against the finding of a duty nor did they robustly assess the extent to which Melville assumed *personal* responsibility for his words. Rather, the Court of Appeal, for example, made short work of the duty question,

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244. *ADGA*, 43 O.R. at para. 10.

245. *Hogarth*, 2013 ABCA at para. 126.

246. As Edward Iacobucci notes in *Unfinished Business: An Analysis of Stones Unturned*, 35 CAN. BUS. L.J. 39, 47 (2001): "Directors faced with personal liability face the full brunt of any tort damage awards against them. Since they bear the costs from a tort judgment in full, directors cannot diversify this risk. As a general proposition, individual directors will be risk adverse. Faced with the possibility of a tort damage award, and possibly uncertain tort is standards, risk-adverse directors may tend to take more care than is efficient. Personal liability and risk aversion could lead to excessive caretaking by directors." *See also* Ronald Daniels, *Must Boards Go Overboard? An Economic Analysis of the Effects of Burgeoning Liability on the Role of Directors in Corporate Governance,* 24 CAN. BUS. L.J. 229, 255 (1994); O'Byrne, Fraser & Philip, *supra* note 6, at 881.

247. NBD Bank, Canada v. Dofasco Inc. (1999), 46 O.R. 3d 514 (Can. Ont. C.A.).

248. *Id.* at para. 58.

stating:

> Mr. Melville was Algoma's Vice-President (Finance), Secretary and Treasurer. He was the respondent's contact at Algoma. He held himself out as capable of making decisions on Algoma's behalf as it related to satisfying the respondent's concerns about its lack of security. He must have known that carelessness on his part would result in a loss by the respondent. The trial judge found that the appellant "would reasonably know and in fact did know, that Mr. Hynes and his bank trusted him and would accept and rely upon what he said to them". This finding was amply supported by the record. Thus, Mr. Melville ought reasonably to have foreseen that the respondent would rely upon his representations. . . . For virtually the same reasons, reliance by the respondent was reasonable. . . .[249]

To reiterate, the question that the court did *not* ask was the basis upon which the bank reasonably relied on Melville as having assumed *personal* responsibility for his negligent words as opposed to simply speaking on behalf of the corporation. Instead, the Court of Appeal simply rejected any policy reasons militating against finding a personal duty of care—since, for example, there was no risk of indeterminate liability on the facts.[250] Accordingly, Melville was found personally liable to the bank, jointly and severally with other named defendants, for the equivalent of $1,984,945.27 USD.[251]

NBD Bank is problematic for too easily finding a duty of care and for its failure, for example, to robustly assess all the circumstances. For example, Justice Slatter in *Hogarth* implicitly critiqued *NBD Bank* when observing that the bank "was obviously a sophisticated party, which knew it was dealing with corporate structures that limited liability, and a borrower under some financial stress."[252] In this way, *NBD Bank* may well have extended director and officer liability in negligence too far.

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249. *Id.* at para. 48.

250. *Id.* at para. 59.

251. NBD Bank, Canada v. Dofasco Inc. (1997), 34 B.L.R. 2d 209 (Can.). Note that the Bank sued Melville for fraud as well but this was disallowed by the trial judge, who found in negligence instead. Given that Melville's misrepresentations were described by both levels of court as "egregious," perhaps the fraud route would have been more appropriate. And a finding of personal liability in the context of fraud would have been entirely non-controversial.

252. *Hogarth*, 2013 ABCA at para. 104.

c. The Third Line of Authority: The Concurring Decision in Hogarth v. Rocky Mountain Slate Inc. *and the Contextualized Duty of Care Approach*

A third line of authority is germinated in the concurring decision of the Alberta Court of Appeal in *Hogarth*[253] and one which addresses the seeming deficiencies of the *NBD Bank* case. In *Hogarth*, Justice Slatter stated that directors and officers *could* be liable for ordinary negligence to third parties, thereby implicitly discarding *ScotiaMcLeod,* which holds to the contrary. However, Slatter J.A. was nonetheless protective of directors and officers because, following his approach, a duty of care (or special relationship in the context of negligent misstatement) would be difficult to establish in the ordinary case. The bright line Slatter J.A. identifies is this: directors and officers do not owe a duty of care to third parties in the context of negligent misrepresentation causing pure economic loss unless they have guaranteed the accuracy of their words to the plaintiff or otherwise assumed *personal* responsibility for what they say.[254] This relates back to the notion of justified reliance discussed in Part I above.

On the facts at bar, Slatter J.A. found that the corporate officer did not owe a personal duty of care to the investors who relied on the officer's words to their financial detriment. As he stated:

> The investors knew they were dealing with a limited liability partnership, and they must be taken to be aware of the legal consequences of that. They willingly accepted and relied on representations from that corporate entity. The only reasonable expectations they could have had was that they were dealing with a corporation. Any expectations about or reliance on the personal involvement of the promoters was unreasonable . . . . They did not even know for sure which director or promoter had prepared which parts of the various documents, and therefore could have had no reasonable reliance based on individual authorship. While there may clearly be some cases where there is sufficient proximity between the directors and the investors, on the facts in this appeal proximity is not shown . . . .[255]

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253. *Id.*

254. *Id.* at para. 116. For discussion, see O'Byrne, Fraser & Philip, *supra* note 6, at 896-897. For subsequent appellate discussion of *Hogarth* on this point, see the Alberta Court of Appeal in *Abt Estate v. Cold Lake Indus. Park GP Ltd.*, 2019 ABCA 16, para. 48 (Can.) (emphasizing *Hogarth* as concerning whether there was reason to believe that the individual defendant was "taking personal responsibility for the representations").

255. *Hogarth*, 2013 ABCA at para. 121. *See also id.* at para 122 ("The issue is whether

It is beyond the scope of this Article to analyze the details of Canadian tort law in establishing a duty of care. Suffice it to say that it is a two-stage process which assesses the relationship between the plaintiff and defendant. The court first considers whether there is a *prima facie* duty of care in place. In this regard, the court looks to proximity (that is, whether the parties are in a close and direct relationship). Of particular note in the context of pure economic loss arising from negligent misrepresentation relates to the defendant's undertaking and the plaintiff's reliance. According to the Supreme Court of Canada in a 2017 decision, "[w]here the defendant undertakes to provide a representation or service in circumstances that invite the plaintiff's reasonable reliance, the defendant becomes obligated to take reasonable care. And, the plaintiff has a right to rely on the defendant's undertaking to do so."[256] Additionally, at this stage, the court assesses whether the defendant should have reasonably foreseen that the plaintiff would rely and whether the reliance, given the circumstances, was reasonable.[257] If these kinds of ingredients are in place, a duty of care is owed on a *prima facie* basis.

Justice Slatter's concurring decision in *Hogarth* precedes the Supreme Court of Canada's latest articulation of the law of negligence—including negligent misstatement—described above but is entirely consistent with it. In his assessment of the *prima facie* duty question, Justice Slatter referred to a number of factors derived from the case law as influencing his deliberations, including whether the plaintiff *chose* to deal with the corporation (which presumably tilts away from the director owing a duty of care) or had the corporate relationship imposed (tilting towards a duty), whether the tort was independent (tilting towards a duty) or "closely related to corporate activity" (tilting away) as well as whether the loss was economic (tilting away) or physical (tilting towards).[258] Justice Slatter's goal was to address, through these factors, the general "concern about the effect that individual liability can have on . . . corporate structures and their

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it was reasonable for the plaintiff to rely on the individual director's personal involvement so as to create a personal duty of care in the director. In this appeal it was reasonable for the respondents to rely on the representations in the promotional documents, but the more focused issue is whether it was reasonable for them to assume that the individual appellant was infused with a personal responsibility for their accuracy.").

256. Deloitte & Touche v. Livent Inc., [2017] 2 S.C.R. 855, para. 30 (Can.). Note in this case that the SCC does not employ the term "special relationship" but instead, relies on duty of care language.

257. *Id.* at para. 35.

258. *Hogarth*, 2013 ABCA at para. 110.

efficacy."[259] He also identified as relevant whether the negligent act was committed "while engaged in the business of the corporation" and that the individual "was not pursuing any personal interest beyond the corporate interest"[260]—both of which presumably tilt away from a finding of personal liability.

The duty analysis also has a second stage. As the Supreme Court confirms, this stage asks "whether there are 'residual policy considerations' outside the relationship of the parties that may negate the imposition of a duty of care?"[261] The idea is to give the court a chance to back away from finding a duty of care if it would have larger, adverse effects. At this point in his analysis, Justice Slatter emphasized that compensation of plaintiffs is important but concurrently, it is a "legitimate desire of entrepreneurs to operate in a limited liability environment."[262] On a related front, Justice Slatter observed that while "holding tortfeasors accountable"[263] and "compensating victims"[264] are important, such concepts also have limits. According to Justice Slatter, these concepts "do not automatically prevail over all other objectives, such as the legitimate desire of entrepreneurs to operate in a limited liability environment. They also do not displace any responsibility on the plaintiff to accept some risk of what is known to be a risky investment."[265] He also emphasized the importance of the corporate vehicle to the Canadian economy and that the corporation—including concomitant limited liability—is "not a loophole, a technicality, or a mischievous stratagem; it is an essential tool of social and economic policy."[266]

Justice Slatter's concurring decision was unanimously endorsed by a subsequent panel of the Court of Appeal in *Hall v. Stewart*[267] as well as in *Abt Estate v. Cold Lake Industrial Park GP Ltd.*,[268] thereby elevating its status. Unlike the court in *ADGA* which easily finds liability, Justice Slatter expressly considered corporate law values in order to temper the influence of tort law. And unlike the court in *ScotiaMcLeod* which renders liability rare and unusual, Justice Slatter brought tort law values to the table

259. *Id.*
260. *Id.* at para. 109.
261. Deloitte & Touche v. Livent Inc., [2017] 2 S.C.R. 855, para. 37 (Can.).
262. *Hogarth*, 2013 ABCA at para. 127.
263. *Id.*
264. *Id.*
265. *Id.*
266. *Id.* at para. 68.
267. Hall v. Stewart, 2019 ABCA 98, para. 18 (Can.).
268. Abt Estate v. Cold Lake Industrial Park GP Ltd., 2019 ABCA 16, para. 44 (Can.).

such that director and officer liability in negligence for pure economic loss becomes possible but subject, first, to robust duty of care policy analysis. In this way, Justice Slatter found a compromise between two extreme camps. Put another way, he threaded the needle between corporate law and tort.

d. The Fourth Line of Authority: Recasting and Broadening Scotia McLeod

The Alberta Court of Appeal's 2019 decision in *Abt Estate* posits the view that in circumstances where the individual defendant takes responsibility for the accuracy of his representations or otherwise invites reliance, that may be "sufficient to identify a separate identity or interest from that of the corporation so as to make the act or conduct complained of his own."[269] In this way, simple negligence causing pure economic loss *might* be encompassed by *ScotiaMcLeod* after all but this requires a reinterpretation of *ScotiaMcLeod*. That is, no longer does *ScotiaMcLeod* merely attach personal liability in relation to the egregious misconduct illustrated by its express hallmarks of liability, such as fraud and dishonesty. Instead, the necessary separateness can now be accomplished when the director or officer has invited the plaintiff to rely on her words, thereby establishing an essential component to a finding that a duty of care or special relationship exists between the parties. While establishing liability on this basis can be helpful and fair, it requires reading *ScotiaMcLeod* in a new way—at least from the perspective of Alberta courts—and thereby marks a fourth evolution in the case law whereby *ScotiaMcLeod* is recast and broadened. That is, the Alberta Court of Appeal in *Abt Estate* followed *ScotiaMcLeod* but it is not consistent with how the Alberta Court of Appeal in *Blacklaws* did. As discussed earlier, the Court of Appeal in *Blacklaws* regarded *ScotiaMcLeod* as positing a test for when a director or officer can secure an immunity for the tort she committed.

As analysis in this Part illustrates, Canadian law in relation to director or officer liability in negligence for pure economic loss is both inconsistent and in flux. For example—and as Justice Marriott in *Rudichuk v. Genesis Land Development Corp.* observed—despite "the seemingly different approaches in *ADGA* and *ScotiaMcLeod*, the SCC has cited both cases with

269. *Id.* at para. 48.

approval. . . ."[270] Beyond this, Canada's most influential appellate court has declared itself as unable to usefully contribute to this area of law anymore. See *Pryce v. Vuckovich* wherein the Ontario Court of Appeal tersely rejected the appellant's request that it reconsider the *ADGA* and *ScotiaMcLeod* dichotomy, stating: "We decline to do so and report what we have said in *ADGA* that the policy considerations involved in these decisions, if they are to be considered it should be done by the Supreme Court of Canada."[271] It is hoped that the Supreme Court of Canada will soon grant leave to a case on point so that the matter can be thoroughly resolved. Directors and officers are entitled to know the liability they face—in advance—and why.[272] Such clarity will also, presumably, drive down the cost of litigation. However, to date, the Supreme Court of Canada has denied leave to appeal to numerous appellate cases on point, including *Hogarth*.[273]

As previously discussed, Justice Slatter's approach in *Hogarth* appears to point the way forward—as endorsed by the *Hall* and *Abt Estate* cases. The notion Slatter J.A. posits in *Hogarth* is that directors and officers *can* be liable for ordinary negligence causing pure economic loss but only once the court has undertaken a contextualized and policy-laden analysis of whether a duty of care exists in the first place. Tort law *and* corporate law principles must be assessed.

CONCLUSION

This Article has identified important deficiencies in U.S. law governing director and officer liability in tort to third parties. Most concerning is that in Delaware, a plaintiff suing directors or officers in negligence causing personal injury or property loss must prove active negligence—that is malfeasance. Put another way, directors and officers are not liable for nonfeasance causing personal injury or property loss whereas other types of defendants are. This exempted status is problematic on its own but particularly so in the context of personal injury. On what policy basis are corporate law values permitted to overwhelm the plaintiff's right that others take reasonable care not to cause her personal injury? Public policy going to the protection of bodily integrity is overwhelming in such circumstances, a matter which California implicitly recognizes by

270. Rudichuk v. Genesis Land Development Corp., 2019 ABQB 132, para. 18 (Can.).
271. Pryce v. Vuckovich 2000 CanLII 27024 (ON CA).
272. O'Byrne, Fraser, & Philip, *supra* note 6, at 897.
273. Lance Hogarth, et al. v. Roger Simonson, 2013 CanLII 40340, 2 (S.C.C).

including nonfeasance in its version of the personal participation doctrine. The same argument holds in relation to director liability for property loss because tort law values should trump corporate law values for this kind of harm. As previously explored, director liability for personal injury and property loss is axiomatic in Canada—across jurisdictions—such that directors and officers are held accountable. Corporate personhood is not considered a relevant factor in these cases.

Another significant concern relates to simple negligence causing pure economic loss. As discussed, although the economic loss doctrine in the U.S. generally precludes recovery in negligence, tort law allows recovery for pecuniary damages for negligent misrepresentation where there is justifiable reliance on the party providing the misleading information. However, in the context of director and officer liability, courts do not seem to even consider whether the plaintiff was justified in relying on the defendant. Cases, including from California, functionally add a further requirement before the plaintiff can succeed, namely that the loss involves personal injury or property damage. The upshot in these jurisdictions is that directors and officers are not liable for negligence causing pure economic loss. This approach—where the duty analysis is *pro forma* and exonerating—reduces the accountability of directors and officers who personally cause financial harm to others by, for example, inviting justifiable reliance. Corporate law notions are intact following this path, but tort law principles are seriously compromised for reasons unmoored to sound policy analysis. This approach to liability should be rejected.

The New York Court of Appeals in *Kimmell*, by way of contrast, leads by offering a more carefully calibrated approach. This is because it examined the relationship between the officer and the third party to determine whether there was a specialized relationship which may give rise to a duty. This included a concern whether reliance was justifiable. For the court in *Kimmell*, it appears that directors and officers have no special protections in relation to negligence causing pure economic loss. Instead, tort law provides that protection (or not) according to its ordinary principles. The New York approach resonates, at least to some degree, with the tack followed by Slatter J.A. in the *Hogarth* case from Canada. Justice Slatter showed he was willing to find a duty of care owed to third parties when, for example, the director or officer assumed personal responsibility for their words. The goal is for courts is to analyze the facts closely so as to find the balance between protecting the defendant and holding the defendant responsible; between under-compensating and over-compensating the plaintiff; between corporate law values and tort law values.

Drawing on all the Article's jurisdictional sources, we conclude that the ideal liability regime is one that eschews special defenses for directors and officers. This is because the ordinary rules of tort law provide sufficient cover to directors and officers while special defenses are a contagion. By winking at unreasonable conduct, special defenses erode accountability, compromise corporate culture, and deny justice to the otherwise worthy plaintiff.