Assessing the Liability of Directors and Officers at the Intersection of Tort and Corporate Law[+]

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The 21st century has been marred by corporate scandal after scandal – including but not limited to 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 reigning 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 creates a moral hazard 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 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

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[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] *See Chapter 7: MLM's Abysmal Numbers* in JON M. TAYLOR, THE CASE (FOR AND) AGAINST MULTI-LEVEL MARKETING, *available at* 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 (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/.
[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.
[5] Frank Easterbook & Daniel Fischel, *Limited Liability and the Corporation,* 52 U. CHI. L. REV. 89, 93–94 (1985). See further discussion, *infra*, Part II.
[6] Janis Sarra, *The Corporate Veil Lifted: Director and Officer Liability to Third Parties*, 35 CAN. BUS. L.J. 55, 66 (2001).
[7] Joan Loughrey, *Breaching the Accountability Firewall: Market Norms and the Reasonable Director,* 37 SEATTLE U. L. REV. 989, 1013 (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 (2009) ("[I]t is accountability as a constant social understanding that tort law serves to reinforce. By a constant social understand – 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.")
[8] For discussion, see Christian Witting, *The Small Company: Directors' Status and Liability in Negligence*, 24 KING'S L.J. 343 (2013).
[9] *See* Solomon, *supra* note 7, at 1809 . *See also* LEWIS KLAR, TORT LAW 14 (2017) ("Tort law operates as an important part of the Canadian society's civil *justice* system. Its theoretical underpinning – that a wrongdoer who

personal liability. Corporate law, by way of contrast, drives hard 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, 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 paper is to measure the coherency and fairness of how certain U.S. state courts attribute personal liability to directors and officers in actions by non-shareholder third parties. The paper'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 important 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 question itself. In short, the economic loss doctrine in U.S. state law is harsh vis-à-vis the injured party, largely insulating director and officer 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

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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.").

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

[12] 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, 1157, 1141 (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).

officers as any other plaintiffs in the context of personal injury and property loss but, in varying ways, stumbles when it comes to assessing liability for simple negligence causing pure economic loss. On the one hand, courts like the Alberta Court of Appeal *underexpose* directors and officers to liability in relation to ordinary negligence causing pure economic loss by functionally denying recovery as a rule of law. On the other hand, courts like the Ontario Court of Appeal *overexpose* 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. Drawing on all the paper's jurisdictional sources, we offer some brief conclusions, including 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 erode accountability, compromise corporate culture, and deny justice to the otherwise worthy plaintiff. In conclusion, we also ask the courts to more carefully assess the duty question in the context of negligence causing pure economic loss. The goal is for courts 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.

I. Directors' and Officers' 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 Delaware Code permits firms to eliminate monetary liability of directors to the corporation for damages ensuing from acts of gross negligence.[17] The amendment's appeal to freedom of contract helped to broadly quell the

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[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 153 (5th ed. 2016).

[16] DEL. CODE ANN. tit. 8, §102(b)(7). 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, 1160–1161 (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 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 Rauterbreg & 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).

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 at common law (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 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 paper 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 includes 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?

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[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, 45 (2012) (quoting William T. Allen et. al, *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law,* 56 BUS. LAW. 1287, 1291 (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] Welsh & Saunders, *supra* note 19, at 854 (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 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.*

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] 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, and 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

The type of injury caused by the defendant is what distinguishes torts in this area, with the law broadly differentiating 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 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

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[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] Lobato v. Pay Less Drug Stores, Inc., 261 F.2d 406, 408–09 (10th Cir. 1958) ("It is a 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 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 1667; *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 1667.

[30] *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.").

[31] RESTAT. (THIRD) OF TORTS § 7(a) (2010).

[32] Palsgraf v. Long Island Railroad, 248 N.Y. 339 (1928).

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 distinct 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 is strict, and 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 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 Copeland had not personally participated in corporate tort of negligence.[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, mere *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 mere 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]

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[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)).
[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.*

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 a property loss claim.[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 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 for the claims against him was that "[the plaintiff] was dealing with the Kennel, which is a corporation" and thus the claims against him as an individual should have been dropped.[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 found 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 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 court denied summary judgment.[59] According to the Delaware Superior Court, Mr. Sills could be potentially 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

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[47] Ayers v. Quillen, No. CIV.A.03C-02-004-RFS, 2004 WL 1965866, at *3 (Del. Super. Ct. June 30, 2004).
[48] *Ayers*, 2004 WL 1965866, at *1.
[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 *2.
[56] *Id.*
[57] *Id.* at *3–5.
[58] *Id.* at *7.
[59] *Id.*

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" negligence, there is no liability. This is a problematic distinction and one which the courts do not seem to spend time justifying. 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 (ie: 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:

> do 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 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 do 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:

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[60] *Id.*
[61] *Id.*
[62] Wash. H. Condominium Assn. of Unit Owners v. Daystar Sills, Inc., No. CVN15C01108WCCCCLD, 2017 WL 3412079, at *16 (Del. Super. Aug. 8, 2017).
[63] Petrin, *supra* note 26, at 1671.
[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-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.

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

> [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

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

> 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 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 main stream tort law but the court nonetheless spent the time to establish the foundation for its determinations on the duty front.

In sum, Delaware law correctly requires personal participation before holding officers and directors liable in the personal capacity on the basis that they should only be liable for their own actions, not merely due to their status in the firm. However, requiring evidence of active malfeasance by the defendant director is highly problematic, 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 turn a blind eye 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.

B. Torts Causing Pure Economic Loss

As a general principle, it is difficult to recover pure economic loss in tort. The genesis for this economic loss rule is the U.S. Supreme Court decision of *Robbins Dry Dock & Repair Co. v.*

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[74] *Id.* at 505.
[75] Michaelis v. Benavides, 61 Cal. App. 4th 681, 684 (1998).
[76] *Id.*
[77] *Id.* at 681.

Flint, where the Court held that pure economic loss is generally not recoverable in this context.[78] In *Robbins Dry Dock & Repair Co.*, 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] as well as because the plaintiff 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 tortfeasor liable to another merely because the injured person was under a contract with that other unknown to the doer of the wrong."[82] Justice Holmes, who wrote the opinion, stated, "[t]he law does not spread its protection so far."[83] Historically, economic damages were relegated to cases where the pecuniary damages were also accompanied by a 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 harm to either the person or property of the plaintiff.[85]

The *Restatement (Second) of Agency* further states that the rule is similarly applicable 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]

This statement regarding economic loss caused by agents is a judicially created doctrine "which prohibits a party from recovering in tort for economic losses, the entitlement to which

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[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. Law 111 (1998).
[79] *Id.*
[80] *Robins,* 275 U.S. 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).
[85] Gruning, *supra* note 78, at 190.
[86] RESTATEMENT (SECOND) OF AGENCY, § 352, 354 (1958).

flows only from a contract"[87] [hereinafter referred to as the economic loss doctrine]. There are, however, exceptions to this doctrine which include liability for intentional torts and liability for some claims of negligence when the connection between the tortfeasor and the plaintiff are 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 misrepresentations

Like officers and directors, when members or principals of an LLC actively participate in fraudulent misrepresentations, on behalf of the entity, they may be found to be personally liable. In *Yavar v. Roffman*, a case was brought against the company 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, however, noting that the case was merely at the motion to dismiss stage, 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 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 had 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 trial court found that the appellants had "failed to alleged 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 a managing member" of the LLC.[94] On appeal, plaintiffs argued that Geiser was "attempting to escape liability by hiding behind the shield of [his] character" as member 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

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[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.*
[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).

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] Likewise, in *Pacific Landmark*, the court 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 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 in tort. 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 the risk of loss. . . ."[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

[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.
[100] Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 543 (2009).
[101] Ultramares Corp. v. Touche, 255 N.Y. 170, 179 (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 (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).

mitigating social cost."[106] This may be especially true with issues 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 negligence, cases where the connection between the tortfeasor and plaintiff is foreseeable.[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, such as in cases of negligent misrepresentation.[116] Building on this foundation, torts committed by directors and officers are, at least in theory, no exception to the economic loss rule.[117] Directors and officers, therefore, may be liable to third parties for economic losses when they commit an intentional tort or a tort falling into one of the rule's exceptions. As stated in §552 of the *Restatement (Second) of Torts*:[118]

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[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.* at 128.
[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.
[115] Gergen*, supra* note 112.
[116] *See e..g.*, Bilt-Rite Contractors, Inc. v. The Architectural Studio, 581 Pa. 454, 479 (2005).
[117] Petrin, *supra* note 26, at 1679.
[118] Guardian Constr. Co. v. Tetra Tech Richardson, Inc., 532 A.2d 1378 (Del. Super. 1990).

> 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.[119]

For a plaintiff to maintain a claim under §522, he or she must establish: (1) "the defendant supplied information to the plaintiff for use in business transactions with third parties" and (2) "the defendant is in the business of supplying information."[120]

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.[121] The defendant corporation had the authority to solicit and underwrite proposals for insurance, to determine the premium rate, and to issue contracts of insurance in the eleven western states in plaintiff's behalf."[122] 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."[123] 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"[124] and thus found the only duty owed by Mr. Haidinger was to the corporation. It held that "more must be shown than the breach of the officer's duty to his corporation to impose personal liability to 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 corporate duties."[125]

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[119] RESTATEMENT (SECOND) OF TORTS § 552 (1977).
[120] 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). 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 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."
[121] United States Liab. Ins. Co. v. Haidinger-Hayes, Inc., 1 Cal. 3d 586 (1970).
[122] *Id.*
[123] *Id.* at 594.
[124] *Id.*
[125] *Id.*

Another California case involving pecuniary (rather than physical harm) also 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.[126] The complaint alleged that the president (1) falsely estimated CCG's worker's 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."[127] Here, the court noted that there are:

> [t]wo 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.[128]

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 toward, 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.[129]

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."[130] 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,"[131] 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

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[126] Self-Insurers Sec. Fund v. Esis, Inc., 204 Cal. App. 3d 1148 (1988).
[127] *Id.* at 1161.
[128] *Id.* at 1162.
[129] *Id.* at 1163.
[130] Omnel v. Tanner, No. C070907, 2013 WL 3357886 (Cal. App. 3 Dist. July 3, 2013).
[131] *Id.*

regulations, and caused Omnel to lose profits and business opportunities.[132] 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."[133]

During construction, Tanner, himself had "falsely advised Omnel that no permits were required" and continued to build without such permits, did not complete the building to code, and relied on cost-cutting shortcuts.[134] 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."[135] Eventually, the construction failed to meet code and did not reach completion. The trial court had reasoned that "any duty owned by Tanner regarding the management and operation of Tanner Industries and Valpo-LLC was owed to those entities, not to Omnel."[136] A result to the contrary would "eviscerate the protection against individual liability that incorporation would otherwise provide."[137] The appellate court affirmed and relied on the *Haidinger-Hayes* and *Francis T.,* line of reasoning, distinguished negligence from intentional torts, and emphasized the fact 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 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 was:

> not personally liable for economic damages 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.[138]

Yet again, in *Mansha Consulting LLC v. Alakai,* a federal trial court in Hawaii considered the negligence claim alleged by Mansha Consulting against Hawaii Health Connector (HHC).[139] Consistent with the rulings in California, the court distinguished between the duty of care owed to the corporation and a duty of care owed to a third party. Mansha alleged that HHC was negligent and breached its fiduciary duties in mishandling invoice payments and accordingly sued Alakai, the chairman of its board, and Matsuda, the interim executive director. In granting a motion to dismiss, the court noted that the consulting agency failed to show that the 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."[140] The complaint here asserted that the defendants owed certain duties

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[132] *Id.*
[133] *Id.*
[134] *Id.*
[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] *Id.*
[139] Mansha Consulting LLC v. Alakai, 236 F.Supp.3d 1267 (2017).
[140] *Id.* at 1274.

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 "an 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."[141] 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."[142]

From these cases it is evident that where the allegations of negligence against corporate officers, directors, and members of LLCs involve pure economic loss, courts in the U.S. are highly unlikely to find the individuals owe a duty of care to the third party. In large part, this is due to the nature of the injury – regardless of whom the defendant is. Put another way, there is already considerably less likelihood of liability when the injury is economic as opposed to one involving personal injury or property damage. Although the exception, the economic loss doctrine allows for liability if harm to the third party is foreseeable. However, courts tend not to explore this possibility when the defendant is a corporate officer or director. Rather, U.S. state courts have effectively determined that these corporate actors have no duty to third parties where the harm is economic as opposed to personal injury or property 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.[143] According to the court, these direct statements to plaintiff imposed no personal duty upon the president but more analysis from the court would have been helpful on this point. This is because the facts appear to engage the exception to the economic loss doctrine since harm to the plaintiff would be foreseeable if indeed permits were required for the project and the president were unable to solve any problems through his friends. This omission in the court's analysis is particularly puzzling given the active steps that the president seemingly took to invite the plaintiff to rely on him and what he said.

Courts are certainly justifiable in being wary of undue liability being imposed on corporate officers and directors. At risk is the evisceration of corporate law principles and the danger that such individuals would otherwise be required to backstop or guarantee corporate operations. But the problem with the cases discussed above 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 on the basis of their status as officers and directors. 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. Even the rather harsh economic loss principle which is reluctant to find liability in negligence for economic harm carves out an exception where the harm caused to the plaintiff is foreseeable. Yet, in the corporate context, courts, even in California, are ignoring the foreseeable plaintiff exception when it comes to deciding whether corporate officers, directors or principals of LLCs may be held liable for negligence to third parties. Put another way, courts seem to have concluded that being a foreseeable plaintiff is such a context is not enough but have not explained why this should be the case.

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[141] *Id.* at 1275.
[142] *Id.* at 1276.
[143] Omnel v. Tanner, No. C070907, 2013 WL 3357886 (Cal. App. 3 Dist. July 3, 2013)

The solution to this dearth of judicial analysis is to actively engage the duty of care question from a more balanced perspective. For example, Stephen Perry suggests just such balance through an "invited reliance" doctrine. He reaches back to *Hedley Byrne,* an English court decision that considered liability for negligent misstatement causing pure economic loss, by introducing the notion of "assumption of responsibility."[144] Hedley Byrne, an advertising firm, employed a bank to conduct a credit check on a potential client. After the bank ensured that the client was "good for its normal business engagements," the client went into liquidation. Hedley Byrne thus suffered a loss of £ 17,000, and sued the bank. The court considered a "special relationship," "sufficiently proximate" to create a duty of care, where one should "be held to have accepted some responsibility for his answer being given carefully, or to have accepted a relationship with the enquirer which requires him to exercise such care as the circumstances required."[145] The court refrained from imposing liability here because the bank had included a disclaimer ("without responsibility on our part") as a preface to the recommendation, which the court found sufficient to relieve it of a special duty of care.[146] According to Perry,

> The principle of *Hedley Byrne* is concerned with a certain type of interaction between persons in which A acts deliberately (in the central case) to persuade B that it is reasonable for B to rely on A in some respect and, in consequence to shift his or her position. In inducing B to rely on this way, A plays a central role in bringing about a relationship of dependence….If B chooses a certain course of action on the basis of an assurance by A that, for example, a certain state of affairs obtains or will obtain, or a that A will behave in a certain way, that choice may well foreclose at least eventually, other courses of action open to B…But a forgone opportunity to act differently is appropriately treated as a loss in the tort sense of if the course of action B would have followed had he or she not relied on A would have been preferable to the one actually taken. A loss of this kind is appropriately regarded as an interference with B's autonomy interest [the idea that 'a person controls aspects of his life, and determines their shape'], since that interest is constituted in party by the nature and character of the opportunities or options in life that are available for one to choose from.[147]

Perry's notion of invited reliance in the context of a negligence claim against a director or officer is easily seen as part of the duty assessment[148] -- either directly or indirectly. In the context of negligence causing pure economic loss where the director or officer has *not* invited reliance, there is likely no duty of care and therefore no liability. However, where reliance is invited, which would seem to be true in *Omnel*, the director or officer is personally liable because that invited reliance helps create a duty of care. Failure to be careful in such circumstances causes loss to the plaintiff which loss should be recoverable.

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[144] Stephen R. Perry, *Protected Interests and Undertakings in the Law of Negligence,* 42 U. TORONTO L.J. 247 (1992); Hedley Bryne & Co. Ltd. v. Heller & Partners Ltd. [1964] AC 465.
[145] Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] AC 465.
[146] *Id.*
[147] Perry, *supra* note 144.
[148] For discussion, see Part II in relation to Canadian law. *See also* Victoria Stace, *Directors' Liability in Negligence to Third Parties: Challenging the Assumption of Responsibility Approach*, 16 OXFORD U. COMMONWEALTH L. J. 183 (Nov 2016).

This idea of invited reliance finds some support in the New York Court of Appeals case of *Kimmell v. Schafer.*[149] In this case, plaintiffs invested in a limited partnership that "provided heat and electricity to industrial and commercial energy users through on-site-gas-powered "cogeneration" units."[150] In soliciting support, the defendant (a lawyer, certified public accountant, former chief financial officer of Pepisco 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."[151] 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.[152] 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."[153] It also found "the existence of a special relationship sufficiently resembling privity to justify holding the defendant liable."[154] The Appellate Division affirmed, holding the defendant liable for negligent misrepresentation. The Appellate court stated that under New York law, "liability for negligent misrepresentation has been imposed only on those persons who possess 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."[155] Furthermore,

> Whether the nature and caliber of the relationship between the parties is such that the injured party's reliance on a negligent misrepresentation claim is justified generally raises an issue of fact. In determining whether justifiable reliance exists in a particular case, a fact finder should consider whether persons 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 the plaintiffs gave rise to a duty to speak with care.[156]

This overall approach to negligence causing pure economic loss represents, in our view, offers a fair compromise between tort law and corporate law values. On the one hand, it is important that directors and officers are not treated as guarantors of corporate obligations via tort law. On the other hand, if the director or officer takes the steps that establish invited reliance, liability should flow.

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[149] Kimmell v. Schafer, 89 N.Y.2d 257, 260 (1996).
[150] *Id.*
[151] *Id.* at 261.
[152] *Id.* at 265.
[153] *Id.* at 262.
[154] *Id.*
[155] *Id.* at 263.
[156] *Id.* at 264.

II. Corporate Directors and Officers Liability to Non-Shareholder Third Parties in Canada

Unlike American law, Canadian law does not distinguish between directors, on the one hand, and officers, on the other when, it comes to liability;[157] they are subject to identical treatment. But as with American case law, Canada 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:*[158]

> 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 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.[159]

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 very 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.[160] 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."[161] As Davies C.J. wrote in the same decision: "The sooner presidents of companies realize that they have duties, the better for them and their fellow

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[157] For example, pursuant to section 122 of the federal Canada Business Corporations Act, both directors and officers owe a duty of care and fiduciary duty to the corporation. This provision is reflected in provincial corporate law statutes as well. See, for example, Ontario, BC, and Alberta.

[158] Mentmore Manufacturing Co. v. National Merchandise Manufacturing (1978), 89 D.L.R. 3d 195, para. 23 (Ont. Fed. Ct.).

[159] *Id.* at 202–203.

[160] Lewis v. Boutilier (1919), 52 D.L.R. 383, 389 (S.C.C.). The boy slipped or was otherwise pulled into a cogwheel and killed. *Id.* at 390.

[161] *Id.* at 393.

men."[162] *Lewis* was recently cited with approval by the Ontario Court of Appeal in *ADGA Systems International Ltd. v. Valcom Ltd.*[163]

A similar analysis holds when the plaintiff sues an officer or director for personal injury. In *Berger v. Willowdale A.M.C.*[164] 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;"[165] that there is "a natural desire on the part of an employee to please persons in authority in the employer corporation"[166] particular in a small corporation;[167] and that to the employee "the president is the symbol of job security and the source of possible promotion."[168] Taken together, this means that the corporate officer has a personal duty to show "due regard"[169] 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."[170] In coming to this conclusion, that court rejected defendant counsel's floodgates argument as being *in terrorem* and without foundation,[171] stating that executive liability will depend on factors including: "the 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."[172] *Berger* has more recently been cited with approval by the Ontario Court of Appeal.[173]

Other Canadian jurisdictions follow an identical analysis. In a 2019 decision, the Alberta Court of Appeal of *Hall v. Stewart*,[174] determined that the defendant director was liable for negligently causing personal injury to the plaintiff-employee on a work site. 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

[162] *Id.* at 386.
[163] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101 (Ont. C.A.).
[164] Berger v. Willowdale A.M.C. (1983), 41 O.R. 2d 89 (Ont. S.C.).
[165] *Id.* at para. 42.
[166] *Id.* at para. 40.
[167] *Id.*
[168] *Id.*
[169] *Id.* at para. 42.
[170] *Id.* at para. 29.
[171] *Id.* at para. 44.
[172] *Id.* at para. 44.
[173] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101 (Ont. C.A.).
[174] Hall v. Stewart, 2019 ABCA 98. Note that this case involved Workers' Compensation legislation but the legislative context did not change the court's reasoning on this point.

to ensure that physically injured plaintiffs are compensated. Claims for pure economic loss raise different issues."[175]

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*,[176] Canada's highest court very clearly adopted the principle that corporate personality "is not a relevant factor" 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."[177] As a result, the individual defendant's status as an officer of the corporate defendant was not relevant to his personal liability for recklessly cutting a fiber-optic cable and causing almost $1 million in damages to the plaintiff.[178] He was found to owe personally owe a duty of care to the plaintiff which duty was breached when he cut the cable.[179]

The same judicial perspective is present in the context of personal liability for property damage caused, in this case, by nuisance. In the New Brunswick Court of Appeal of *Desrosiers v. Sullivan*,[180] 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 pollution to the plaintiff's land caused by a manure lagoon escaping from the hog farm. The court found both the corporation and the individual liable in nuisance, rejecting Mr. Sullivan's reliance on *Salomon v. Salomon & Co.*[181] The Court of Appeal stated 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.[182]

Sullivan, too, has recently been recited by the Ontario Court of Appeal.[183]

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[175] *Id.* at para. 23.
[176] Peracomo Inc. v. TELUS Communications Co., 2014 SCC 29. 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.*
[177] *Id.* at para. 16.
[178] *Id.* at para. 2.
[179] *Id.* at para. 17.
[180] Desrosiers v. Sullivan (1986), 76 N.B.R. 2d 271.
[181] Salomon v. Salomon & Co. Ltd. [1897] AC 22.
[182] Desrosiers v. Sullivan (1986), 76 N.B.R. 2d 271, 278.
[183] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 21 (Ont. C.A.).

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

B. Torts Causing Pure Economic Loss

It is beyond the scope of this paper to discuss all intentional torts causing pure economic loss which directors of officers might commit. Instead, two examples are selected for discussion, namely fraudulent misrepresentation and the tort of inducing breach of contract, followed by a discussion of economic loss caused by negligence.

1. Fraudulent misrepresentation

Directors and officers in Canada are personally liable to third parties for fraud,[184] with the presence of a corporation being irrelevant to the analysis. In *Midwest Amusement Park, LLC v. Cameron Motorsports Inc.*,[185] 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.[186] 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[187] the result is the same – personal liability on the director of officer. Accordingly, this paper does not discuss the corporate veil cases and their complexities.[188] 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 annul that personal accountability.

2. Inducing breach of contract (or interference with contractual relations)

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[184] The test for civil fraud has recently been described as follows by the Supreme Court of Canada in *Bruno Appliance & Furniture, Inc. v. Hryniak*:

> 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.

Bruno Appliance & Furniture, Inc. v. Hryniak, 2014 SCC 8, para. 21. It is beyond the scope of this paper to consider whether the SCC mistakenly failed to include in its test that the defendant intended to deceive the plaintiff, as was required in the case it purportedly relied on, namely Parna v. G. & S. Properties Ltd., [1971] S.C.R. 306, para. 19.

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

[186] *Midwest Amusement Park,* at para. 86, 87.

[187] For example, in *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club,* 2000 ABCA 116, 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 view 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, paras 71–81, *aff'd* 2016 ABCA 80, leave to appeal to SCC refused 37023 (October 13, 2016).

[188] For comprehensive discussion of the corporate veil, *see, e.g.*, *Spring Garden Holdings Ltd. v. Ryan Duffy's Restaurants Ltd.*, 2010 NSSC 71.

Directors and officers can be personally liable for the tort of inducing breach of contract,[189] 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.[190]
Importantly, this tort is subject to what is called the defense of *Said v. Butt.*[191] This case 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 "servant acting *bona fide* within the scope of his authority." [192] In this way, the agency roots of the rule in *Said v. Butt* comes 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 of officer for reasons of public policy. In a Montana case quoted with approval in a Canadian corporate law text book, the court observed that officers and directors "must be shielded from personal liability for acts taken on behalf of the corporation, including the breach of contracts in furtherance of corporate goals, policies, and business interests. This corporate shield is needed in order to allow corporations to effectively function."[193] And as the Ontario Court of Appeal expresses the matter, the *Said v. Butt* defense:

> assures 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 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.[194]

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."[195] An illustrative decision is *McFadyen v. 481782*

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[189] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 34–35 (Ont. C.A.).
[190] The tort is comprised of the following elements according to *369413 Alberta Ltd v Pocklington*, 2000 ABCA 307, para.13: 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
[191] Said v. Butt [1920] 3 KB 487 (Eng.).
[192] 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.
[193] Kevin McGuinness, 2 CANADIAN BUSINESS CORPORATIONS LAW 737 (3rd ed. 2017) (quoting Phillips v. Montana Ed. Ass'n, 187 Mont. 419, 425–26 (1980)).
[194] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 15 (Ont. C.A.).
[195] McGuinness, *supra* note 193, at 738.

Ontario Ltd.[196] wherein the plaintiff successfully sued the corporate directors personally for inducing the corporate employer to wrongfully dismiss him.[197] 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.[198] The court found that the directors, via the wrongful dismissal, had induced the corporation to breach of contract with the plaintiff.[199] 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, seeking to drain corporate funds and, in the words of the trial judge, "feather their own nest" rather than fulfill their duty to serve the corporate defendant.[200] This kind of asset stripping in an example of the personal advantage-seeking alluded to by McGuinness above[201] and is a regular feature in the relevant case law.[202]

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.* It 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 damages 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 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 in the immediately previous section, the law regarding directors' and officers' personal liability for simple (or ordinary) negligence causing pure economic loss is considerably less settled in Canada. In fact, the law splits into two established lines of authority and one emerging line. It will be seen that the first line of authority favors corporate law values, the second line favors tort law values, while an emerging line is located somewhere in between.

The first line of authority appears to conclude that directors are not liable for simple negligence and is represented by *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.,*[203] a 1995 decision from the Ontario Court of Appeal. In *ScotiaMcLeod,* the plaintiff investor purchased senior unsecured debentures issued by the defendant corporation, Peoples Jewellers. Disappointed with

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[196] McFadden v. 481782 Ontario Ltd (1984), 47 O.R. 2d 134 (Ont. S.C.).
[197] *Id.* at para. 1.
[198] *Id.* at para. 22.
[199] *Id.* at para. 42.
[200] *Id.*
[201] McGuinness, *supra* note 193, at 739.
[202] *Id.*
[203] ScotiaMcLeod Inc v. Montreal Trust Co. of Canada (1995), 26 O.R. 3d 481.

the investment, the plaintiff sued the defendant underwriters (ScotiaMcLeod) for negligent misrepresentation, alleging that the prospectus and other documents were deficit. 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.[204] In reply to being third partied, the directors brought a motion to dismiss the claim against them as disclosing no cause of action.[205] What follows is the court of appeal's most important 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].[206]

In the result, the court released several directors from the lawsuit, requiring only two to remain. Against these two directors, the plaintiffs had pled particulars of negligence. Though the court expressed severe reservations as to the viability of the action, it was permitted to stand on the basis that an action should not be summarily dismissed at this early stage only because it is "novel"[207] and "attempting to stretch the envelope of available jurisprudence."[208]

Jurisdictions like Alberta have appeared to interpret *ScotiaMcLeod* as excluding liability for a director's simple (or ordinary) negligence.[209] This approach to liability extensively shelters directors and officers. For example, and as summarized in *McDonald & Bychkowski Ltd. (CMB Insurance Brokers) v. Lougheed:*[210] "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…."[211] Intentional torts (such as fraud) are easily absorbed under the *ScotiaMcLeod* rubric but simple negligence would generally be outside its pale. This is because simple negligence is not easily captured by *ScotiaMcLeod*'s test that the tort at bar

[204] *Id.* at para. 24.
[205] *Id.*
[206] *Id.,* at para. 25. 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.*
[207] ScotiaMcLeod Inc v. Montreal Trust Co. of Canada (1995), 26 O.R. 3d 481, para. 39.
[208] *Id.*
[209] *See, e.g.* the Alberta Court of Appeal decisions in *Blacklaws v. Morrow*, 2000 ABCA 175 as well as *Hogarth v. Rocky Mountain Slate Inc.*, 2013 ABCA 57.
[210] McDonald & Bychkowski Ltd. (CMB Insurance Brokers) v. Lougheed, 2015 ABQB 792.
[211] *Id.* at para. 49.

exhibit a "separate identity"[212] nor is it a fit within *ScotiaMcLeod*'s pronouncement that absent "fraud, dishonesty, and want of authority,"[213] a director's personal liability to third parties will be rare.[214] In *Hogarth v. Rocky Mountain Slate Inc.,*[215] for example, the Court of Appeal followed *ScotiaMcLeod* and ruled that a director was *not* liable for simple negligence causing economic loss, expressly reversing the trial judge's decision to the contrary.[216] Applying *ScotiaMcLeod,* the majority found that the defendant director's negligent misrepresentation to potential investors "was not tortious in itself" and did not exhibit "a separate identity of interest from that of…the corporation."[217] Put another way, the individual defendant's tortious conduct occurred in furtherance of his duties as a director and was not was not "independent from his activity as a corporate officer."[218]

In the context of a tort claim, *ScotiaMcLeod* endorses a corporate law "add-on" so as to shield directors and officers from personal liability. It does so by relying on the directing mind theory as a crucial thread. In relation to the directing mind theory,[219] for example, the court in *ScotiaMcLeod* quoted from Lord Reid in *Tesco Supermarkets Ltd. v. Nattrass,*[220] who observed that, in conducting corporate business, the director is not simply acting as agent. Rather, he is "an embodiment of the company…within his appropriate sphere."[221] 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.[222] 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

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[212] ScotiaMcLeod Inc v. Montreal Trust Co. of Canada (1995), 26 O.R. 3d 481, para. 25.
[213] *Id.*
[214] *Id.* As Janis Sarra summarized the matter, *ScotiaMcLeod* stands for the proposition that "tortious conduct in the best interests of the corporation" does not found liability. Sarra, note 6, at 64.
[215] *Hogarth v. Rocky Mountain Slate Inc.*, 2013 ABCA 57.
[216] *Id.* at para. 14.
[217] *Id.*
[218] *Id.*
[219] The directing mind theory is the means by which a corporation is found primarily liable for the tort in question via those who in the corporation who hold governing executive authority. In *R. v. Canadian Dredge & Dock Co.*, the Supreme Court of Canada states that the directing mind includes "the board of directors, the managing director, the superintendent, the manager or anyone else delegated by the board of the directors to whom is delegated the [governing] executive authority of the corporation, and the conduct of any of the merged entities is thereby attributed to the corporation." R. v. Canadian Dredge & Dock Co., [1985] 1 S.C.R. 662.
[220] ScotiaMcLeod Inc v. Montreal Trust Co. of Canada (1995), 26 O.R. 3d 481, para. 29 (citing Tesco Supermarkets Ltd. v. Nattrass, [1972] AC 153, 170 (HL)).
[221] *Id.* at para. 29 (quoting *Tesco*, [1972] AC 153, 170 (HL)).
[222] *See* R. v. Canadian Dredge & Dock Co., [1985] 1 SCR 662 .

> 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.[223]

ScotiaMcLeod 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, such overexposure would be concerning on a number of grounds, including for: trenching on the principle that the corporation is a separate legal entity;[224] eroding the benefits of incorporation by offering the plaintiff a backdoor to personal liability;[225] and reducing the pool of individuals willing to serve as a director.[226] Another concern is more generally identified by the Ontario Court of Appeal in the case of *ADGA*, 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…."[227] For any of these reasons, *ScotiaMcLeod* is careful to limit personal liability to circumstances of extreme misconduct – identified in the case as "fraud, dishonesty or want of authority."[228] On a related front, the case limits personal liability to circumstances where there is sufficient separateness from the corporation such that the director has made the tort his or her own.

The *ScotiaMcLeod* view of liability can be cast as *generally* consistent in outcome with case law described in the previous section, including: *Midwest Amusement Park*[229] (personal liability for fraud) and *McFadden*[230] (personal liability for the tort of inducing breach of contract). It also captures *Lewis*[231] (personal liability for negligence causing death), *Berger*[232] (personal liability for negligence causing personal injury), and *Desrosiers*[233] (personal liability for negligence causing property loss). 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 otherwise manifests the director making the tort her own.

Points for consistency aside, 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, the decision creates moral hazard 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 paper, namely that the law not "reward unreasonable and unethical conduct and deny recovery to injured third parties with valid

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[223] ScotiaMcLeod Inc v. Montreal Trust Co. of Canada (1995), 26 O.R. 3d 481, para. 26.
[224] Sarra, *supra* note 6, at 67.
[225] *Id.*
[226] *Id. See also* ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 9 (Ont. C.A.).
[227] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 9 (Ont. C.A.).
[228] *Id.* at para. 25.
[229] Midwest Amusement Park, LLC v. Cameron Motorsports Inc., 2018 ONSC 4549.
[230] McFadden v. 481782 Ontario Ltd (1984), 47 O.R. 2d 134 (Ont. S.C.).
[231] Lewis v. Boutilier (1919), 52 D.L.R. 383, 389 (S.C.C.).
[232] Berger v. Willowdale A.M.C. (1983), 41 O.R. 2d 89 (Ont. S.C.).
[233] Desrosiers v. Sullivan (1986), 76 N.B.R. 2d 271.

legal claims."[234] 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 because – but for the *ScotiaMcLeod* caveats describe above – such plaintiffs would 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.[235]

In what appears to be a second line of authority out of Ontario, is the appellate court decision of *ADGA Systems International Ltd. v. Valcom Ltd.*[236] Whereas *ScotiaMcLeod* stated the director and officer tortious liability to third parties would be "rare," 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."[237] 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.[238]

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 Valcom Ltd. for employment there.[239] 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.[240] (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.)

It is very difficult to accept *ADGA*'s claim that it was merely following *ScotiaMcLeod* in finding the director and senior employees personally liable. Indeed, *ADGA*'s claim on this front

[234] Checchia, *supra* note 14.
[235] Peoples Department Stores Inc v. Wise, 2004 SCC 68.
[236] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 9 (Ont. C.A.).
[237] *Id.* at para. 18.
[238] For discussion of this tort, see notes 189-202, *supra* and accompanying text.
[239] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 3 (Ont. C.A.).
[240] *Id.* at para. 6.

has been challenged,[241] including by members of the judiciary.[242] However, for the purposes of this paper, this debate does not much matter. What does matter is that *ADGA* posits an approach to personal liability which 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."[243] With little hesitation, the court stated an all encompassing rule of personal liability which 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."[244] 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 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."[245] 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.[246]

ADGA is also problematic for incentivizing directors to act with undue caution out of fear for personal liability,[247] thereby jeopardizing the best interests of the corporation. In sum, *AGDA* extracts personal accountability from the directors at too high a price.

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[241] *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.
[242] Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57, 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 9, para. 18.
[243] As stated in *Hogarth v. Rocky Mountain Slate Inc.*, 2013 ABCA 57, para. 101.
[244] Nicholls, *supra* note 241, at 37.
[245] ADGA Systems International Ltd. v. Valcom Ltd. (1999), 43 O.R. 3d 101, para. 10 (Ont. C.A.).
[246] Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57, para. 126.
[247] 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 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).

The difficulties posed by *ADGA* are manifest in the subsequent Ontario Court of Appeal decision of *NBD Bank, Canada v. Dofasco Inc*.[248] In this case, the VP Finance, Mr. Melville, described the credit worthiness of the Algoma Steel Corporation (Algoma) in the form of "egregious, serious misstatements."[249] 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, 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, 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….[250]

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 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.[251] Accordingly, Melville was found personally liable to the bank, jointly and severally with other named defendants, for the equivalent of $1,984,945.27 U.S.[252]

It is difficult to imagine an American court coming to the same decision based on the cases discussed in Part I.B.2. above. For reasons noted earlier, these courts failed to find that the individuals owed a personal duty of care to the harmed party – instead finding the duty owed only by the corporation.

An emerging, third line of authority is found 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

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[248] NBD Bank, Canada v. Dofasco Inc. (1999), 46 O.R. 3d 514.
[249] *Id.* at para. 58.
[250] *Id.* at para. 48.
[251] *Id.* at para. 59.
[252] NBD Bank, Canada v. Dofasco Inc. (1997), 34 B.L.R. 2d 209. 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 preferable and certainly a finding of personal liability would have been entirely non-controversial.
[253] Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57.

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 would be difficult to establish in the ordinary case. The bright line Slatter 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 invited 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 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]

It is beyond the scope of this paper 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

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[254] *Id.* at para. 121.
[255] *Id.* at para 121. *See also id.* at para 122 ("The issue is whether 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 SCC 63, para. 30.

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 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 influencing his deliberations, in relation to the *prima face* duty of care questions, 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] Slatter J.A.'s goal was to address, through these factors, the general "concern about the effect that individual liability can have on…corporate structures and their efficacy."[259]

The duty analysis then moves to the second stage. It asks "are there any 'residual policy considerations' outside the relationship of the parties that may negative the imposition of a duty of care?" [260] 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, Slatter J.A. emphasized that compensation of plaintiffs is important but concurrently, it is a "legitimate desire of entrepreneurs to operate in a limited liability environment."[261] On a related front, Slatter J.A. observed that while "holding tortfeasors accountable"[262] and "compensating victims"[263] 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 operation 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."[264] He also emphasized the importance of the corporate vehicle to the Canadian economy and that the corporation is not a stratagem.[265]

Justice Slatter's decision is not the majority position of the Court of Appeal but it has much to commend it and portions of it have been referenced in a subsequent decision of the Alberta Court of Appeal.[266] 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 *Scotia McLeod* which renders liability rare and unusual, Justice Slatter brought tort law values to the table such that director and officer liability in negligence for pure economic loss becomes possible but subject, first, to robust policy analysis. In this way, Slatter J.A. found a compromise

[257] *Id.* at para 35.
[258] Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57, para. 110.
[259] *Id.*
[260] Deloitte & Touche v. Livent Inc, 2017 SCC 63, para. 37.
[261] Hogarth v. Rocky Mountain Slate Inc., 2013 ABCA 57, para. 127.
[262] *Id.*
[263] *Id.*
[264] *Id.*
[265] *Id.* at para. 68.
[266] Hall v. Stewart, 2019 ABCA 98 at para 18.

between two extreme camps. Put another way, he threaded the needle between corporate law and tort.

How future courts might approach this matter is an open question. As recently as April of 2019, the British Columbia Supreme Court in *Foresters Life Insurance Company v. Bingham Group Services Corps*[267] considered an application to strike the pleadings in relation to claims against the individual defendant directors. In denying that application, the court noted that proximity can be established "if the relational context set out in the pleadings is sufficient to conclude the Individual Defendants 'inferentially assumed responsibility' for the Plaintiffs' interests…."[268] According to the BC Supreme Court, the underlying question is "whether a duty of care should be imposed, taking into account all relevant factors disclosed by the circumstances…."[269] This seems to follow the lead of the concurring decision in *Hogarth* by assessing the question of duty from an expansive perspective. It is interested to note, however, that the court in *Foresters Life Insurance Company* did not require that the individual director had expressly assumed personal responsibility – "inferentially assumed responsibility" is sufficient.

A recent decision from the Alberta Court of Appeal posits the view that in circumstances where the individual defendant takes responsibility for the accuracy of his representations, that may be "sufficient to identify a separate identify or interest from that of the corporation so as to make the act or conduct complained of his own."[270] In this way, simple negligence *might* be encompassed by *ScotiaMcLeod* after all. While such an interpretation has the benefit of making seemingly disparate precedents suddenly resolve, it does require a reading *ScotiaMcLeod* in a new way. It would be perhaps better for the Alberta Court of Appeal to expressly reverse its reliance on *Scotia McLeod* as traditionally understood and turn the page.

The law in Canada in relation to director or officer liability in negligence for pure economic loss is both inconsistent between jurisdictions and in flux. It is hoped that the Supreme Court of Canada will soon grant leave to a case on point so that the matter can be finally and thoroughly resolved. To date, the Supreme Court of Canada has denied leave to appeal to numerous appellate cases on point, including, most recently, *Hogarth*.[271]

Conclusion

This paper has identified important deficiencies in the 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 would be. Such an 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

[267] Foresters Life Insurance Company v. Bingham Group Services Corps, 2019 BCSC 556.
[268] *Id.* at para 58.
[269] *Id.*
[270] Abt Estate v. Cold Lake Industrial Park GP Ltd., 2019 ABCA 16.
[271] Lance Hogarth, et al. v. Roger Simonson, 2013 CanLII 40340 (S.C.C).

integrity is overwhelming in such circumstances, a matter which California implicitly recognizes by including nonfeasance in its version of the personal participation doctrine. The same argument holds, albeit somewhat less strongly, in relation to director liability for property loss. As previously explored, director liability for personal injury and property loss is axiomatic in Canada, across jurisdictions. Corporate personhood is not considered a relevant factor in these cases.

Another gap in director and officer liability concerns negligence causing pure economic loss. As discussed, the economic loss doctrine in the U.S. generally precludes recovery in negligence unless an exception applies, including the foreseeable plaintiff exception. However, in the context of director and officer liability, courts seem to conclude that it is generally *not* enough that the plaintiff is foreseeable. Cases, including from California, functionally add a further requirement before the plaintiff can succeed, namely the loss involves personal injury or property damage. The upshot in such 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 inviting 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 courts, by way of contrast, more carefully examine the relationship between the officer or director and the third party to determine whether there is a specialized relationship which may give rise to a duty. In this regard, the New York approach appears similar to the approach advocated by Perry whereby a duty attaches when the corporate insider invites reliance. This approach also accords with the concurring opinion of Justice Slatter in the Canadian *Hogarth* case. Justice Slatter appears willing to find a duty of care owed to third parties if the officers or directors assumed personal responsibility for their actions. In this way, Justice Slatter openly acknowledges the importance of both tort law and corporate law values.

The invited reliance approach (described by Perry) and the assumed personal responsibility approach (articulated by Justice Slatter in Canada) provide coherent analyses and accountability in relation to negligence causing pure economic loss. Jurisprudence in both the U.S. and Canada would benefit from more carefully analyzing corporate third party liability cases in this manner. Such carefulness is important for its own sake because it helps to ensure that the plaintiff is appropriately compensated for tortious conduct endured. But even where the aggrieved party receives adequate compensation from the corporate defendant, the risk of personal liability provides incentives for individual executives to act responsibly. In sum, directors and officers should not be accorded special protection under tort law because tort law itself provides a sufficient stable of defenses. Special protections are a contagion and have no place. They erode justice by providing directors and officers with a form of tortious immunity that is untied to robust public policy analysis. And they erode personal accountability by winking at unreasonable conduct.