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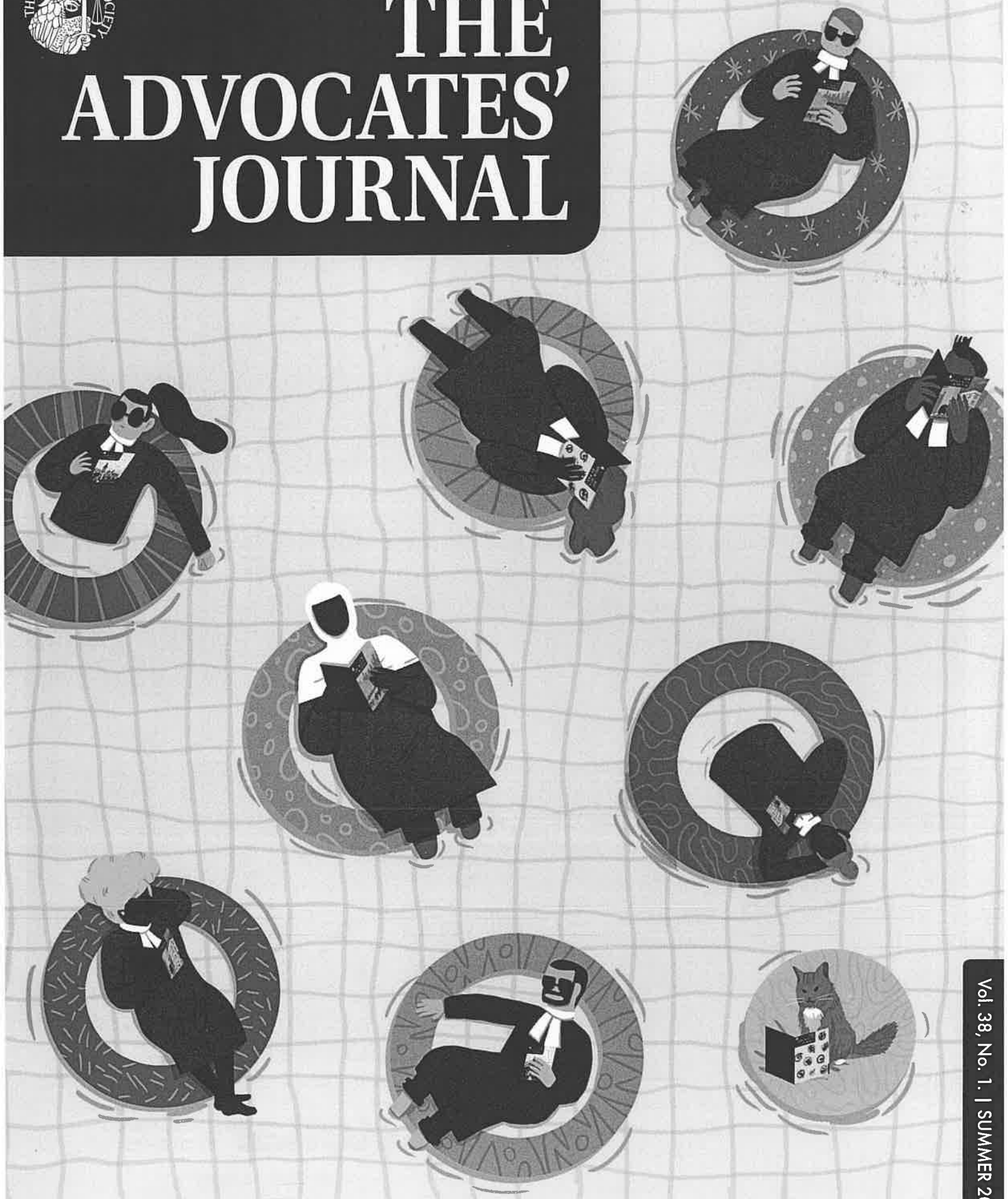

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Yaiguaje v. Chevron Canada Corporation:

A new and restrictive approach to piercing the corporate veil

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In *Yaiguaje v. Chevron Canada Corporation*, 2018 ONCA 472 (*Yaiguaje*), the Court of Appeal for Ontario significantly restricted the court's ability to "pierce the corporate veil." This decision (for which leave to appeal to the Supreme Court of Canada was recently denied) could have far-reaching consequences for nearly every field of law in Ontario.

Background

Since the basic principle that a corporation has a separate legal personality from its shareholders or principals, and that the debts of one cannot be collected from the other, was first articulated in *Salomon v. Salomon & Co.*, [1897] AC 22 (HL) (*Salomon*), it has served as a cornerstone of corporate law in the common-law courts. As the courts have explained, this limited liability is a hallmark of incorporation. Although it may at times frustrate creditors, it is necessary for enterprise and business adventure to thrive.[1]

Our courts have rigidly applied this principle in almost every case. However, there have been exceptional cases where our courts have found it necessary to "pierce the corporate veil" and, to avoid a substantial injustice, look beyond the facade of the corporation to hold its directing minds responsible for the company's debts or actions.

Yaiguaje v. Chevron Canada Corporation is certainly an exceptional case. The case arose as a result of extensive environmental damage caused by oil exploration and extraction carried out by a subsidiary of Texaco Inc. on the traditional lands of Indigenous peoples in Ecuador between 1964 and 1992. Texaco is now a subsidiary of Chevron Corporation, an American company based in California.

The Indigenous peoples affected by Texaco's operations first filed suit against Chevron Corporation in the United States. Chevron opposed on jurisdictional grounds, and, after Chevron agreed to attorn to the jurisdiction of the Ecuadorian courts, the American court declined to assume jurisdiction over the matter. The case then proceeded through the Ecuadorian courts and resulted in judgment against Chevron in the amount of US$9.5 billion.

Chevron Corporation did not have any assets in Ecuador. The plaintiffs therefore commenced a proceeding in the United States to enforce the Ecuadorian judgment against Chevron there.

However, the American court hearing the matter found that the plaintiffs' lawyers had perpetrated extensive frauds in the course of the Ecuadorian proceedings, including bribing the Ecuadorian judge to appoint a "hired gun" expert of the plaintiffs' lawyers' choosing to advise the court, and ultimately ghost-writing the judgment that the Ecuadorian judge signed.

Because of this finding, the American court refused to recognize

the Ecuadorian judgment and issued an injunction on enforcement of the judgment against Chevron Corporation in the United States. As they were without recourse in the United States, the plaintiffs initiated a proceeding in the Ontario Superior Court of Justice seeking to enforce the Ecuadorian judgment against Chevron Canada Limited, a seventh-level wholly owned subsidiary of Chevron Corporation based in Calgary.

Initially, the Ontario proceeding was opposed by Chevron on jurisdictional grounds. That issue went all the way up to the Supreme Court of Canada, where it was ultimately determined that Ontario had jurisdiction to hear the case.

The majority decision

The action then proceeded to a summary judgment motion to determine whether the shares and assets of Chevron Canada were exigible to satisfy the judgment against Chevron Corporation.

Chevron raised as its defence that Chevron Canada and Chevron Corporation are at law separate and distinct legal entities, notwithstanding that the former is a wholly owned subsidiary of the latter.

Chevron was successful on the motion at first instance. On appeal, the Court of Appeal reviewed two main arguments advanced by the plaintiffs.

First, the plaintiffs argued that Chevron Canada's assets are made exigible to satisfy the judgment debt of Chevron Corporation by the provisions of the *Execution Act*, which permits execution against any legal or equitable right, whether direct or indirect, held by the judgment debtor. The Court of Appeal rejected this argument, noting that the *Execution Act* is a purely procedural statute that simply provides a mechanism for the enforcement of judgments and, as such, it cannot provide substantive rights to a judgment creditor which do not otherwise exist in law.

Second, the plaintiffs asked the court to pierce the corporate veil: to look beyond the legal fiction that Chevron Canada and Chevron Corporation are separate and distinct entities, to the underlying reality that Chevron Canada is fully owned and controlled by Chevron Corporation and, for all practical purposes, is one and the same entity.

The plaintiffs submitted that, as the Supreme Court of Canada stated in *Kosmopoulos v. Constitution Insurance Co.*, [1987] 1 SCR 2 (*Kosmopoulos*), a court has jurisdiction to do so where necessary to avoid a result that would be "too flagrantly opposed to justice."

The Court of Appeal rejected this argument as well. In doing so, Justice Hourigan, writing for the majority of the court, held that the law has evolved since the *Kosmopoulos* decision and that the courts no longer possess a residual discretion to pierce the corporate veil simply because it is in the interests of justice to do so.

Instead, Justice Hourigan adopted in very strong terms the approach suggested by the Ontario Divisional Court in *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.*, [1996] OJ No. 1568 (*Transamerica*).

Justice Hourigan stated, as had been suggested in *Transamerica*, that the corporate veil can be pierced in only three scenarios: when the court is construing a statute, contract or other document; when the court is satisfied that a company is a "mere facade" concealing true facts; and where the company is an authorized agent for its controllers or members.

In cases of the second type, where the court is asked to find that the company is a mere facade, Justice Hourigan stated that a two-part test must be met before the court will pierce the corporate veil.

First, it must be established that there is complete control of the subsidiary, such that the subsidiary is the "mere puppet" of the parent corporation; and second, it must be established that the subsidiary was incorporated for a fraudulent or improper purpose or was used by the parent as a shell for improper activity.

In this case, the plaintiffs did not even allege that Chevron Canada was incorporated or used for an improper purpose, and Justice Hourigan held that this was fatal to their case, as they could not hope to meet the second part of this test.

A new and restrictive approach to piercing the corporate veil

The approach adopted by Justice Hourigan represents a significant restriction on the court's ability to pierce the corporate veil. While Canadian courts have always been reluctant to deviate from the *Salomon* principle and look beyond the corporate veil, there have been cases where the courts have deemed it necessary to do so in the interests of justice.

Although such cases have often fallen into the categories articulated by Justice Hourigan, our courts have not previously restricted the ambit of the court's ability to pierce the veil to only those cases. Even the *Transamerica* decision itself did not state the proposition in such strict terms, as is evident from the following passage:

> There are undoubtedly situations where justice requires that the corporate veil be lifted. The cases and authorities already cited indicate that it will be difficult to define precisely when the corporate veil is to be lifted, but that lack of a precise test does not mean that a court is free to act as it pleases on some loosely defined "just and equitable" standard.

Given the finding by the American courts that the Ecuadorian judgment was obtained by fraud, *Yaiguaje* was perhaps not the clearest example of a case where the demands of justice require the corporate veil to be pierced despite not otherwise meeting the strict *Transamerica* criteria. Nevertheless, one can certainly envision such cases.

One example is the case of *Manley Inc. v. Fallis*, [1977] OJ No. 1080 (*Manley*), in which the Court of Appeal for Ontario did pierce the veil to hold accountable an employee of a Canadian subsidiary of an American company who ran a side business that directly competed with the American parent corporation of his employer. Even though the employee was not competing with his employer, the court decided to pierce the corporate veil and view the American parent and Canadian subsidiary as one and the same for competition purposes.

Although Justice Hourigan rejected the "group enterprise" theory that *Manley* seems to espouse, it is nevertheless a clear case where the interests of justice demanded that the corporate veil be pierced.

The concurring decision

Justice Nordheimer concurred in the result with Justice Hourigan, in that he felt this was not an appropriate case in which to pierce the corporate veil, particularly as the equities of the case are so unclear.

However, he disagreed with Justice Hourigan that a strict test must be met in order to pierce the corporate veil, and that the court has no residual discretion to do so where justice demands it. Justice Nordheimer pointed out that the *Transamerica* case did not deal with the enforcement of a judgment, as this case does, but rather with the imposition of liability on a party by piercing the corporate veil. He further noted that the authorities Justice Hourigan relied on for the proposition that there should not be a residual authority in the courts to pierce the corporate veil where the *Transamerica* criteria are not satisfied do not state that proposition quite so strongly or broadly as Justice Hourigan suggests.

Justice Nordheimer explained that the court's ability to pierce the corporate veil has its roots in equity, and the court's equitable jurisdiction supersedes its legal jurisdiction. He concluded that if the court's equitable jurisdiction is to be curtailed in the manner suggested by Justice Hourigan, there should be very clear jurisprudential authority or legislation to that effect. Otherwise, the courts should retain the equitable jurisdiction to pierce the corporate veil where the interests of justice demand it.

An alternative solution

As the Supreme Court of Canada has recently denied the appellants leave to further appeal this matter, Justice Hourigan's decision is now the law of the land in Ontario. Unless and until the Court of Appeal

has occasion to revisit this issue, Ontario courts will no longer have any residual discretion to pierce the corporate veil where the interests of justice demand it, if the criteria in *Transamerica* are not met.

Justice Hourigan felt that if the courts retained discretion to pierce the corporate veil where the *Transamerica* test is not met, this would result in a purely ad hoc test for piercing the corporate veil. His Honour's concern that the statutory rights of corporations should be interfered with only on a strictly principled basis is well founded. However, rather than revoke the court's equitable discretion to pierce the corporate veil altogether, it was open to the court to develop a principled approach to the exercise of that discretion.

One possible approach is suggested in the relatively recent case of *Kozel v. The Personal Insurance Company*, 2014 ONCA 130 (*Kozel*). In *Kozel*, the Court of Appeal set out an extensive framework for the granting of a different equitable remedy: relief from forfeiture. In that case, the Court of Appeal held that when considering whether equitable relief from forfeiture should be granted, the court should consider the conduct of the person leading to the forfeiture of the right for which relief is sought; the gravity, nature and impact of the breach that caused the forfeiture; and the disparity of the value of the forfeiture compared with the damage caused by the breach.

A similar approach could have been adopted in considering when the court might pierce the corporate veil in cases where the *Transamerica* factors are not met or do not apply. The court could consider the conduct of the party requesting that the corporate veil be pierced in the context of the dispute giving rise to the request along with the gravity or importance of the issue to both parties, and balance the value in maintaining separate legal personality vs. piercing the corporate veil in a given case.

In *Yaiguaje*, consideration of these factors would likely lead to the same result actually obtained. This case could be decided on the first factor, as the plaintiffs do not have clean hands since the judgment they seek to enforce may have been obtained through fraud. In the absence of clean hands, equitable relief should not be granted.

The other factors in this case are likely balanced, as the gravity of Texaco's breach in causing environmental damage, for which Chevron has been held responsible through the Ecuadorian judgment, is likely sufficiently substantial to compete with its interest in maintaining separate legal identity and the value to each party is the same: US$9.5 billion.

This test would likely also have applied in *Manley* to reach the correct result. The employer corporations had clean hands in their dealings with the defendant employee, while the defendant did not and sought to hide from liability behind the separate corporate identities of his employer.

The gravity of the defendant's breach in competing with the employer's parent corporation was certainly non-trivial, and the defendant's interest in upholding the separate corporate personality of the plaintiff corporations in order to avoid liability for his breach is plainly outweighed by the value of the plaintiffs being able to seek justice for that breach.

All this would lead to the conclusion that the corporate veil ought to be pierced in that case.

Conclusion

The Court of Appeal's decision in *Yaiguaje* represents a significant restriction on the court's ability to pierce the corporate veil. Henceforth, if the *Transamerica* criteria are not met in a given case, the courts will be powerless to pierce the corporate veil, regardless of whether the interests of justice demand it.

The authors respectfully submit that rather than strip the courts of their equitable discretion to pierce the corporate veil where the *Transamerica* test is not met, it would have been preferable to provide a principled framework for the exercise of that discretion.

One possible approach, as set out above, would be similar to the *Kozel* test applied in the context of the equitable remedy of relief from forfeiture. The court could consider:

1. the conduct of the party seeking to pierce the veil;
2. the gravity or importance of the issue to both parties; and
3. the balance between the value in maintaining separate legal personality vs. piercing the corporate veil in the context of the case.

It is our view that although the imposition of such a test would not have altered the outcome in *Yaiguaje*, it would nevertheless have provided discretion to the court to pierce the veil when the interests of justice demand it and provide some guidance and structure to the circumstances where that discretion should be exercised.

The facts in *Yaiguaje* can be seen to have driven the outcome. As pointed out by Justice Nordheimer in dissent, the interests of justice did not compel the court's intervention in this case.

If and when a particularly compelling case comes before the Court of Appeal that does not quite meet the *Transamerica* test, one wonders if the court might be persuaded to reconsider its approach and intervene. In such a case, Justice Nordheimer's dissent might be used in an attempt to move the law along in a direction the background facts of the case might be better situated to support.

While *Yaiguaje* will no doubt remain the law in Ontario for some time, it is the authors' hope that when the Court of Appeal does have occasion to revisit this issue, it will consider reinstating the court's equitable jurisdiction to pierce the corporate veil where it is necessary to ensure that justice is done – and to provide a principled framework for the exercise of that jurisdiction.

Note

1. See eg *Clarkson Co. Ltd. v Zhelka et al*, 1967 CanLII 189 (ON SC).