Tort Law Liability of Directors and Officers towards Third Party Creditors - a Comparative Study of Common and Civil Law with Special Focus on Canada and Germany

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ABSTRACT

Where individuals standing outside of the corporation have been harmed by the acts of one of its directors or officers, the question becomes whether they have only a claim against the corporation or whether they may have also a personal claim against the executive inflicting the harm on them.

The issue of how far it should be possible to hold directors and officers personally liable for tort has been a contested one and even courts within one and the same jurisdiction provide different solutions. On the one hand, there is the general basic principle that individuals causing harm to others should be held responsible. On the other hand, the fact that directors and officers act as agents on behalf of the corporation might call for an exception to this basic tort law principle.

This thesis will compare the solutions proposed by Common law (with focus on the law of Ontario) and German law as an example of a Civil law jurisdiction. An attempt will be made to see in how far the proposed solutions are consistent with legal principles like the separate legal entity of the corporation and the concept of limited liability as well as with arguments related to economic efficiency.

RÉSUMÉ

Dans le cas où un individu est victime d'un délit civil commis par un directeur d'une société, la question qui se pose est de savoir si cette personne peut ensuite agir en justice seulement contre la société ou si elle peut également agir contre le directeur.

La question de savoir si les directeurs peuvent être tenus responsables d'un acte délictuel est très controversée puisque les cours d'un même pays proposent des solutions parfois différentes. D'un côté, le principe général en matière de responsabilité délictuelle conduirait à affirmer que les personnes qui commettent des actes nuisants aux autres doivent être tenues responsables. D'un autre côté, le fait que les directeurs agissent en tant que mandataires de la société pourrait justifier une exception en matière de responsabilité délictuelle.

Dans ce mémoire, une comparaison sera établie entre les solutions issues de différents systèmes juridiques en matière de responsabilité délictuelle concernant les directeurs. Pour la Common Law, c'est le droit de l'Ontario qui servira d'exemple. Pour le droit civil, l'exemple retenu sera celui de l'Allemagne. Ensuite, ces solutions différentes seront analysées pour voir si elles respectent d'autres principes légaux tels que celui de l'indépendance de la personne morale de la société ou celui de la responsabilité limitée attachée aux personnes juridiques. Enfin, l'analyse s'attardera sur les interactions qui existent entre les solutions proposées et les théories économiques.

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CHAPTER 1: INTRODUCTION

The question, how it should be possible to hold directors and officers of corporations personally accountable for behaviour connected to the running of business has recently become one of the most pressing issues in the debates on corporate reforms. The focus has often been on the question of how far it should be possible for shareholders to hold executives personally liable. The reason for this is that the duty of executives to manage the running of business in the best interests of the corporation is traditionally equated with acting in the best interests of shareholders, since these are the "owners" of the legal entity. In recent discussions on corporate governance, the idea that directors and officers should also be accountable to other stakeholders and not only to shareholders has gained more and more support.

This thesis will concentrate on the accountability of executives to third party creditors under tort law. Where individuals standing outside of the corporation have been harmed by the acts of a director or officer of a corporation, the question becomes whether they have only a claim against the corporation or whether they may also have a personal claim against the individual inflicting the harm on them. The issue of how far it should be possible to hold directors and officers personally liable for tort has always been a contested one. As will become obvious later on, even courts within one and the same jurisdiction have taken different approaches to the issue. On the one hand, there is the general basic principle of the law of torts that those who cause harm to others should be held responsible. On the other hand, the issue of tort liability of directors and officers has been complicated by the fact that these executives are acting

as agents of the corporation. While it is clear that there can be no contractual claim against a director or officer personally where he has disclosed his agency, the question becomes whether the executive may be held personally liable when he has participated in or ordered a tort. The topic of tort liability is perceived to involve several conflicts with corporate law policies. There are concerns that the personal liability of directors and officers may interfere with the separate legal identity of the corporation and with the principle of limited liability attached to the corporate form. It is in this context that sometimes the expression of "piercing the corporate veil" has been used with regard to cases where a director or officer has been held personally liable for the commission of a tort. Attaching personal liability to executives has sometimes also been harshly criticised for economic reasons. While on the one hand, there seems to be a demand for more personal liability of directors and officers, there are on the other hand those who fear that an expansive liability regime will put too much pressure on executives who, as a consequence, will be too afraid to take the business decisions which would actually be in the best interest of the corporation. The reasoning has been that this may eventually hinder the effective functioning of business and deter individuals from taking on a job as executive at all. On the other hand, tort victims need to be compensated and directors and their corporations are better suited to risk-bearing and risk-shifting. All these different arguments will be explored more closely in the final analysis and conclusion of the thesis (Chapter 4).

Since there are these different point of views on the issue of directors' and officers' liability, it becomes interesting to see how the problem is being dealt with in different legal systems. This is especially true because corporations are active everywhere nowadays due to globalization and it may be helpful to know how their executives

could be held personally liable in different places in the world. In addition, a study on this may be interesting with regard to the harmonization attempts in the European Union with regard to tort and company law. The thesis will explore the solutions developed to the issue of directors' and officers' liability under Common law, focussing in particular on the law of Ontario (Chapter 2), and under German law as an example of a civil law jurisdiction (Chapter 3). The study of German law will also include examples of cases dealing with the personal liability of the managing director of a limited liability company (Gesellschaft mit beschränkter Haftung (GmbH)). This will be done because of the practical relevance of the limited liability company as the form to organize business in Germany. Also, the personal liability of the managing director of a limited liability company does not raise issues distinct from the issues raised by the personal liability of the director of a corporation. The results with regard to the management liability of one of these two business associations can therefore be transferred to the other without any problems.

CHAPTER 2: THE COMMON LAW APPROACH: THE LAW OF ONTARIO AND ENGLAND

In the following, the Common Law approach with respect to the issue of directors' and officers' personal liability will be explored. This will be done with special focus on the development in Canadian Law, or more precisely the law of Ontario, with some consideration of English jurisprudence where the English courts do come to a different result or propose a different solution.

In recent years, the tendency in Canadian Law has generally been to extend the scope of directors' and managers' liability.[1] The activism of institutional investors as

[1] J. Anthony VanDuzer, *The Law of Partnerships and Corporations*, 2nd ed. (Concord, Ontario: Irwin Law, 2003) at 269-70.

important role-players in the Canadian financial market has led to a greater accountability of directors and officers to the interests of shareholders.[2] At the same time, Canadian courts have worked on extending the scope of liability with regard to other stakeholders.[3] After providing short definitions of some relevant terms (A.) and setting the general frame for the beginning of a discussion on directors' and officers' liability (B.), this paper will solely concentrate on the remedies open to third parties creditors for their personal claims against directors and officers on the foundation of tort law (C.), an area in which jurisprudence has been particularly active. I will only mention the most representative cases in order to explore what the attitude in Canadian (and English) Law is today with regard to the issue of directors' and officers' personal tort law liability.

A. Definition of "Director" and "Officer" under Common Law

The term "directors" generally refers to persons appointed or elected to sit on a board that manages the affairs of a corporation or company by electing and exercising control over its officers.[4] The term "officer" is used to describe a person appointed by the board of directors to manage the daily operations of a corporation, such as a CEO, president, secretary, or treasurer.[5]

For Canadian law, there is section 102 (1) of the Canadian Business Corporations Act[6] which explicitly defines "directors" to be the persons responsible under corporate statues for managing the business and affairs of the corporation. The directors are

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[2] *Ibid.*.
[3] *Ibid.*.
[4] *Black's Law Dictionary*, 7th ed., *s.v.* "director".
[5] *Ibid. s.v.* "officer".
[6] R.S.C. 1985, c. C-44 (as amended) [CBCA].

elected by the shareholders and there may be more than one.[7] Concerning officers, there are few requirements.[8] In most corporations, the officers are designated in a by-law, and the directors appoint people to fill them by resolution.[9]

For English law, the term "director" is not as such defined in the Companies Act. It will be the articles of association of a company that provide that the business of the company shall be managed by the directors who will act collectively as board, although the articles may also provide for the delegation of extensive powers to smaller committees or individual directors.[10] Although English law, like other Common law jurisdictions, officially provides for a one-tier board system, a lot of companies operate what is effectively a two-tier board system: The full board will deal with general policy and overall supervision while a smaller board, made up of executive or managing directors, is responsible for the day to day running of the business.[11] The function of the executive or managing directors corresponds more or less to what has been described above to be the function of officers.

In the scope of this thesis, the statements made will generally refer to both directors and officers even if for the sake of simplification only one of the groups is explicitly named. "Directors and officers" will also be referred to together as executives or management. In general, directors as such are less likely to commit torts because they are limited to corporate decision making and do not personally interact with outsiders.

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[7] VanDuzer, *supra* note 1 at 476.
[8] *Ibid.* at 480.
[9] *Ibid.*.
[10] John H. Farrar, Brenda Hannigan, *Farrar's Company Law*, 4th ed. (London, Edinburgh and Dublin: Butterworths, 1998) at 332. For corporations incorporated under the CBCA, this is mentioned in section 115 (1).
[11] Stephen W. Mayson, Derek French & Christopher L. Ryan, *Company Law*, 19th ed. (Oxford: University Press, 2002) at 451; Paul L. Davis, *Gower's Principles of Modern Company Law*, 6th ed. (London: Sweet & Maxwell, 1997) at 193.

Officers, however, must interact with outsiders in order to do their job and are therefore more likely to participate in a tort and to be afterwards confronted with a personal claim. Yet, especially in smaller corporations, the directors are often also the officers so that the issue of personal liability in tort towards outsiders also becomes relevant to them.

B. Where to Start the Discussion: *Salomon v. Salomon & Co.*[12] – A Relevant Case With Regard to Directors' and Officers' Liability?

The common law approach to the question of directors' and managers' liability has not always been very clear and courts decisions with regard to the issue have not always followed a consistent line.[13] In fact, there are already different opinions on what case to consider as a starting point for any further discussion. While some consider the old English case *Salomon v. Salomon & Co.* as a starting point also with regard to directors' liability, others contest that the case is of any relevance for the issue. The main point of *Salomon* is that the House of Lords did confirm the existence of the corporation as separate legal entity, separate in its existence from the natural persons standing behind it. The process of incorporation leads to the creation of a new legal person whose rights and obligations may be thought of as analogous of those of a human person[14]:

The story of *Salomon v. Salomon & Co.* is that of Aron Salomon transferring a leather boot business operated by him as a sole proprietor to a corporation in which he and six of his family members were the shareholders. In return for transferring his business to

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[12] Salomon v. Salomon & Co., [1897] A. C. 22, [1895-1899] All E.R. Rep. 33, 66 L. J. Ch. 35, 75 L. T. 426, 45 W. R. 193, 4 Mans. 89 (H. L.) [*Salomon* cited to A.C.].

[13] VanDuzer, *supra* note 1 at 307; Christopher C. Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (2001) 35 Can. Bus. L.J. 1 at 5.

the corporation, Salomon was issued debentures representing a claim of £ 10,000 against the corporation. The debentures were secured against the assets of the business now owned by the corporation. In addition, Salomon was also issued shares of the corporation which resulted in him becoming by far the most important shareholder and being in effective control of the corporation. When the corporation got into financial difficulties and a liquidator was appointed to gather in the corporation's assets, pay off its debts and eventually transfer any remaining assets to the shareholders, it was Salomon's secured claim against the corporation which actually was to be paid first. Given that because of the size of Salomon's claim this meant that no assets would be left to pay off unsecured creditors afterwards, the liquidator claimed the corporation to be only a sham with Salomon actually continuing to personally operate the business even though doing it under another name. According to the liquidator the corporation had to be seen as acting merely as an agent for Salomon to run his business meaning that Salomon's claim against the corporation was actually only a claim against himself and would therefore not be enforceable. As a consequence of this, all assets of the business in the eyes of the liquidator should go to the unsecured creditors only. The House of Lords rejected the liquidator's claim. It judged Salomon to have fulfilled all the requirements for incorporation set out in the Companies Act of 1862 and therefore did not see any reason why effect should not be given to the separate legal existence of the corporation resulting in Salomon's claim to be paid before the claims of any of the unsecured creditors. The fact that the incorporation of the business did not lead to any changes in the way it was run so that the business before and after incorporation could be said to be exactly the same was considered to be irrelevant by the House of Lords as well as the point that it was still Salomon alone who was actually in effective control of the corporation given that the

[14] VanDuzer, *supra* note 1 at 98.

other six shareholders, family members of his, were "not partners" but "only servants" of his. [15] The Companies Act of 1862 did not include any requirement for shareholders to each have a mind of their own the House of Lords argued and the fact that there were no organizational changes whatsoever after incorporation was considered not sufficient to make the corporation only the agent of the shareholder Salomon.

The case *Salomon v. Salomon & Co.* is basically universally being cited for the proposition that the corporation is a separate legal entity and that the corporation is not to be considered an agent of the controlling shareholder.[16] It is also mentioned in the context of limited liability and as an introduction for the discussion on situations in which it seems more suitable to exceptionally disregard the separate legal entity of the corporation, a process sometimes labelled as "piercing of the corporate veil".[17] However, as already mentioned, it is not clear in how far *Salomon* can also be considered to say something relevant with regard to the issue of directors' and officers' liability.

On the one hand, the case can be considered relevant in so far as it tries to resolve the general problem of finding a balance between the interest of holding individuals accountable for their acts and the idea of the corporation as separate legal entity with limited liability. This is the issue also with regard to directors' and managers' liability.[18]

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[15] See Lord MacNaghten, *Salomon*, *supra* note 12 at 48.
[16] VanDuzer, *supra* note 1 at 100.
[17] *Ibid.* at 107.
[18] *Ibid.* at 103.

On the other hand, *Salomon* is explicitly only a statement in favour of the limited liability of shareholders: Salomon is not being sued by the liquidator as corporate director[19] but it is his limited liability as a shareholder which is being questioned. In this context, it is being argued that the term "limited liability" could only have ever logically referred to an immunity enjoyed by shareholders since a corporation's main economic advantage consists in rendering passive investment more attractive by removing personal liability from its shareholders.[20] Whether and when directors and officers should or should not be held personally liable therefore is considered a different topic for which *Salomon* cannot provide any guidelines or answers.[21] Looking back in history, there are some legal events which are in support of this opinion: In *Derry v. Peek*[22], a case that preceded *Salomon*, in which the House of Lords rejected a claim to find directors liable for corporate misrepresentation because of the nature of the tort but without mentioning in any way to the nature of the tortfeasor.[23] The main argument to reject the liability of Salomon, that the wrong in question was committed by an "other" meaning "the corporation as separate legal entity", was not used in the context of directors' liability in *Derry v. Peek*. The enactment of the Directors' Liability Act[24] in 1890 to stop the liability gap created by the House of Lords in *Derry v. Peek* is seen as a further indication that the topics of directors' and shareholders' liability have long been understood to involve distinct policy issues.[25]

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[19] In fact, a board of directors was never appointed in *Salomon*, a point which the liquidator in his claim actually used for supporting his argument that the corporation was only a sham, see *Salomon*, *supra* note 12 at 25.
[20] Nicholls, *supra* note 13 at 2.
[21] *Ibid.* at 4; Robert Flannigan, "The Personal Tort Liability of Directors" (2002) 81 Can. Bar Rev. 247 [Flannigan, "Personal Tort Law Liability of Directors"] at 258.
[22] (1889), 14 A.C. 337 (H.L.).
[23] Nicholls, *supra* note 13 at 3.
[24] The central underlying principle of the act was that where managerial power rests, there rests responsibility, see *ibid.*.
[25] *Ibid.*.

Another factor rendering the relevance of *Salomon* for the issue of tort liability of directors and officers more doubtful is that the case actually only gives a direct answer to who is the debtor of a creditor in case of a contractual claim (*only* the corporation). The question of who can be sued in case of a tort being committed (the individual director involved or the corporation alone) is beyond the actual scope of *Salomon*.[26]

Trying to come to a conclusion on the relevance of *Salomon* for the present issue, one could say that although *Salomon* was originally designed to protect only shareholders from personal liability where they were merely investors of the corporation, the notion of limited liability set out in this case was soon extended to also include directors to a certain degree.[27] As directors and officers have an obligation to act in the best interests of the corporation[28] which is largely interpreted by Canadian courts to be equivalent to shareholder wealth maximization, the potential conflict which might be created by also assuming a direct responsibility of these individuals to third parties was initially resolved by establishing the paradigm that decision-makers acting in good faith and within the scope of their authority according to their duties owed to the corporation and its shareholders should generally not attract personal liability.[29] This is consistent with the hierarchy of norms resulting in the equitable or statuary obligation owed to the corporation by the director or officer to act in its best interest to be more important

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[26] Edward M. Iacobucci, "Unfinished Business: An Analysis of Stones Unturned in *ADGA Systems International v. Valcom Ltd.*" (2001) 35 Can. Bus. L.J. 39 at 51; Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 259.

[27] Janis Sarra, "The Corporate Veil Lifted: Director and Officer Liability to Third Parties" (2001) 35 Can. Bus. L.J. 55 at 56.

[28] What was originally a fiduciary obligation in Equity is now enacted as a statuary obligation in most Canadian jurisdictions, e. g. s. 122 (1)(a) CBCA, s. 134 (1)(a) OBCA.

[29] Sarra, *supra* note 27 at 56.

than legal (tort) obligations owed to strangers.[30] In recent years, there has been, however, a tendency in Canadian Law to further extend the personal liability of directors by now reversing the idea that the notion of limited liability and the concept of the separate legal entity of the corporation in any way address the issue of directors' and officers' liability. While *Salomon* has for a certain period of time been cited in the context of cases treating the problem of directors' and officers' liability, this has now been dismantled to have been an error for the reasons laid out above which actually argue against the relevance of the case for the topic.[31]

That *Salomon* cannot provide a solution with regard to the personal tort liability of directors also becomes clear when one considers the following: *Salomon* rejected the suggestion that the controlling shareholder could be made responsible for the payment of the debt incurred by another, the corporation.[32] This is a solution which, transferred to tort law, only amounts to a rejection of vicarious liability for the controlling shareholder. There are, however, no implications for what the result would be if the tortious acts were one's own acts and not the acts of another. Accordingly, *Salomon* provides no solution with regard to the question whether a director who committed a tort himself may be held personally liable.

C. Personal Claims against Directors and Officers for Torts

In the following, it will be explored in how far third party creditors can proceed a claim against directors and officers personally to hold them liable for the commission

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[30] Bruce Welling, "Individual Liability for Corporate Acts: The Defence of Hobson's Choice" (2000) 12 S.C.L.R. (2d) 55 [Welling, "Individual Liability for Corporate Acts"] at 69.
[31] See in particular Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 258-59, 281.
[32] See also Bruce Welling, *Corporate Law in Canada – The Governing Principles*, 2nd ed. (Tortonto, Vancouver: Butterworths, 1991) [Welling, *Corporate Law in Canada*] at 88.

of a tort. The first part will be on personal liability for intentional torts (I.), the second on personal liability for negligent torts (II.).

I. Intentional Torts

In general, where directors participate in or order the commission of a tort, they will be found personally liable.[33] In the following, the discussion of personal liability for intentional torts will take place in two sections: The first section will deal with the particular tort of inducing breach of contract and some questions of principle which were attached to it (1.). The second section will deal with personal liability for the commission of other intentional torts (2.).

1. The Tort of Inducing Breach of Contract

Originally a judgement on a case involving the tort of inducing breach of contract, the old English decision of the House of Lords in *Said v. Butt*[34] soon raised an issue of principle with respect to the question of directors' and officers' personal liability for torts on a general level (especially with view to negligent torts, e. g. negligent misrepresentation).[35] The different interpretations of the case, in fact, caused much confusion, controversy and uncertainty in Canadian Law.[36] Given this special problematic, the following summary and analysis from the original *Said v. Butt* case to its diverse interpretations and the current point of view will present one of the most important parts of this study with regard to Canadian Law.

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[33] VanDuzer, *supra* note 1 at 308.
[34] [1920] 3 K.B. 497.
[35] See Part II.2. at 56-61, below.
[36] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 284; Sarra, *supra* note 27 at 55; Iacobucci, *supra* note 26 at 39.

a. Said v. Butt and Its Interpretation: An Exception from Personal Liability in the Case of Inducing Breach of Contract or More?

In *Said v. Butt*, the plaintiff brought a claim against the director of an opera company personally for the tort of inducing the opera company to breach its contract with him. The opera company, because of a dispute with the plaintiff, had refused to sell him a ticket to the opening performance of a new play. The plaintiff then send an agent, a friend of his, to purchase a ticket for him. When the plaintiff showed up at opening night, the defendant, the director of the opera company recognized him and had him ejected after offering him to repay the ticket price which the plaintiff rejected. The Court of King's Bench came to the conclusion that there was no contract between the plaintiff and the opera company. Consequently, the plaintiff's claim for the tort of inducing breach of contract was dismissed on this basis. However, McCardie J. still continued to examine weather a tort could have been proved under the hypothetical proposition that there had been a contract between the plaintiff and the opera company. He came to the conclusion that even if there had been a contract, the plaintiff would not have been successful in suing the director personally for tort. He stated:

> [I]f 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 to tort at the suit of a person whose contract has thereby been broken.[37]

At the same time, McCardie J. emphasized:

> I abstain from expressing any opinion as to the law which may apply if a servant, acting as an entire stranger, or wholly outside the rage of his powers, procures His master to wrongfully break a contract with a third person. Nothing I have said today is, I hope, inconsistent with the rule that a director or servant who actually takes part in or actually authorizes such torts as assault, trespass to property, nuisance, or the like may be liable in damages as a joint participant in on of such recognized heads of tortious wrong.[38]

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[37] *Said v. Butt, supra* note 34 at 506.
[38] *Ibid.*.

While *Said v. Butt* introduced an early exception to the personal liability of directors, the case is problematic in so far as it can be interpreted in at least two different ways, one broad, the other narrow. On the one hand, *Said v. Butt* can be understood to be generally applicable, with the tort of inducing breach of contract being but *one* example. If one follows this interpretation the result is that where a corporate director, officer or employee acts within the scope of his or her duty and in the best interests of the corporation, no personal liability should attach.[39] On the other hand, *Said v. Butt* can be understood to argue generally for the liability of corporate directors, officers and employees involved in committing a tort, even when they act within the scope of their duties, with the single *exception* that the tort committed is the tort of inducing breach of contract.[40] Making the tort of inducing breach of contract an exception to a general personal tort liability of directors and officers seems justified because of the claim for breach of contract that the plaintiff already has available against the corporation.[41] To a certain extent, the frequent conversion of simple debt and breach of contract cases into tort cases against directors and officers might even be considered abusive of the civil litigation system.[42]

In addition, there are economic reasons for not allowing a personal claim against directors or officers for the tort of inducing breach of contract: Contracts deal with economic relations and corporations through their directors or officers, accordingly, do have to occasionally breach contracts in order to achieve economically efficient goals. Threatening a director or officer with a direct tort claim against his person in

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[39] Nicholls, *supra* note 13 at 8; Iacobucci, *supra* note 26 at 41.
[40] *Ibid.*.
[41] Sarra, *supra* note 27 at 59; see also the Ontario Court of Appeal in *ADGA Systems International Ltd. v. Valcom Ltd.* (1999), 43 O.R. (3d) 101, 168 D.L.R. (4th) 351 (C.A.), leave to appeal to S.C.C. refused [2000] 1 S.C.R. xv, 134 O.A.C. 400*n* [*ADGA* cited to O.R.] at 104.
[42] John J. Chapman, "Joinder of Corporate Directors, Officers and Employees" (2001) 80 Can. Bar Rev. 857 at 861.

such a situation means to put him into conflict with his equitable or statuary obligation to act in the best interests of the corporation.[43] Other torts, however, do not involve these immediate economic advantages for the corporation and making a direct claim against a director or officer possible does not create any conflict with his duties.[44] The exemption from liability in *Said v. Butt* may also be explained with the special nature of the tort of inducing breach of contract. Where the breach of contract is economically efficient because it is advantageous for the contract breaker while the other party is no worse off since it receives full compensation, the inducement of breach of contract cannot be considered wrongful.[45] This is why the courts do not always attach all the usual consequences of torts to inducing breach of contract and have placed various restrictions on its scope by the requirements of intention and by the evolution of special defences and justifications.[46]

The narrow interpretation of *Said v. Butt* generally seems to be favoured by Canadian courts although there seems to be some controversy and confusion with regard to this question as will be seen later on.[47]

(1) Scotia McLeod Inc. v. Peoples Jewellers[48]*: A Broad Interpretation of Said v. Butt?*
The decision of the Ontario Court of Appeal on *Scotia McLeod Inc. v. Peoples Jewellers* represents an "important milestone" on the path to the development of the

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[43] Sarra, *supra* note 27 at 60; Welling, "Individual Liability for Corporate Acts", *supra* note 30 at 85; see also the Ontario Court of Appeal in *ADGA.*, ***supra*** note 41 at 106.
[44] Nicholls, *supra* note 13 at 9.
[45] S. M. Waddams, "Breach of Contract and the Concept of Wrongdoing" (2000) 12 S.C.L.R. (2d) 1 at 2.
[46] *Ibid.* at 26; Lewis N. Klar, *Tort Law*, 3rd ed. (Toronto: Thomson Carswell, 2003) at 619.
[47] Iacobucci, *supra* note 26 at 39; Sarra, *supra* note 27 at 55.
[48] (1995), 26 O.R. (3d) 481, 129 D.L.R. (4th) 711, 87 O.A.C. 129, *sub nom. Montreal Trust Co. of Canada v. Scotia McLeod Inc.* (C.A.), leave to appeal to S.C.C. dismissed [1996] S.C.C.A. No. 40 (QL), 137 D.L.R. (4th) vi [*Scotia McLeod* cited to O.R].

current law of officers' and directors' liability.[49] The same key passage of the decision has afterwards been cited by many courts in support of differing views as to the proper scope of directors' and officers' personal liability.[50]

In the case itself, Peoples Jewellers Ltd. had contingent liabilities to an affiliate corporation that were not disclosed to the purchasers of its debentures. The plaintiff therefore launched a claim for negligent misrepresentation against the dealer as well as against Peoples Jewellers Ltd.. Scotia McLeod, defendant in the main action, sought to bring a third party claim against certain directors and officers of Peoples Jewellers. The lower court dismissed the claim against all individual defendants. The Ontario Court of Appeal upheld in part, but reversed in part. The dismissal of the claim against directors who were not alleged to be individually involved in the misrepresentations was upheld. The dismissal was set aside, however, with regard to two directors which were also officers and who were direct participants in the alleged misrepresentation. These two directors/officers had signed the original prospectus, therefore according to Scotia McLeod signalizing that there was no other relevant information with respect to Peoples Jewellers' financial condition, they had made direct representations during the dealers' due diligence investigation to the effect that the contingent liabilities were remote and immaterial and, apparently, they had also signed bring-down certificates indicating that the representations and warranties in the debenture purchase agreement were true and correct at the time of closing. In finding that proceedings could be brought against these two directors/officers and not against those not individually involved who just happened to be on the board at the time of the

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[49] Nicholls, *supra* note 13 at 9.
[50] *Ibid.*.

transaction, Finlayson J.A. for the Court of Appeal made the following often cited statement:

> 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. Those cases in which the corporate veil has been pierced usually involve transactions where the use of the corporate structure was a sham from the outset or was an afterthought to a deal which had gone sour. There is also a considerable body of case-law wherein injured parties to actions for breach of contract have attempted to extend liability to the principals of the company by pleading that the principals were privy to the tort of inducing breach of contract between the company and the plaintiff ... Additionally, there have been attempts by injured parties to attach liability to the principals of failed businesses through insolvency litigation. 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][51]

The last sentence of this passage can be understood to imply that directors and officers need to act in pursuit of an interest separate from that of the company in order for them to be found liable for any tort, not just that of inducing a breach of contract.[52] It sounds like a director or officer will only be held personally liable if he or she has made the act complained of his or her own by acting in pursuit of an interest distinct from that of the corporation.[53] This impression is reinforced by a later sentence of the Court of Appeal:

> To hold the directors of Peoples personally liable, there must be some activity on their part that takes them out of the role of directing minds of the corporation.[54]

According to this sentence, directors do not have to face personal liability for their tortious conduct as long as they are acting within the role of "directing minds" of the

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[51] *Scotia McLeod, supra* note 48 at 490-91.
[52] Iacobucci, *supra* note 26 at 42.
[53] *Ibid.*.

corporation.[55] It might be that the court's intent here was only to point out that, as a practical matter, directors of public companies normally do not carry out any operational duties that could potentially lead to the commission of an independent tort.[56] In combination with the passage cited above, it seems more likely, however, that the court is, in fact, promoting a broad understanding of *Said v. Butt*, meaning that where a corporate director or officer acts within the scope of his or her duty and in the best interests of the corporation, no personal liability should attach.[57]

The general rule in the area of tort law that everyone should be accountable for their tortious acts has been narrowed down significantly for corporate directors and officers by the decision of the Court of Appeal in *Scotia McLeod*.[58] Earlier cases did not suggest, as is doing this one, that the liability of the directing mind merges with that of the corporation so that directors, absent wrongful conduct, are not exposed to personal liability for corporate decisions that they take in the course of their regular duties.[59] The use of the directing mind or identification doctrine in the present context is "somewhat revolutionary" and alters its legal significance: The doctrine was developed not as a means of circumscribing the personal liability of directors and officers, but rather as a means to impose liability upon the corporation, as a non-

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[54] *Scotia McLeod*, *supra* note 48 at 491.
[55] Nicholls, *supra* note 13 at 11.
[56] *Ibid.*.
[57] Iacobucci, *supra* note 26 at 41; the Court of Appeal in *ADGA*, *supra* note 41, actually does not arrive at this interpretation of *Scotia McLeod Inc.*: It promotes in *ADGA* a narrow interpretation of *Said v. Butt*, as will be seen later, without seeing any need to officially revise the conclusions of *Scotia McLeod*.
[58] Sarra, *supra* note 27 at 65: She names *Mentmore Manufacturing Co. v. National Merchandising Co.* (1978), 89 D.L.R. (3d) 195 at 203, 40 C.P.R. (2d) 164 (F.C.A.) [*Mentmore Manufactoring* cited to D.L.R.], as an example of this earlier jurisprudence. The court here looked at the degree of involvement in the impugned conduct and whether the wrongful conduct had a knowing and deliberate quality to it in order to determine if the director or officer was sufficiently involved to make the tortious act his or her own.
[59] Sarra, *supra* note 27 at 65.

natural but legal personality, for its misconduct.[60] This was achieved by declaring that specific corporate actors could constitute a corporation's mind so that the wrongful conduct of these actors would create a direct "personal" liability of the corporation.[61] The identification doctrine was developed for those cases where the doctrine of vicarious liability was inoperable, in particular, for cases of corporate criminal liability.[62] Prior to *Scotia McLeod Inc. v. Peoples Jewellers*, there was no suggestion, however, that individual officers and directors should not also be held liable for their wrongful acts. The point of earlier decisions had been that the corporation could *also* be said to be liable, and that such liability was not merely vicarious.[63] The actions of the directing mind were considered to be at the same time those of the individual actor and that of the corporation of which that actor was the directing mind and will. It had never been the intent behind the directing mind doctrine to shield the directing mind whose conduct renders the corporation liable itself from personal liability.[64] The use of the doctrine in *Scotia McLeod Inc. v. Peoples Jewellers* in this sense therefore adds a complete new aspect to the theory which may even be considered to be contrary to its original rationale.[65]

The Ontario Court of Appeal confirmed the approach it had taken in *Scotia McLeod v. Peoples Jewellers* on several occasions when it was again confronted with the issue of directors' and officers' liability:

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[60] Nicholls, *supra* note 13 at 11.
[61] *Ibid.*; VanDuzer, *supra* note 1 at 172.
[62] Nicholls, *supra* note 13 at 12.
[63] *Ibid.*.
[64] Sarra, *supra* note 27 at 66.
[65] *Ibid.*.

In *Normart Management Ltd. v. West Hill Redevelopment Co.*[66], the court dismissed a conspiracy claim against individual directors clearly making allusion to the language from Peoples Jewellers:

> It is well established that the directing minds of corporations cannot be held civilly liable for the actions of the corporations they control and direct unless there is some conduct on the part of those directing minds that is either tortious in itself or exhibits a separate identity or interest from that of the corporations such as to make the acts or conduct complained of those of the directing minds.[67]

The Court of Appeal, per Finlayson J.A., rejected the idea that the decision of the directing minds of the two defendant corporations to cause them to ignore their corporate obligations under the joint venture agreement with a third corporation and pursue an independent course would amount to a conspiracy of those directing minds to injure the third contracting party or its directing mind with the reasoning that "To give effect to this argument simpliciter would eliminate any semblance of the corporate veil.".[68] Although the court never explicitly refers to Said v. Butt, it seems that it follows Scotia McLeod v. Peoples Jewellers in also promoting a broad understanding of the case.[69] In particular the statement of Finlayson J.A. that "There is no allegation that the individual respondents were acting outside the scope of their authority or not acting in the best interests of their corporations."[70] suggests that the case stands for the proposition that directing minds, acting within the scope of their authority and in the best interests of the corporation, can, in fact, not be held personally liable.[71]

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[66] (1998), 37 O.R. (3d) 97, 155 D.L.R. (4th) 627 (C.A.)[*Normart Management* cited to O.R.].
[67] *Ibid.* at 102.
[68] *Ibid.* at 105-06.
[69] Nicholls, *supra* note 13 at 14.
[70] *Normart Management.*, *supra* note 66 at 104.
[71] Nicholls, *supra* note 13 at 14.

In *Alper Development Corp. v. Harrowston Corp.*[72], the Court of Appeal permitted a negligence action against an individual corporate officer to proceed. In order to determine whether the corporate director could be held personally liable, the court referred to the criteria established in *Scotia McLeod v. Peoples Jewellers*, testing whether or not the actions of the corporate officer were, as alleged, in and of themselves tortious.[73] The exact scope of the Peoples Jewellers standard remained however unclear until two other Court of Appeal decisions[74] appeared to signal that while directors might indeed be found liable when acting within the scope of their duties and in the best interest of the corporation, this result could only occur where a statuary provision (in particular, the corporate law oppression remedy) had altered the common law accordingly.[75]

(2) ADGA: Some Clarification of the Canadian Approach and a Narrow Interpretation of Said v. Butt

The case *ADGA Systems International Ltd. v. Valcom Ltd.*[76] provided the Ontario Court of Appeal with another opportunity to reflect on the issue of directors' and officers' liability. It appears that the court in *ADGA* takes another approach with respect to the topic than it had done in *Scotia McLeod v. Peoples Jewellers*. The Ontario Court of Appeal, however, does not seem to see it this way. It seems to consider its reasoning in *ADGA* to be consistent with its reasoning in *Scotia McLeod* as it never states any intent to officially revise the conclusions arrived at in *Scotia McLeod*. In any case, no matter if *ADGA* constitutes, in fact, an unofficial revision of *Scotia McLeod* or if it is rather just a clarification of the present state of law resolving

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[72] (1998), 38 O.R. (3d) 785 at 787, 107 O.A.C. 318 (C.A.).
[73] *Ibid.* at 787.
[74] *Sidaplex-Plastic Suppliers, Inc. v. Elta Group Inc.* (1998), 40 O.R. (3d) 563, 162 D.L.R. (4th) 367 (C.A.); *Budd v. Gentra Inc.* (1998), 43 B.L.R. (2d) 27, 111 O.A.C. 288 (C.A.).
[75] Nicholls, *supra* note 13 at 15.

some of the misunderstandings in the context of *Scotia McLeod*, the case does go through important parts of the legal development and therefore renders a valuable account of the current attitude in Canadian Law towards the question of directors' and officers' liability. It is also of great relevance with respect to the newest trends in this area of law.

The story of *ADGA Systems International Ltd. v. Valcom Ltd.* begun with the plaintiff, ADGA Systems, having a long-standing contract with Correctional Services Canada to provide technical support and maintenance of security systems for federal penal institutions. In 1991, the contract came up for renewal and the Department of Supply and Services put out a call for tenders. One of the requirements for the tender to have any chance was that the tendering party had to show that it was competent to perform the contract by presenting the names and qualifications of twenty-five experienced technicians. Since ADGA Systems was already serving the needs of Corrections Canada for ten years, it naturally had many qualified technicians. The defendant, Valcom, however, had no experienced staff. In order to be able to present a competitive tender, Valcom, through one of his directors and two senior officers convinced all but one of ADGA's technicians to allow their names to be listed on Valcom's tender and to agree to work for Valcom in case of the tender being successful. The result was that Valcom and ADGA ended up presenting an almost identical staff of technicians in their tenders. It was Valcom which won the contract.

ADGA brought claims against his former employees for breach of contract and breach of fiduciary duty and against Valcom and its director and officers for inducing breach of contract, interference with contractual relations as well as inducing breach of

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[76] *Supra* note 41.

fiduciary duty. The defendants brought a motion for summary judgement asserting that there was no legitimate claim against the director and officers in their personal capacities. The motions judge, however, held that there were triable issues and refused to grant the motion. The Divisional Court then reversed the decision stating that there were, in fact, no triable issues. It did grant the motion for summary judgement.[77] The court came to the conclusion that there were no triable issues because it identified the acts of the director and the officers to be the acts of the corporation.[78] While it acknowledged that under certain circumstances tort claims can be brought against directors and officers in their personal capacities, it also mentioned that in order to support such a tort claim the directors and officers involved must have acted outside the scope of their duties.[79] This last remark of the Divisional Court takes up the corresponding statement of the Ontario Court of Appeal in *Scotia McLeod* in the interpretation set out above[80] which is then (unofficially) revised or at least clarified by the Ontario Court of Appeal decision in *ADGA*.

The Ontario Court of Appeal reversed the Divisional Court's ruling in *ADGA* in a judgement that declared the question of whether there was an "independent cause of action" against the individual director or officer to be the applicable test in order to determine the scope of liability of this personnel to the plaintiff.[81] According to the court, where such an "independent cause of action" exists, a claim may proceed against the director or officer personally because no conflict with the principle of the corporation being a separate legal entity can occur.[82] As for the statement of the Court

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[77] (1997), 105 O.A.C. 209, 33 C.C.E.L. (2d) 135 (Div. Ct.).
[78] *Ibid.* at 213-14.
[79] *Ibid.* at 215.
[80] See Part *(1)* at 18, above.
[81] Nicholls, *supra* note 13 at 17.
[82] Colin Feasby, "Corporate Agents' Liability in Tort: A Comment on *ADGA Systems International Ltd. v. Valcom Ltd.*" (1999) 32 Can. Bus. L.J. 291 at 293/294.

of King's Bench in *Said v. Butt* concerning the scope of directors' and officers' liability, the Court of Appeal in *ADGA* considered it as a narrow exception to the "general rule that persons are responsible for their own conduct".[83] The Court of Appeal declared:

> 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 corporation, always subject to the *Said v. Butt* exception.[84]

This statement of the Ontario Court of Appeal in *ADGA* clarifies that it is only in the case of the tort of inducing breach of contract that there is a defence available to directors acting bona fide and within the scope of their authority.[85] The exemption from personal liability in this particular case is acceptable for the Court of Appeal since it corresponds to the business necessity for directors and officers to authorize breaches of contract where it is economically in the best interests of the corporation to do so.[86] The Court of Appeal acknowledges:

> The exception [to personal liability] 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 damages for the failure to perform.[87]

For all other cases, however, the Court of Appeal insists that the general tort law rule of liability of any individual for personal conduct is left intact and that therefore directors and officers are responsible for their tortious acts.[88]

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[83] *ADGA*, *supra* note 41 at 106.
[84] *Ibid.* at 107.
[85] Iacobucci, *supra* note 26 at 43/44.
[86] Nicholls, *supra* note 13 at 17; Feasby, *supra* note 82 at 297.
[87] *ADGA*, *supra* note 41 at 106.
[88] *Ibid.*; Iacobucci, *supra* note 26 at 44.

The Court of Appeal then goes on to explain the "correct" interpretation of judgements which actually before seemed to head into a different direction: First, there is the often-cited quotation from *Normart Management Ltd. v. West Hill Redevelopment Co.*[89] where a personal claim against directors was refused on the ground that "there is no factual underpinning to support an allegation that the personal defendants were at any time acting outside their capacity as directors and officers of the corporation of which they were the directing minds".[90] Without the help of the Court of Appeal in *ADGA*, this statement seemed to suggest a rather narrow scope of liability for directors and officers.[91] Carthy J.A., speaking for the court in *ADGA*, explained, however, that he could see "nothing in the reasons to detract from my rationale that, where properly pleaded, a claim may be asserted for the tortious conduct of individuals where the defence of *Said v. Butt* is not available".[92] Second, there is the quotation from *Scotia McLeod* that also inspired the Divisional Court with regard to *ADGA* as already mentioned above.[93] While the Court of Appeal in *ADGA* proves to be aware of the fact that the Divisional Court (as other courts before) understands *Scotia McLeod* in a way that suggests "some limitation on the liability of directors and officers who are acting in the course of their duties", the court claims at the same time that "no limitation was ever intended".[94] Rather, the Court of Appeal in *ADGA* considers *Scotia McLeod* to confirm "that, where properly pleaded, officers and employees can be liable for tortious conduct even when acting in the course of duty".[95] Viewing it this way, the Court of Appeal in *ADGA* insists that its decision

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[89] (1998), 37 O.R. (3d) 97, 155 D.L.R. (4th) 627 (C.A.).
[90] *Supra* note 66 at 102.
[91] Nicholls, *supra* note 13 at 18.
[92] *ADGA*, *supra* note 41 at 113.
[93] See at 23, above.
[94] *ADGA*, *supra* note 41 at 112.
[95] *Ibid.*.

does not represent a change in law, but merely an exercise in clarification.[96] This, however, is hard to accept since also the Court of Appeal itself seems to have relied on the "mistaken" interpretation of *Scotia McLeod* on earlier occasions.[97] Anyway, change in law or not, since the decision of the Court of Appeal in *ADGA* it is clear that in the law of Ontario the exemption from personal liability for directors and officers set out in *Said v. Butt* should be interpreted narrowly.[98]

While the Court of Appeal in *ADGA* allows the action against the individual defendants to proceed, it admits at the same time that there are certain policy reasons which actually do argue against a too broad scope of directors' and officers' liability in certain cases. Drawing on the distinction made by La Forest J. in his dissenting opinion in *London Drugs Ltd. v. Kuehne & Nagel International*[99] between voluntary and involuntary creditors of the corporation, the Court of Appeal in *ADGA* argues in favour of a "definitive extension" of the defence in *Said v. Butt* for directors and officers when "they are acting in the best interest of the corporation with parties that have *voluntarily* chosen to accept the ambit of risk of a limited liability company [emphasis added]".[100]

The basic idea of La Forest J., referred to by the court in *ADGA*, is that involuntary creditors, meaning plaintiffs without any relationship to the corporation prior to the commitment of the tort (the typical example is the plaintiff getting run over on the road by a truck whose driver happens to be employed by a corporation), cannot foresee the limited liability of the corporation as their "tort debtor" and therefore do

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[96] Nicholls, *supra* note 13 at 19.
[97] *Ibid.*: Nicholls names the Court of Appeal's own previous decision in *Budd v. Gentra* as an example.
[98] Iacobucci, *supra* note 26 at 43; Sarra, *supra* note 27 at 66.
[99] [1992] 3 S.C.R. 299, 97 D.L.R. (4th) 261 [*London Drugs* cited to S.C.R.].

not have any opportunity to protect themselves from it.[101] As a consequence, La Forest J. reasons that these creditors should have available a personal claim against the individual acting on behalf of the corporation.[102] On the contrary, those plaintiffs which do enter into a contractual relationship with a corporation and therefore do know about the limited liability risk that is connected to it can be expected to protect themselves against this risk.[103] Accordingly, where a tort is committed in the contractual context by a natural person acting on behalf of the corporation in the course of performing his or her duties, the plaintiff should only be able to hold the corporation liable for it.[104] If, however, the tort committed is unrelated to the performance of the contract entered into with the corporation, the corporate actor committing this tort remains liable to the plaintiff personally since the commitment of such a tort is not a risk assumed when contracting with a corporation.[105]

However, although the Court of Appeal in *ADGA* says that it would welcome a further limitation on the scope of directors' and officers' liability where these corporate actors have acted in the best interests of the corporation and the tort victim has voluntarily chosen to deal with a corporation therefore assuming the risk of personal liability, the court states at the same time that the facts in *ADGA* do not present the circumstances necessary to declare such an additional exception (the conduct of the individual defendants in *ADGA* was intentional and the relationship between the two corporate parties was only as competitors).[106] In addition, the Court of Appeal draws attention to the fact that the opinion of La Forest J. in *London Drugs* has not been that of the

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[100] *ADGA*, *supra* note 41 at 113-14.
[101] *London Drugs*, *supra* note 99 at 304-05.
[102] *Ibid.* at 304.
[103] *Ibid.* at 305.
[104] *Ibid.*.
[105] *Ibid.* at 306.
[106] *ADGA*, *supra* note 41 at 113-14.

majority so that actually a new decision of the Supreme Court of Canada would have to be awaited in order to change the present approach and adopt the liability continuum of La Forest J..[107] Until then, the only possibility open to courts would be to stop those claims against individual defendants which are either improperly pleaded or where the evidence does not justify an allegation of personal tort. [108]

(3) After ADGA

After *ADGA*, the Ontario Court of Appeal pronounced some other judgements in which it affirmed its reasoning that generally directors and officers can be held liable for tortious conduct even when acting within the course of their duties as long as the tortious allegations have been specifically pleaded.[109] However, other courts have not fully embraced the reasoning in the *ADGA* line of cases or have given it a narrower reading.[110] Some judgements have also again taken up some of the confusions from the times prior to *ADGA*, from the deprivation motive (dominant purpose), to directing minds and piercing the veil.[111] In order to clear all confusions with regard to the scope

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[107] *Ibid.*.
[108] *Ibid.*.
[109] Sarra, *supra* note 27 at 66: *Lana International Ltd. v. Menasco Aerospace Ltd.*, [2000] O.J. No. 3261 at paras. 43-44 (C.A.) (QL); *Immocreek Corp. v. Pretiosa Enterprises Ltd.*, [2000] O.J. No. 1405 (C.A.) (QL) at paras. 28, 32, 35, 43; *Meditrust Healthcare Inc. v. Shoppers Drug Mart* (1999), 124 O.A.C. 137 at 141, [1999] O.J. No. 3243 (C.A.) (QL) at 141; *46035 Ontario Ltd. v. 1002953 Ontario Ltd.*, [1999] O.J. No. 4071 (C.A.) (QL) at para. 8; *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514, 181 D.L.R. (4th) 37 (C.A.), leave to appeal to S.C.C. refused [2000] 1 S.C.R. x, 183 D.L.R. (4th) vii.
[110] Sarra, *supra* note 27 at 67: *Schmidt v. Bell Canada* (1999), 48 C.C.E.L. (2d) 128, [1999] O.J. No. 317 (S.C.J.) (QL); *Thibeault v. Canadian Airlines International Ltd.*, [2000] B.C.J. No. 1626 (S.C.) (QL); *Rafiki Properties Ltd. v. Integrated Housing Development Ltd.*, [1999] B.C.J. No. 243 (S.C.) (QL); *Insurance Corp. of British Columbia v. Leland* (1999), 91 A.C.W.S. (3d) 49, [2000] B.C.J. No. 2073 (S.C.) (QL).
[111] See Flannigan, „Personal Tort Law Liability of Directors", *supra* note 21 at 293 who names the following cases as examples: *Cavendish Promotions Inc. v. Tourism Industry Association of Prince Edward Island*, [1998] P.E.I.J. 63 (P.E.I.S.C.) (QL); *Jade Agencies Ltd. v. Meadow's Management Ltd.*, [1999] B.C.J. No. 214 (B.C.S.C.) (QL), *Rafiki Properties Ltd. v. Integrated Housing Development Ltd.* (1999), 45 B.L.R. (2d) 316 (B.C.S.C.); *Balanyk v. University of Toronto* (1999), 1 C.P.R. (4th) 300 (Ont. Sup. Ct.); *Simpson v. Consumers' Association of Canada* (1999), 41 C.C.E.L. (2d) 179 (Ont. Gen. Div.); *Squires v. Corner Brook Pulp and Paper Ltd.* (1999), 44 C.C.E.L. (2d) 246 (Nfld. C.A.); *Dodge v. Kaneff Homes Inc.*, [2000] O.J. No. 1455 (Ont. Sup. Ct.) (QL); *100563 Ontario Ltd. v. Winchester Arms Ltd.* (2000), 8 B.L.R. (3d) 176 (Ont. Sup. Ct.); *Albayrak v. Nesbitt Burns Inc.* (2000), 4 C.C.E.L. (3d) 78 (B.C.S.C.); *Blacklaws v. Morrow* (2000), 187 D.L.R. (4th) 614 (Alta. C.A.); *369413 Alberta*

of *ADGA*, one will have to await a decision of the Supreme Court of Canada on the matter.[112]

b. Conclusion with Regard to the Exception Set out in Said v. Butt: An Exception for the Tort of Inducing Breach of Contract

The judgement of the Ontario Court of Appeal in *ADGA* shows where Canadian Law is today with regard to the issue of directors' and officers' personal liability. Although there are still many judgements taking up arguments from decisions prior to *ADGA*, the new point of view, at least for Ontario, seems to be that generally directors and officers of the corporation are responsible for their tortious conduct even though the conduct was directed in a *bona fide* manner in the best interests of the corporation. This is subject always to the exception set out in *Said v. Butt* for the tort of inducing breach of contract and assuming that the tortious allegations are properly pleaded. *Said v. Butt* is understood to constitute only a narrow exception for the particular case of inducing breach of contract exempting directors from liability for actions that would otherwise give rise to personal liability. The exemption from liability established in *Said v. Butt* for directors acting in good faith and in the scope of their duties when inducing the corporation to breach its contract may be explained with the special nature of this tort. Where it is economically in the best interest of the corporation to breach its contract while the breach is indifferent to the other party receiving full compensation, the act of inducing the breach on the part of the director cannot be considered wrongful.[113] This is why there have always been exemptions from tort liability in this context and the courts have introduced various defences and

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Ltd. v. Pocklington (2000), 194 D.L.R. (4th) 109 (Alta. C.A.); *Thibeault v. Canadian Airlines International Ltd.*, [2000] B.C.J. No. 1626 (B.C.S.C.) (QL); *Morriss v. British Columbia*, [2001] B.C.J. No. 369 (B.C.S.C.) (QL); *Zesta Engineering Ltd. v. Cloutier* (2001), 7 C.C.E.L. (3d) 53 (Ont. Sup. Ct.), *1174538 Ontario Ltd. v. Barzel*, [2001] O.J. No. 580 (Ont. Sup. Ct.) (QL); *Cityscape Richmond Corp. v. Vanbots Construction Corp.* (2001), 8 C.L.R. 196 (Ont. Sup. Ct.); *Kay Aviation b.v. v. Rofe* (2001), 202 D.L.R. 683 (P.E.I. C.A.); *565486 Ontario Inc. v. Tristone Properties Inc.* (2001), 54 O.R. (3d) 689 (Ont. Sup. Ct.); *Unisys Canada Inc. v. York Three Associates Inc.*, (2001), R.P.R. (3d) 138 (Ont. C.A.).

[112] Sarra, *supra* note 27 at 67.

justifications in this area.[114] The idea of justification in the case of inducing breach of contract therefore is a rather open-ended idea and the solutions proposed in this context are not necessarily transferable to other torts, a conclusion that was also made by the court of Appeal in *ADGA*.[115] Similar to the position taken in *ADGA* is the point of view for English law expressed in *C. Evans & Sons Ltd. v. Spritebrand Ltd.* where it was also said that directors could be held liable even where they commit the tort in the course of carrying out their duties as director of the company.[116]

The results presented here are consistent with the basic principle of tort law that those who cause others harm must be held personally liable for their conduct. There have, however, also been many critical voices with regard to the decision in *ADGA*. For example, there has been the reproach that the Ontario Court of Appeal, although it accepted the argument of overdeterrence to exclude liability under certain conditions in the context of the tort of inducing breach of contract, failed to examine its effects in the context of other torts.[117] If one assumes that overdeterrence can be avoided by contracting around it with regard to other torts (for example by including indemnification clauses in the contracts with directors), the question becomes why this should not also be possible in the context of the tort of inducing breach of contract.[118] Furthermore, the liability model set out by La Forest J. in his dissenting opinion in *London Drugs* which the Ontario Court of Appeal mentions as an attractive solution for the liability of directors has been criticized to be based on unrealistic assumptions.[119] The idea to differentiate between voluntary and involuntary creditors

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[113] Waddams, *supra* note 45 at 2.
[114] *Ibid.* at 26; Klar, *supra* note 46 at 619-20.
[115] Klar, *ibid.* at 619.
[116] [1985] 2 All E.R. 415 (C.A.) [*Evans v. Spritebrand*] at 419.
[117] Iacobucci, *supra* note 26 at 39-40, 47.
[118] *Ibid.* at 49.
[119] *Ibid.* at 51/52; Sarra, *supra* note 27 at 70.

is based on the apprehension that involuntary creditors have no possibility to protect themselves from the consequences of limited liability attached to the corporate form.[120] This is the reason why it is being argued that in turn, directors should be personally liable to this class of tort victims. On the contrary, voluntary creditors who know that they are dealing with a limited liability corporation are assumed to be able to take the necessary precautions to protect themselves.[121] This is criticized to be based on the incorrect and unrealistic presumption that voluntary creditors implicitly accept to have also tort claims only against the corporation when they contract with it.[122] The majority of voluntary creditors, however, would assume to have a contract claim only against the corporation but for a tort claim, they would still assume to have first of all a personal claim against the individual tortfeasor, even if this happens to be the director or officer of the corporation.[123] Other criticism concerning *ADGA* has been based on economic arguments (in particular, the idea of risk aversion and overcompliance) and on the idea that the personal tort liability of directors and officers may conflict with the separate legal entity of the corporation and the principle of limited liability attached to it.[124]

2. Other Intentional Torts

In the previous part, a closer look has been taken at the liability of directors and officers for the particular intentional tort of inducing breach of contract. It has been shown that some of the issues originally brought up in the context of this tort have come to raise questions of principle concerning the personal liability of managers. The

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[120] Iacobucci, *supra* note 26 at 52; see also *London Drugs*, *supra* note 99 at 304-05, La Forest J., dissenting.
[121] Sarra, *supra* note 27 at 70.
[122] *Ibid.*; Iacobucci, *supra* note 26 at 52.
[123] *Ibid.*.
[124] Theses arguments will be taken up and analysed more closely in the final conclusion, see Chapter 4 at 109, below.

focus of the present section will be on liability of directors and officers for other intentional torts. The statements made here will be only of general character since an enumeration of all the different intentional torts is beyond the scope of this thesis.[125] In addition, the differences between the results concerning managers' liability for particular intentional torts are of rather minor importance, apart from the tort of inducing breach of contract which has already been dealt with above. However, it needs to be pointed out that some of the confusions associated originally with the tort of inducing breach of contract will rather reappear in cases involving more "modern" torts like passing off or patent infringements and not in cases involving more "classical" torts like fraud, deceit, dishonesty or want of authority. In the same way, personal liability will be attached for tortious conduct causing physical injury, "classical" property damage or nuisance even when the directors or officers are acting pursuant to their duties to the corporation.[126] That a director or officer may be held liable for having committed one of these more "classical" torts seems not to be questioned so much.[127]

In general, whether a director of officer is considered responsible for tortious acts will depend on the degree of his or her personal involvement.[128] Where the director or officer has performed, ordered or procured the action causing the tort, he or she is likely to be found liable.[129] On the contrary, where an individual has only general management responsibilities in the area of the corporation's activities in which the tort was committed, but neither knows about nor is involved in the actions resulting in the

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[125] For an overview of all the different torts in common law, see Bernard Rudden, "Torticles" (1991-1992) 6-7 Tulane Civil Law Forum 105.
[126] *ADGA.*, *supra* note 41 at 109.
[127] Sarra, *supra* note 27 at 64. In *Scotia McLeod*, *supra* note 48 at 490-91, the court recognized the establishment of personal liability of directors and officers in cases of fraud, deceit, dishonesty or want of authority to be much more likely.
[128] VanDuzer, *supra* note 1 at 308.

tort, he or she is unlikely to be found personally liable.[130] Directors and officers generally will not be found liable for the corporation's torts simply because of their positions within the corporation.[131] In *Morgan v. Saskatchewan*[132], a Canadian case, the court provided a good summary of the English position[133] pointing out that:

> (...) a director is not to be held liable merely because he is a director but may be liable when he participates in or orders a tortious act and cannot escape personal liability by asserting that his act was merely and act of the corporation. In other words, the "corporate veil" is not to be used as a shield to protect shareholders and directors when they have been guilty of wrongdoing. This approach is consistent with the notion that everyone should be answerable for his tortious acts.[134]

However, Canadian courts have not always followed the English position so closely. There have been several deviations from this position in the sense that the issue of directors' liability for torts has been re-considered from different angles, leading to the introduction of new criteria in order to determine when managers may be held personally liable. One example is the judgement of the Canadian Federal Court of Appeal in *Mentmore Manufacturing Co., Ltd. v. National Merchandising Co. Inc.*[135], a case about patent infringement, where the issue of directors' liability was considered to involve a conflict between corporate law and tort law. Le Dain J. elaborated on this point:

> 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 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

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[129] *Ibid.*; Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 294.
[130] VanDuzer, *ibid.*.
[131] *Ibid.* at 307.
[132] (1985), 31 B.L.R. 173 (Sask. C.A.) [*Morgan*].
[133] Two of the most important English cases in this area are: *Rainham Chemical Works, Limited v. Belvedere Fish Guano Company*, [1921] 2 A.C. 465 [*Belvedere*]; *Limited and Performing Right Society, Limited v. Ciryl Theatrical Syndicate, Limited*, [1924] 1 K.B. 1 [*Ciryl*], see Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 278.
[134] *Morgan*, *supra* note 132 at 180-81.
[135] *Supra* note 58.

> tortious acts. The balancing of these two considerations in the field of patent infringement is particularly difficult.[136]

Seeing it from this angle, Le Dain J. went on to introduce a new criterion to test whether a director could be held responsible for the commission of a tort:

> What, however, is the kind of participation in the acts of the company that should give rise to personal liability? It is an elusive question. It would appear to be that degree and kind of involvement by which the director or officer makes the tortious act his own. It is obviously a question of fact to be decided on the circumstances of each case. I have not found much assistance in the particular case in which courts have concluded that the facts were such as to warrant personal liability. But there would appear to have been in these cases a knowing, deliberate, wilful quality to the participation: (...)[137]

The problem of this new criterion of "knowing, deliberate, wilful quality of participation" is that it is rather fluid and unclear.[138] This impression is reinforced by Le Dain J.'s later comment in the case that the precise formulation of the appropriate test was obviously a difficult one and that room would have to be left for a broad appreciation of the circumstances of each case to determine whether as a matter of policy they called for personal liability.[139] The point of view that the issue of directors' liability would involve a conflict between corporate law and tort law has been taken up by different courts and commentators.[140] In England, there was one case

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[136] *Ibid.* at 202. The "wilful participation" criterion has been taken up in many other cases across Canada (primarily but not exclusively in cases of patent infringement), see Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 295, note 187 who names the following examples: *Visa International Service Association v. Visa Motel Corporation* (1984), 1 C.P.R. (3d) 109 (B.C.C.A.); *Dictionnaires Robert Canada SCC v. Librairie Du Nomade Inc.* (1987), 16 C.P.R. (3d) 319 (F.C.T.D.); *Windsurfing International Inc. v. Novaction Sports Inc.* (1987), 18 C.P.R. (3d) 230 (F.C.T.D.); *Pater International Automotive Franchising Inc. v. Mister Mechanic Inc.* (1989), 28 C.P.R. (3d) 308 (F.C.T.D.); *Serel v. 371487 Ontario Ltd.*, (1996), 180 O.T.C. 135 (Ont. Gen. Div.); *Norac Systems International Inc. v. Prairie Systems and Equip. Ltd.* (1997), 72 C.P.R. (3d) 303 (F.C.T.D.); *Paula Lisham Ltd. v. Erom Roche Inc.* (1997), 72 C.P.R. (3d) 214 (F.C.T.D.); *Cudworth Drilling Ltd. v. MacDonald* (1998), 174 Sask. R. 225 (Sask. Q.B.), affd., (2000), 207 Sask. R. 216 (C.A.); *B.B. Bargoon's (1996) Corp. v. 744776 Ontario Inc.*, (1998), 83 C.P.R. (3d) 225 (F.C.T.D.).

[137] *Mentmore Manufactoring, supra* note 58 at 205.

[138] See f. ex. Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 280: One of the problems is that also the English cases cited by Le Dain J. do not help to clarify the criterion since they do not really seem to support his view.

[139] *Mentmore Manufactoring, supra* note 58 at 205.

[140] Some examples of commentators associating the issue of directors' liability with having to solve a conflict between corporate law and tort law are: Ross Grantham & Charles Rickett, "Directors' „Tortious" Liability: Contract, Tort or Company Law?" (1999) 62 Mod. L. Rev. 133 at 137. (Contrast

dealing with the tort of passing off which also took up the "wilful participation" criterion of *Mentmore Manufactoring*, the case of *White Horse Distillers Limited v. Gregson Associates Limited*[141]. However, this was soon reversed in *Evans v. Spritebrand*[142], a case dealing with infringement of copyright, where the judge expressed serious doubts about the idea that a deliberate and willful participation was required on the part of the director in order to be able to hold him or her personally liable. The main concern was that the effect of such a requirement would be to treat directors more kindly that other agents or employees.[143]

The traditional position considering directors' liability for intentional torts as summarized in *Morgan v. Saskatchewan* has further been challenged by some of the confusions originally brought up in the context of the tort of inducing breach of contract.[144] One example of this kind is the relevance of the "piercing" idea. While in some cases, the courts have denied the idea of the "piercing of the corporate veil" to be of any relevance with regard to the issue of directors' liability, other decisions have affirmed a connection.[145] The issue of directors' liability has been denied to involve a "piercing of the corporate veil" in the following cases: In *B.G. Preeco I (Pacific Coast) Ltd. v. Bon Street Holdings Ltd.*, the British Colombia Court of Appeal found directors personally liable for fraudulent acts while stating that "(...) the proper remedy is not to lift the corporate veil, but to award damages for fraud against

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the views of John P. Lowry & Rod Edmunds, "Personal Liability of Company Directors" (1998) 77 Can. Bar Rev. 467 at 467.

[141] [1984] R.P.C. 61.

[142] *Supra* note 116.

[143] *Ibid.* at 425. The result of this was a return to the law expressed in *Belvedere* and *Ciryl*, see *supra* note 133, meaning that it would be sufficient for a director to have expressly or impliedly directed or procured the commission of a tortious act in order for him or her to be found liable.

[144] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 295. The cases mentioned in the following are only examples.

[145] *Ibid.*.

individuals and the company that committed the fraud".[146] This perspective was taken up in *Shibamoto & Co. v. Western Fish Producers, inc. Estate (T.D.)*[147] where the judge in charge declared the issue of whether or not the particular case was a proper case for the lifting of the corporate veil to be irrelevant to the question of holding the defendant director personally liable. Instead, the determination of whether to hold the director involved personally liable or not was based upon the legal principle " (...) that an individual who directs a tort to be committed is personally liable regardless of the fact that he is an officer of the company for whose benefit the tort is executed".[148] Also in *Bakerview Trout Farm (1983) v. Petgus Holding Ltd.*, the court held a director personally liable for fraud rejecting the defendant counsel's proposition that "(...) this amounts to the legal sin of piercing the corporate veil".[149] On the contrary, there is also one example of a case where the issue of directors' liability has been affirmed to involve a "piercing of the corporate veil": In *Island Getaways Inc. v. Destinair Airlines Inc.*[150] a claim for fraudulent misrepresentation was considered as "piercing issue" even though the defendant was judged not to be entitled to the protection that the law generally offers to companies and their agents by way of the principle of limited liability.[151]

Other examples of confusions leaping from cases involving the tort of inducing breach of contract or cases dealing with negligence to cases involving other intentional torts are the ideas of a director being personally liable because he or she is the "directing mind" of the corporation or because he or she acts for a separate interest from that of

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[146] (1989), 43 B.L.R. 67 at 79 (B.C.C.A.).
[147] [1991] 3 F.C. 214 at 236 (F.C.T.D.).
[148] *Ibid.*.
[149] [1996] B.C.J. No. 983 at para. 26 (B.C.S.C.) (QL).
[150] (1996), 29 B.L.R. (2d) 298 (Ont. Gen. Div.).

the corporation[152]: The argument that the defendant director had represented the "directing mind" of the corporation was used, in particular, to establish personal liability in *347154 Ontario Ltd. v. John Garay and Associates Ltd.*[153] for the tort of conversion and in *Concord Construction Inc. v. Camara*[154] for fraudulent acts. In *North York Branson Hospital v. Praxair Canada Inc.*[155], a case giving rise to a claim for conspiracy considering prize-fixing and bid-rigging, the court insisted that "to sustain a civil action against the directing minds of corporations, there must be some allegation of conduct on the part of those directing minds that is either tortious itself or exhibits a separate identity or interest from that of the corporation".[156] The same argument that a director would have to pursue an interest separate of that of the corporation in order for him or her to be directly liable for procuring the commission of a tort in *Hoare v. Tsapralis*[157] led to the dismissal of a claim for liability of a director who had ordered the demolition of a building, thereby establishing all the elements for the tort of waste. The director was excused by the court with the reasoning taken from *Scotia McLeod*[158] that there was no evidence that he "was acting outside the scope of his employment or in a manner inconsistent with the objects of, or interest of [the corporation]".[159]

In England, there have been some confusions because of the "assumption of responsibility" test, a test developed in the context of negligent misrepresentation or

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[151] See also *Chenier v. Johnson* (1964) 48 D.L.R. (2d) 380 (B.C.S.C.); *Lewis v. Smith*, [1991] O.J. No. 1992 (Ont. Gen. Div.) (QL); *1175777 Ontario Ltd. v. Magna International Inc.* (2001), 200 D.L.R. (4th) 521 (Ont. C.A.), this latter one dealing with the liability of directors of a parent corporation.
[152] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 296. Only some examples of cases are mentioned in the following.
[153] (1996), 15 E.T.R. (2d) 79 (Ont. Gen. Div.).
[154] (1992), 4 C.L.R. (2d) 263 (Ont. Gen. Div.).
[155] (1998), 84 C.P.R. (3d) (Ont. Gen. Div.).
[156] *Ibid.* at 21.
[157] (1997), 10 R.P.R. (3d) 89 (Ont. Gen. Div.) [*Hoare*].
[158] *Supra* note 48.

negligence for words [160], being brought up as a standard to decide about personal liability in a case involving the commission of an intentional tort. In *Standard Chartered Bank v. Pakistan National Shipping Corporation (No. 2)*, the Court of Appeal had to render a decision concerning a director who had orchestrated the fraudulent tendering of falsely dated bills of lading.[161] Normally, a finding of such involvement in the fraudulent act would have resulted in personal liability for the director.[162] The Court of Appeal, however, arrived at the conclusion that because the director had made the fraudulent representations on behalf of the corporation, only the corporation could be held liable.[163] In addition, the court insisted on the "assumption of responsibility" test to be applicable also to intentional torts in order to decide whether there had been the necessary special relationship between the director and the plaintiff to justify personal liability.[164] The court, in doing so, completely neglected the fact that the "assumption of responsibility" test had been developed and was again confirmed in *Williams*[165] to be applicable to cases involving the recovery of economic loss in the context of negligent misrepresentation.[166]

The Court of Appeal's decision in *Standard Chartered Bank v. Pakistan National Shipping Corporation (No. 2)* was reversed afterwards by the House of Lords.[167] The House of Lords declared the fact that Mr Mehra, the director, in orchestrating the fraudulent representations, had been acting on behalf of the corporation to be irrelevant to decide on his liability. Lord Hoffmann explained:

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[159] *Hoare*, *supra* note 157 at 97.
[160] See Part II.1.b. at 50-53, below.
[161] [2000] 1 Lloyd's L.R. 218 (C.A.) [*Standard Chartered Bank* (C.A.)].
[162] See above at 38.
[163] *Standard Chartered Bank* (C.A.), *supra* note 161 at 233, 236.
[164] *Ibid.* at 235.
[165] See Part II.1.b. at 52, below.
[166] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 308.

> (...) Mr Mehra says, and the Court of Appeal accepted, that he committed no deceit because he made the representation on behalf of Oakprime and it was relied upon as a representation by Oakprime. That is true but seems to me irrelevant. Mr Mehra made a fraudulent misrepresentation intending SCB to rely upon it and SCB did rely upon it. The fact that by virtue of the law of agency his representation and knowledge with which he made it would also be attributed to Oakprime would be of interest in an action against Oakprime. But that cannot detract from the fact that they were his representation and his knowledge. He was the only human being involved in making the representation to SCB (...). It is true that SCB relied upon Mr Mehra's representation being attributable to Oakprime because it was the beneficiary under the credit. But they relied upon it being Mr Mehra's representation, because otherwise there could have been no representation and no attribution.[168]

The House of Lords went on afterwards to reject the application of the "assumption of responsibility" test to cases dealing with intentional torts. Referring to the test, Lord Hoffmann stated:

> This reasoning cannot in my opinion apply to liability for fraud. No one can escape liability for his fraud by saying "I wish to make it clear that I am committing this fraud on behalf of someone else and I am not to be personally liable".[169]

Lord Hoffmann further refused to understand the present case as raising the issue of whether a director may be held liable for the torts of the company. He insisted that:

> (...) Mr Mehra was not being sued for the company's tort. He was being sued for his own tort and all the elements of that tort were proved against him. (...) He is liable not because he was a director but because he committed a fraud.[170]

In the same way, Lord Hoffmann also rejected the idea of the Court of Appeal that the decision had anything to do with company law. Instead, he emphasized that the solution of the case implied an application of the law of principal and agent.[171] The fact that Mr Mehra acted on behalf of a company and not on behalf of a natural person

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[167] [2002] UKHL 43, [2003] 1 AC 959, [2002] 1 All ER 173, [2002] 2 All ER (Comm) 931, [2003] 1 Lloyd's Rep. 227, [2003] 1 BCLC 244 [*Standard Chartered Bank* (H.L.)].
[168] *Ibid.* at para. 20. While Oakprime Ltd., on behalf of which Mr Mehra had acted, was the beneficiary of the credit issued by Standard Chartered Bank (SCB), the shipping agents and shipowners of Pakistan National Shipping Corporation (PNSC) were the ones who, orchestrated by Mr Mehra, produced the false bills of lading stating an earlier date for shipment than the date when the goods were really being shipped. The earlier shipment date was crucial for the credit to be issued.
[169] *Ibid.* at para. 22.
[170] *Ibid.*.

would therefore not lead to any difference with regard to the result when looking at his own personal liability for the fraudulent representations. Accordingly, one could test the matter by asking whether Mr Mehra would have been liable if he had acted on behalf of a natural person. As Lord Hoffmann put it, one could ask:

> (...) whether, if Mr Mehra had been acting as manager for the owner of the business who lived in the south of France and had made a fraudulent representation within the scope of his employment, he could escape personal liability by saying that it must have been perfectly clear that he was not being fraudulent on his own behalf but exclusively on behalf of his employer.[172]

Asking and reasoning in this way, the House of Lords allowed the appeal, implicitly concluding that Mr. Mehra could, in fact, be held liable personally for the tort.[173]

Before the decision of the House of Lords in *Standard Chartered Bank v. Pakistan National Shipping Corporation (No.2)*, the Court of Appeal had, in fact, already itself "corrected" its position expressed in this case concerning the application of the "assumption of responsibility" test. In *SX Holdings Ltd. v. Synchronet Ltd.*[174], the Court of Appeal conceded that no "special relationship" was required in the ordinary case to establish liability for intentional torts as long as the elements of the particular tort could be proven.[175] In its reasoning, the court referred to the special deterrent and moral functions of tort law in the case of intentional wrongdoing due to which the imposition of wider personal liability upon the tortfeasor could be justified.[176]

The deterrent and moral functions of tort law support what, apart from the confusions pointed out, seems to be the general principle for intentional torts: Where the director

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[171] *Ibid.* at para. 23.
[172] *Ibid.*.
[173] *Ibid.* at para. 24.
[174] [2000] E.W.J. No. 5156 (C.A.) (QL).
[175] *Ibid.* at para. 25.
[176] *Ibid.*.

or officer has performed, ordered or procured the action causing the tort, he or she is likely to be found liable.[177] On the other hand, directors and officers will not be held personally liable merely because of their positions.[178] The tort liability of directors as agents of their corporation is therefore not different from the tort liability of other agents. The exceptions for the tort of inducing breach of contract should not be transferred to other intentional torts because of the special economic circumstances behind this tort.[179] As already pointed out above, there may be situations where it is economically more advantageous for a corporation to breach its contract and pay damages than to perform its contract with a third party.[180] Here, it would not make sense to hold the director or officer who had authority to procure the breach of the contract and who acted in the best interests of his corporation personally liable.[181] This, however, is unique to the tort of inducing breach of contract. For other intentional torts, there are no convincing reasons which could justify a discrimination with regard to the liability question in favour of directors as against other actors in society.

II. Negligent Torts

In this section, the possibilities to hold directors or officers personally liable for negligent torts will be examined. There will be some reference also to English cases in so far as these laid the basis, influenced and partly differ in their results from the approach taken in Canadian law. In addition, it will be necessary to mention some information and cases which concern the tort of negligence on a more general level and which are only indirectly linked to the question of directors' and officers' liability.

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[177] VanDuzer, *supra* note 1 at 308; see above at 32.
[178] VanDuzer, *supra* note 1 at 308; see above at 32.
[179] See Part C.I.1.b. at 29-30, above.
[180] *Ibid.*.

This will be done in order to grasp the particular issue of directors' and officers' personal liability for negligence in the broader context of the problems principally attached to all cases of negligent torts.

In general, the tort of negligence refers to a breach of a legal duty to take reasonable care, which results in damage suffered by the plaintiff.[182] In other words, one may also say that the tort of negligence is concerned with the damage caused by the defendant's failure to observe the appropriate standard of care required by law under the circumstances.[183] The defendant will usually be liable for damage caused through lack of care as long as the damage is not too remote.[184] The tort of negligence involves of a number of distinct elements: The defendant must owe a duty of care to the plaintiff, the defendant has to breach the duty owed and, in addition, the plaintiff needs to suffer damage as a result of the breach of duty. There should be a casual link between the damage and the breach of duty and the damage ought not be too remote.[185] As will be seen later on, policy concerns also play an important role in order to determine whether a defendant will be held liable.[186]

The first part of the following text will deal with the existence and standard of a duty of care of a director of officer towards a third party (1.). The second part will discuss whether acting within the scope of his or her duties when the negligent tort occurs represents a valid excuse for a director or officer and therefore exempts him or her

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[181] *Ibid.*.
[182] W. V. H. Rogers, *Winfield and Jolowicz on Tort*, 16th ed. (London: Sweet & Maxwell, 2002) at 101; Klar, *supra* note 46 at 148; see also *Heaven v. Pender* (1883), 11 Q.B.D. 503 at 507 (C.A.).
[183] Bryan A. Garner, ed., *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West Group, 1999), *s.v.* "negligent tort".
[184] Klar, *supra* note 46 at 417.
[185] *Ibid.* at 149-50.
[186] *Ibid.* at 161-63; *Winfield and Jolowicz on Tort*, *supra* note 182 at 101.

from liability (2.). In this context, it will be attempted to examine the potential consequences of ADGA with regard to liability for negligent torts.

1. The Existence and Standard of a Duty of Care

In this part, it will be explored under what circumstances a personal duty of care of a director or officer may be presumed towards a third party. In addition, the standard of such a duty of care if it can be said to exist will be mentioned. This will be done in a first part where also the "neighbour" or "proximity" analysis as a general test to determine the existence of a duty of care will be introduced (a.). It turns out that it is much harder to determine the circumstances giving rise to the existence of a duty of care of a director or officer towards a third party than it is to establish the standard of such a duty of care. In a second part, special criteria to test the existence of a duty of care in cases involving the recovery of pure economic loss will be presented (b.). This part will also mention recent tendencies in Canadian jurisprudence to combine the *Anns* test with a reliance-based approach which can also be found in English cases and which in *London Drugs* has been referred to in the dissenting opinion of La Forest J..

a. The "Neighbour" or "Proximity" Analysis: A First General Principle for All Negligent Torts

When it comes to personal liability of directors and officers for negligent torts, the main controversy seems to be about what test or criteria to apply to determine when a duty of care *exists* towards the third party. With regard to the standard of care, once the courts find that a duty is owed by a director or officer to a third party, they appear to apply the general negligence standard of the reasonable person.[187] This is actually contrary to the situation where the duty of care is owed to the corporation instead of a

[187] Flannigan, "Personal Tort Liability of Directors", *supra* note 21 at 273.

third party. In this case, the existence of the duty of care is generally unproblematic while the required standard of care represents the indecisive issue.[188] The difference, in the end, may result from the duty owed to the corporation being a duty to manage and not a duty to avoid causing harm. The duty owed to the corporation represents in a sense a status obligation, connected to the office of "director", whereas the duty of directors owed to third parties is not. Accordingly, the duty owed to third parties arises under the general law when certain criteria are satisfied.[189] As a conventional agency or tort law matter, the rule is that agents are liable for negligent conduct that causes injury to their "neighbours".[190] It was in *Donoghue v. Stevenson*[191] that the "neighbour" test was declared to be the criteria generally applicable to determine whether a duty of care exists.[192] "Neighbours", according to Lord Atkin in *Donoghue v. Stevenson*, are persons "who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I'm directing my mind to the acts or omissions which are called into question".[193]

With regard to the liability of directors for negligent acts, it was not clear from the beginning that the "neighbour" test would be accepted as criteria to decide about the existence of a duty of care: The English case of *Wilson v. Lord Bury*[194], where a creditor sued for capital lost through the negligence of directors, seems to be based on the assumption that a duty of care could only exist if there was a contractual relationship between the directors in their personal capacities and the creditor.[195] The case does not mention in any way that liability could be independently imposed on the

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[188] *Ibid.*.
[189] *Ibid.*.
[190] *Ibid.*.
[191] [1932] AC 562.
[192] Klar, *supra* note 46 at 153.
[193] *Donoghue v. Stevenson*, *supra* note 191 at 580.
[194] (1880), 5 Q.B.D. 518.

directors through the application of the general tort law duty of care.[196] It was soon, however, that the "neighbour" test was used in order to establish a duty of care in the context of directors' personal liability to third parties for negligence: The Supreme Court of Canada took up this approach in the decision of *Lewis v. Boutilier*[197] where the defendant, the president of a company, had personally put a young employee to work in a dangerous place, thereby negligently causing his death. The court applied the "neighbour" test of the general law of negligence without making any suggestion that the absence of a contractual relationship between the president and the employee was in any way problematic.[198] Also the decision in the English case *Yuille v. B. & B. Fisheries (Leigh), Ltd.*[199], in the end, was based on the "neighbour" test of the general law of negligence after the two different possible approaches had been considered before by the court. The "neighbourhood" principle was subsequently applied in cases throughout the Commonwealth.[200]

Still today, the "neighbour" principle is being used as a means to decide whether a director owes a duty of care to a third party. One example of a newer case referring to the "neighbour" analysis to establish a duty of care between the president of a company and one of its employees is *Berger v. Willowdale A.M.C.*[201]. The employee slipped on the sidewalk when leaving work after a snowstorm. Since the Workmen's Compensation Act barred her from suing the corporate employer in tort, she sued the president of the corporation personally, alleging negligence. The Ontario Court of Appeal came to the conclusion that the president was, indeed, personally liable. It

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[195] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 273.
[196] *Ibid.*.
[197] (1919), 52 D.L.R. 383 (S.C.C.).
[198] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 274.
[199] [1958] 2 Lloyd's Rep. 596 (Adm. Ct.).
[200] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 275.

reasoned that the plaintiff was a "neighbour" whom the president of the company "ought reasonably to have had in contemplation", that the danger must have been apparent to the president and the he had the authority and ability to control the situation as well as the access to the means to rectify the danger.[202] The result of this case has attracted some criticism, in particular, from Welling who deplores that the special relationship giving rise to a duty of care between the president and the employee was established only by virtue of the president's position in the corporation.[203] Welling, in general, argues for a *separate* special relationship between director and third party as a condition to be able to hold the director personally liable.[204] According to him, it should not be possible to simply derive a director's duty of care from the corporation having a duty arising out of its relationship to the plaintiff and the tortious actions occurring in the general area of the director's responsibility. In such a situation, Welling claims, the director should be considered merely the "human manifestation of the corporation" and, as such, should not be held liable.[205]

La Forest J. in his dissenting opinion in *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*[206], seems to have taken an approach similar to that of Welling. The case was actually not about directors' or officers' but about employees' personal liability for negligence (the claim against the corporate employer was barred by a contractual limitation of liability clause). However, the case is also of interest with regard to the present topic since it raises general questions about what test to apply in order to establish a personal duty of care of corporate agents towards third parties. La

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[201] (1983), 145 D.L.R. (3d) 247 (Ont. C.A.), leave to appeal refused, (1983), 145 D.L.R. (3d) 247*n* (S.C.C.) [*Berger v. Willowdale* cited to D.L.R. (Ont. C.A.)].
[202] *Ibid.* at 254.
[203] VanDuzer, *supra* note 1 at 103.
[204] Welling, *Corporate Law in Canada*, *supra* note 32 at 116-17.
[205] *Ibid.*.
[206] *Supra* note 99.

Forest J., similar to Welling, argued for a narrow "independent duty of care", in the sense that a personal duty of care should only be assumed where there is a relationship between a corporate employee and a third party that is wholly unrelated to the performance of the employment contract.[207] La Forest J. suggested the application of a two-stage test.[208] The first step of the test consists of the distinction whether the alleged tort is independent or whether it is related to the performance of the employee's employment contract. In the case of the tort being independent, liability will attach. Only if the tort is related to the employment contract, will it need to be established in the second step of the test that there was *reasonable reliance* by the plaintiff on the individual employee in order for the latter to be held liable personally.[209] The main point of La Forest J. position is that an employee acting in the course of his or her duties can only be personally liable to his or her employer's customer when there is a specific and reasonable reliance by the customer to the employee.[210] La Forest J. even notes further that:

> In most if not all situations, reliance on an employee will not be reasonable in the absence of an express or implied undertaking of responsibility by the employee to the plaintiff. Mere performance of the contract by the employee, without more, is no evidence of the existence of such an undertaking since performance is required under the employee's contract with the employer.[211]

La Forest J. opinion, however, was not that of the majority of the Supreme Court of Canada in London Drugs. Instead, the Supreme Court applied and still applies the duty of care test founded on Lord Wilberforce's decision in *Anns v. Merton London*

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[207] *London Drugs*, *supra* note 99 at 303-04, La Forest J., dissenting.
[208] *Ibid.* at 305-06.
[209] *Ibid.*.
[210] Feasby, *supra* note 82 at 299.
[211] *London Drugs*, *supra* note 99 at 305-06, La Forest J., dissenting. The same thought was taken up again by La Forest J. in his concurring reasons in *Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd.*, [1993] 3 S.C.R. 206, 107 D.L.R. (4th) 169 [*Edgeworth Construction* cited to S.C.R.] (A claim was made both against the individual engineers involved in the case and the contracting engineering firm).

Borough Council[212] which the House of Lord itself actually already overruled.[213] The *Anns* test may be considered a kind of specification of the standard "neighbour" test set out in *Donoghue v. Stevenson*[214]. Originally developed and applied in order to deal with new and emerging claims in several modified duty of care situations (maybe most notably, liability for failing to control and protect, liability for pure economic losses and liability for public authorities), the Supreme Court of Canada has, in recent years, adopted *Anns* as a more general test of the duty of care.[215] The *Anns* test also consists of two steps, the first one referring to the principles established in *Donoghue v. Stevenson*. Under this step, the court must ask:

> ... whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter, in which case a *prima facie* duty of care arises [emphasis added].[216]

Provided that the conditions under the first step are satisfied, it will be tested in a second step whether there are any policy concerns which make it necessary to modify the preliminary result with respect to the scope of the duty of care. The court has to consider:

> ... whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom the duty is owed or the damages to which a breach of it may give rise.[217]

Applying the *Anns* test, Iacobucci J. speaking for the majority of the Supreme Court came to the conclusion that in *London Drugs* it had been reasonably foreseeable that

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[212] [1977] 2 All E.R. 492 (H.L.) [*Anns*].
[213] Feasby, supra note 82 at 301/302; Robert M. Solomon, R.M. Kostal & Mitchell McInnes, *Cases and Materials on The Law of Torts*, 5th ed. (Scarborough, Ontario: Carswell, 2000) at 6. The *Anns* test was overruled by the House of Lords in *Murphy v. Brentwood District Council*, [1990] 2 All E.R. 908 because it was considered too open-ended. The House of Lords announced that new duties should be based on logical extensions of existing precedents and should evolve on a category-by-category basis.
[214] [1932] AC 562.
[215] Solomon, Kostal & McInnes, *ibid.* at 221-22.
[216] *Anns*, *supra* note 212 at 498 (H.L.).
[217] *Ibid.*.

negligence on the part of the defendant employees would result in damages to the plaintiff's property. A modification of this result in view of policy concerns was rejected on the grounds that:

> There is no general rule in Canada to the effect that an employee acting in the course of his or her employment and performing the "very essence" of his or her employer's contractual obligations with a customer, does not owe a duty of care, whether one labels it "independent" or otherwise, to the employer's customer.[218]

Since the Supreme Court of Canada applies *Anns* as a general test to check whether a duty of care exists in a particular case, the criteria set out may also be used to establish a personal duty of care of a director or officer towards a third party. The result of the "neighbourhood" or "proximity" test, developed in *Donoghue v. Stevenson* and specified in *Anns*, is generally that corporate agents will often be found to have a *prima facie* duty of care to parties contracting with the corporation and even to strangers as long as the consequences of their negligent actions are foreseeable. In addition, the majority in *London Drugs* did not recognize the situation where an employee acts in the course of his or her duties as a valid policy concern to deny a personal duty of care towards a third party, and this even not where the employee only acts in order to perform the contractual obligations of his or her employer towards this third party. It is not sure, however, whether also for directors and officers the case where they act within the scope of their duties in the best interests of the corporation is not able to exempt them from personal liability. *Scotia McLeod* actually did exempt directors and officers from liability in such a situation in a case of negligent misrepresentation. *ADGA* may, however, have revised this result and extended the

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[218] *London Drugs*, *supra* note 99 at 300.

scope of liability also with regard to negligent conduct on behalf of directors and officers.[219]

b. Specifications with Regard to the Recovery of Pure Economic Loss

While the "neighbour" principle is still referred to today, in particular, by Canadian courts, there has been a significant qualification with respect to liability involving the recovery of economic loss.[220] The discussion around liability for negligent torts resulting in pure economic loss will be outlined shortly in the following as far as the issue is of relevance with regard to liability of directors.

Concerns with respect to negligence claims by third parties for economic loss have been expressed throughout the Commonwealth.[221] In *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*[222], the House of Lords accepted the possibility of recovery for economic loss in the case of negligent misstatement. The House of Lords stated that liability will be imposed where there is a "special relationship" between the parties.[223] There ought to be sufficient proximity between the parties and the defendant must be held to have assumed responsibility for the statement, as for example when he is

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[219] Further discussion of the impact of *ADGA* on the issue of personal liability of directors and officers for negligent torts in Part 2. at 56-61, below.
[220] Flannigan, "Personal Tort Law Liability of Directors", supra note 21 at 303, 307.
[221] *Ibid.* at 303. The argument which is most often put forward to limit the recovery of economic loss is that of „indeterminate" exposure. According to Cardozo J. in *Ultramares Corporation v. Touche*, 174 N.E. 441 at 444 (NY App 1931), the mischief would be „liability in an indeterminate amount for an indeterminate time to an indeterminate class." Flannigan, *ibid.* at 305, n. 259, however, doubts that this concern is of any real significance. He argues that the extent to which recovery for the negligent infliction of economic loss should be permitted is a question of content and that every loss is, before the fact, an indeterminate one which must await the crystallization of the particular damage caused by the tortious conduct. In addition, he emphasizes that law has established general quantum (f. ex. the level of personal bankruptcy) and temporal (limitation periods) caps on liability. In his view, it also seems that judges are relatively comfortable in dismissing or discounting the indeterminancy concern on the facts.
[222] [1963] 2 All E.R. 575 (H.L.) [*Hedley Byrne*].
[223] Demetra Arsalidou, *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (The Hague/London/Boston: Kluwer Law International, 2001) at 104.

aware of the fact that the plaintiff will rely on it.[224] Lord Morris of Borth-y-Gest explained on behalf of the House of Lords that a special relationship between the parties may be assumed if a person:

> ... is so placed that others could *reasonably rely* upon his judgement or his skill or upon his ability to make careful inquiry, [and] a person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise [emphasis added].[225]

After some more judicial discussion in the years following the decision, the House of Lords confirmed in *Henderson v. Merret Syndicates Ltd.*[226] that economic loss was recoverable if there had been an "assumption of responsibility". In the eyes of Lord Goff, *Hedley Byrne* had:

> ... established that, in certain circumstances, a duty of care may exist in respect of words as well as deeds, and further that liability may arise in negligence in respect of pure economic loss which is not parasitic upon physical damage.[227]

The rationale presented by Lord Goff was that:

> the concept provides its own explanation why there is no problem in cases of this kind about liability for pure economic loss; for if a person assumes responsibility to another in respect to certain services, there is no reason why he should not be held liable in damages for that other in respect of economic loss which flows from the negligent performance of these services.[228]

The new aspect with regard to *Henderson* was that it explicitly stated that the "assumption of responsibility" test set out in *Hedley Byrne* was not confined to statements but could also be extended to apply to any "assumption of responsibility" for the provision of services.[229]

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[224] *Ibid.*.
[225] *Hedley Byrne*, *supra* note 222 at 594.
[226] [1994] 3 All E.R. 506 (H.L.) [*Henderson*].
[227] *Ibid.* at 518.
[228] *Ibid.* at 521.
[229] Arsalidou, *supra* note 223 at 115.

It was a couple of years later, in *Williams v. Natural Life Health Foods Ltd.*[230], that the House of Lords had the occasion to specifically confirm the application to directors of the "assumption of responsibility" test for third party economic loss claims in negligence. Referring to both, *Hedley Byrne* and *Henderson*, Lord Steyn for the House of Lords, stated that:

> The extended *Hedley Byrne* principle is the rationalization or technique adopted by English law to provide a remedy for the recovery of damages in respect of economic loss caused by the negligent performance of services.[231]

Applied to the facts of the case, the "assumption of responsibility" test did, in the end, not result in the personal liability of Mr. Mistlin, the primary shareholder and director of the defendant's company, Natural Life Health Foods Ltd.: In the case, the plaintiff had purchased a retail health food franchise from Natural Life Health Foods Ltd. that had presented itself as having the necessary expertise to provide the reliable advice to franchisees. In the company's brochure, it was pointed out that the expertise was derived from Mr. Mistlin's experience in operating his own shop, but in the House of Lords it was estimated that those circumstances were insufficient to make him personally liable to the plaintiff.[232] The House of Lords, through Lord Steyn, went on to clarify that a director of a contracting company might only be held liable where it was shown that he had assumed personal liability and that there had been the necessary actual reliance by the plaintiff. As there were no personal dealings between the parties or exchanges or conduct that could have made the plaintiff believe that the defendant was willing to assume personal responsibility, it was concluded that there was nothing to show that Mr. Mistlin was willing to be personally answerable to the

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[230] [1998] 1 W.L.R. 830 (H.L.) [*Williams*]. See also *Burns v. Shuttlehurst Ltd.*, [1999] 2 All E.R. 27 (C.A.); *Hamble Fisheries Ltd. v. L. Gardner & Sons Ltd.*, [1998] E.W.J. No. 3530 (C.A.) (QL).
[231] *Williams*, *ibid.* at 834.
[232] *Ibid.* at 838.

company's customers.[233] The fact that in a small company the managing director's qualities can be esteemed vital for the functioning of the company, was not considered to represent by itself already an indication for the director being, indeed, ready to assume personal responsibility.[234] In fact, to see this already as an indication, according to Lord Steyn, would mean to deny the very purpose of incorporation.[235]

The issue of recovery of pure economic loss will not be explored further in the context of this study. The topic is of general relevance in tort law and there is nothing with respect to directors that would demand a different or distinct approach to the question once they are involved.[236] It is important to note, however, that the "assumption of responsibility" test seems to be reserved solely for negligence claims involving pure economic loss. With regard to claims for economic loss associated with personal injury or damage to property, courts have denied its application so that the "neighbour" test will continue to be the relevant criteria.[237] It is also important to note that, in the end, the courts may always as a matter of *policy* deny liability in tort for negligent conduct.[238] Even though controversies remain[239], the "assumption of responsibility" test can be said to represent the current answer of English law with regard to directors' personal liability for negligent acts resulting in pure economic loss.[240]

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[233] *Ibid.*.
[234] *Ibid.*.
[235] Feasby, *supra* note 82 at 301; *Williams*, *ibid.*.
[236] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 306.
[237] *Ibid.*.
[238] Klar, *supra* note 46 at 161-63; *Winfield and Jolowicz on Tort*, *supra* note 182 at 101.
[239] See f. ex. *Bellefield Computer Services Ltd. v. E. Turner & Sons Ltd.*, [2000] E.W.J. No. 320 (C.A.) (QL); *Merret v. Babb*, [2001] 3 W.L.R. 1 (C.A.); *Parkinson v. St. James and Seacroft University Hospital NHS Trust*, [2001] E.W.J. No. 1761 (C.A.) (QL); *Smith v. Eric S. Bush*, [1989] 2 All E.R. 514 (H.L.); *Caparo Industries plc v. Dickman*, [1990] 1 All E.R. 568 (H.L.).
[240] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 306.

Canadian courts, although also struggling with the economic loss question, have not really given notice to the English developments in this area.[241] In particular, *Williams v. Natural Life Health Foods Ltd.* has not captured much attention.[242] Instead, Canadian courts with regard to cases involving economic loss still use the two-stages *Anns* test which in English law has already been rejected.[243] The application of this test has, in recent years, been more and more extended to negligent torts in general as a specification of the also still used standard "neighbour" principle.[244] In addition, several cases seem to repeat some of the confusions generated in the intentional tort cases.[245] There is, however, a tendency in more recent cases to mention *reliance* as a factor affecting proximity under the first branch of the *Anns* test.[246] This seems to represent a shift towards the approach set out in *Hedley Byrne* or taken by La Forest J. in his dissenting opinion in *London Drugs*. Both, the House of Lords in *Hedley Byrne* and thereafter in *Henderson* and *Williams* as well as La Forest J. in his dissenting opinion in *London Drugs*, used *reasonable reliance* as a criteria to test the existence of a special relationship between the plaintiff and the defendant which would give rise

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[241] *Ibid.* at 306-07.
[242] *Ibid.* 307. One of the few Canadian cases citing *Williams* has been *Millgate Financial Corp. v. B.F. Realty Holdings Ltd.* (1998), 28 C.P.C. (4th) 72 (Ont. Gen. Div.).
[243] Flannigan, *ibid.* at 307; Solomon, Kostal & McInnes, *supra* note 213 at 6, 221.
[244] Solomon, Kostal & McInnes, *ibid.* at 221/222; Flannigan, *ibid.* at 307. Examples for cases referring to the standard "neighbour" analysis or the qualified "proximity" test of *Anns* are: *Medina v. Danbury Sales (1971) Ltd.*, [1991] O.J. No. 2225 (Ont. Gen. Div.) (QL); *Hall-Chem Inc. v. Vulcan Packaging Inc.* (1994), 12 B.L.R. (2d) 274 (Ont. Gen. Div.); *British Columbia v. R.B.O. Architecture Inc.* (1994), 27 C.P.C. (3d) 80 (B.C.C.A.); *Nairne v. Wagon Wheel Ranch Ltd.*, [1995] O.J. No. 1234 (Ont. Gen. Div.) (QL), affid. [1998] O.J. No. 533 (Ont. C. A.) (QL), *NBD Bank, Canada v. Dofasco Inc.* (1999), 181 D.L.R. (4th) 37 (Ontario C.A.), leave to appeal refused (2000), 183 D.L.R. (4th) vii (S.C.C.), *Anger v. Berkshire Investment Group Inc.*, [2001] O.A.C. 301.
[245] Flannigan, *ibid.* at 307. Examples are: *Leon Kentridge Associates v. Save Toronto's Official Plan Inc.*, [1990] O.J. No. 488 (Ont. Dist. Ct.) (QL); *Hopwood v. 927463 Ontario Ltd.*, [1995] O.J. No. 3184 (Ont. Gen. Div.) (QL); *Highberm Holdings Inc. v. Ronzino*, [1994] O.J. No. 2035 (Ont. Gen. Div.) (QL); *Power Contracting Inc. v. Falby*, (1995), 20 C.L.R. (2d) 100 (Ont. Gen. Div.); *Scotia McLeod v. Peoples Jewellers Limited* (1995), 129 D.L.R. (4th) 711 (Ont. C.A.); *McKinley Transport Ltd. v. Motor Transport Industrial Relations Bureau of Ontario* (Inc.), (1996), 96 C.L.L.C. 210 (Ont. Gen. Div.); *Toronto Dominion Bank v. Alfred*, (1996), 28 C.L.R. (2d) 163 (Ont. Gen. Div.); *Rushton v. Condominium Plan No. 8820668*, (1997) 202 A.R. 299 (Alta Q.B.). See also *MacEwen Petroleum Inc. v. Petro-Canada*, [2001] O.J. No. 2362 (Ont. Sup. Ct.) (QL).
[246] Feasby, *supra* note 82 at 302.

to a duty of care.[247] In *Hercules Management Ltd. v. Ernst & Young*, a case on auditors' liability for negligent misrepresentation giving rise to pure economic loss, La Forest J., this time for the majority of the Supreme Court of Canada, held that proximity exists where *reliance* on statements is both *foreseeable and reasonable.*[248] For cases involving negligent torts causing physical or property damage the criteria is said to be only that of *reasonable foreseeability* since it can be estimated, according to La Forest J., that it is always reasonable for a plaintiff to expect that a defendant will take reasonable care of the plaintiff's person and property.[249] Faced with the problem that auditors might be confronted with potentially limitless claims for pure economic loss arising from errors in financial statements, La Forest J. ended up denying the auditors' liability in *Hercules*, therefore giving notice to "special considerations" under the second branch of the *Anns* test.[250] *Reliance* was also taken up as a factor to determine proximity under the first branch of the *Anns* test in *NBD Bank Canada v. Dofasco Inc.*[251], a case affirming the personal liability of the vice president of a corporation for negligent misrepresentation as well as in *Anger v. Berkshire Investment Group Inc.*[252], a case about the personal liability of officers and directors of a corporation for negligence. In *Anger*, the court rejected the argument of the individual defendants that they only owed a duty towards their corporation by citing ADGA and the decisions following it.[253]

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[247] See above at 51. In fact, Lord Steyn in *Williams*, *supra* note 230 at 837 even refers to La Forest J.'s reasoning in *London Drugs* and *Edgeworth Construction* when he states that „[La Forest J.'s] reasoning is instructive. The test is whether the plaintiff could *reasonably* rely on an assumption of personal responsibility by the individual who performed the services on behalf of the company.".

[248] *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, 146 D.L.R. (4th) 577 [*Hercules* cited to S.C.R.] at 188.

[249] *Ibid.* at 189. The only exception to this rule is the case where the plaintiff voluntary assumes a risk for his or her property or physical integrity.

[250] Feasby, *supra* note 82 at 303-04.

[251] (1999), 46 O.R. (3d) 514, 181 D.L.R. (4th) 37, 127 O.A.C. 338 (C.A.), leave to appeal to S.C.C. refused [2000] 1 S.C.R. x, 183 D.L.R. (4th) vii.

[252] (2001), 141 O.A.C. 301 (C.A.). The plaintiffs sued the defendants for their respective roles in persuading the plaintiffs to make improvident investments in certain limited partnerships.

[253] *Ibid.* at 305-06 (para. 11) (C.A.).

2. Acting within the Scope of Authority – A Valid Defence for Directors Involved in a Negligent Tort?: ADGA and its Consequences

In the following, it will be examined whether acting within the scope of authority may protect directors and officers from personal liability for negligent torts. It will be discussed in how far the above outlined decision of the Ontario Court of Appeal in *ADGA* may be of relevance with regard to this issue.

There is the valid policy concern that directors and officers do have to be able to take certain risks when they take part in running the business without always having to fear personal liability every time they assume responsibility.[254] If too much threatened by the risk of incurring personal liability, directors and officers might be inhibited to take any risks which is contrary to their job and the corporation's interest.[255] However, the decision of the Ontario Court of Appeal in *ADGA* may be interpreted as a shift in Canadian law towards a wide scope of personal liability of directors and officers also in the context of negligent torts committed in the course of their duties. The question is whether this was really intended by the Court of Appeal, though.

On the one hand, the facts in *ADGA* reveal that the conduct of the defendant director was intentional. This argues for the decision only being of relevance with regard to intentional torts committed by a director or officer. Following this interpretation, the result of *ADGA* is that where directors or officers commit intentional torts the fact that they acted within the scope of their authorities and in the best interest of the corporation does not exempt them from liability, except for the case where the

[254] Arsalidou, *supra* note 223 at 116.
[255] *Ibid.*.

intentional tort committed is that of inducing breach of contract following *Said v. Butt*. This interpretation of *ADGA* is further supported by the court's conclusion with regard to the adoption of La Forest J.'s distinction between voluntary and involuntary creditors. The court, although generally in favour of introducing a further exemption from liability for corporate agents who acted in the best interests of the corporation with parties who have voluntarily chosen to accept the ambit of risk of a limited liability company, says that the creation of such a policy cannot evolve from the facts in *ADGA* since the conduct in question here was intentional. The court therefore gives notice to the fact that La Forest J.'s approach was developed in and for the context of negligence torts and concludes that it is not in the position to change the law with regard to negligence based on the case in front of it dealing with intentional tort.

On the other hand, the fact that the Ontario Court of Appeal does mention the approach of La Forest J. in his dissenting opinion in London Drugs at all, although it is an approach suitable for negligent torts only, argues for the intention of the court to pronounce a judgement which will also have an impact on liability for negligent torts. The court may have mentioned and approved La Forest J.'s idea to differentiate between voluntary and involuntary creditors only because it felt that it was rendering a decision which would also affect claims for liability concerning negligent torts. That the court did not already adopt La Forest J.'s approach might have been only because it felt that it was restricted by the facts of the case. Another argument for the court in *ADGA* intending to render a decision which will also have an impact on liability for negligent torts is the mentioning and clarification of *Scotia McLeod v. Peoples Jewellers*[256], a case involving a personal claim against directors and officers for

[256] *Supra* note 48.

negligent misrepresentation. In *Scotia McLeod*, the Ontario Court of Appeal had made the statement that:

> ... Absent allegations which fit within categories described above, officers and employees of limited companies are protected form 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 as to make the act or conduct complained of their own.[257]

This could and was understood in the way that, at least in the case of negligent misrepresentation or other negligent torts if not in general, a director or officer would be exempted from personal laibility where he or she committed the tort whithin the scope of his or her duties in the best interests of the coporation.[258] In *ADGA*, the Ontario Court of Appeal, however, gave a different interpretation of this passage by pointing out:

> The operative portion of this paragraph is the final sentence which confirms that, where properly pleaded, officers or employees can be liable for tortious conduct even when acting in the course of duty.[259]

The Ontario Court of Appeal in *ADGA* chose to pick *Scotia McLeod*, a case involving a negligent tort, to clarify that acting in the course of duty would not provide an admissible defence against a claim for personal liability of a corporate agent. Considering this, it seems likely that the court, indeed, had the intention for its judgement to have an impact also on the law of liability for negligent torts. Following this interpretation, *ADGA* can be understood to generally reject the defence of corporate agents that they were acting within the scope of their authority and in the best interests of the corporation when it comes to personal liability for all torts including negligence. The only situation where such a defence is admitted, then, is in the case of tort of inducing contract as set out in *Said v. Butt*.

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[257] *Scotia McLeod, supra* note 48 at 490-91.
[258] See above at 18.

Although there are some good arguments for the assumption that the Ontario Court of Appeal rendering its decision in *ADGA* actually intended to make a statement also with regard to liability for negligent torts, there still remains some uncertainty with respect to this issue. This uncertainty is mostly due to the court in *ADGA* not clearly distinguishing between intentional and negligent torts.[260] For example, one can not be really sure whether the court referred to *Scotia McLeod* because it, in fact, had the intention to regulate also the law with regard to liability for negligent torts or simply because the defendants in *ADGA* happened to refer to having acted within the scope of their duties in the best interests of their corporation as a potential defence, a notion that also appeared in *Scotia McLeod.* One will therefore have to await further clarification by Canadian courts in the future. For now, however, it looks like the court in ADGA chose to reconcile the earlier judgements in Scotia McLeod and London Drugs by using the broader approach of the majority in London Drugs as a basis of this reconciliation.[261] By placing the issues in ADGA within the context of personal liability of corporate agents in general, the Ontario Court of Appeal expands the ambit of directors' and officers' liability substantially.[262] Once a court in the future dealing with adequate facts will chose to officially adopt the distinction of La Forest J. in his dissenting opinion in London Drugs between voluntary and involuntary creditors as suggested already by the court in ADGA, the scope of personal liability of corporate actors will be reduced again to a more reasonable level. At that time, directors and officers will only be held liable for negligent torts committed against strangers and for negligent torts committed against third parties who are in a contractual relationship with the corporation but where the negligent conduct occurs

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[259] *ADGA*, *supra* note 41 at 49 (para. 39).
[260] Feasby, *supra* note 82 at 298.
[261] *Ibid.* at 291.
[262] *Ibid.* at 291, 298.

under circumstances unrelated to that contract. With regard to negligent torts committed in the context of the performance of the contract between the corporation and the third party, corporate agents will be exempted from personal liability since the third party can be said to have voluntarily chosen to accept the ambit of risk of a limited liability company. Until the adoption of this policy, however, corporate agents, after *ADGA*, run a great risk to be held personally liable for all negligent torts, including those occurring within the scope of their regular duties. This broad scope of liability may create problems with regard to the effective functioning of business.[263] As already mentioned directors and officers do have to take certain risks when running a business and they may be inhibited to take those risks because of the fear to be held personally liable every time they assume responsibility. The job of director or officer may become eventually "a job nobody wants".[264] And although directors and officers will generally be insured by their corporations for the risks of personal liability, this does not solve the problem since directors' and officers' (D&O) insurance premiums may rise substantially with the greater risk of liability therefore creating great costs for corporations.[265] Another possibility is that more and more clauses will be included in D&O insurance contracts excluding liability for situations presenting too much of a risk.[266] One may also argue that a too broad personal liability of the people acting on behalf of the corporation contradicts with the original purpose

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[263] This problematic is actually also being acknowledged by the Ontario Court of Appeal in *ADGA*, supra note 41 at 104-05. This is probably the reason why the court also argues so much in favour of the distinction between voluntary and involuntary creditors developed by La Forest J. in his dissenting opinion in London Drugs. However, the court does not officially adopt this policy since it does not see itself confronted with the adequate facts to do so. The argument in how far it may be economically desirable to limit the personal liability of directors will be taken up and further analysed in the final conclusions, see Chapter 4 at 108-17.

[264] See introductory part of: Karl Kreuzer, ed., *Die Haftung der Leitungsorgane von Kapitalgesellschaften*, 1st ed. (Baden-Baden: Nomos, 1991) at 7 (citation from the front page of the Business Week of Sept. 8th, 1986).

[265] *Ibid.* at 7.

[266] *Ibid.*.

of incorporation.[267] The only hope of corporate agents for now is that the claim for liability might already fail because it is impossible to establish a special relationship giving rise to a duty of care or because there may be policy concerns in the particular case that induce the court to limit the scope of the duty under the second step of the *Anns* test. This, however, does not present a principled solution and results may not be very predictable, therefore giving rise to more uncertainty in this area of law.

3. Conclusion on Liability for Negligence

With regard to directors' and officers' personal liability for negligent torts, it seems harder to agree on the applicable criteria to determine whether a duty of care *exists* than to agree on the standard of such a duty of care once it is affirmed. Courts appear to apply the general negligence standard of the reasonable person also with regard to directors and officers if a duty of care could be presumed. In general, the "neighbour" or "proximity" test serves as a means to decide on the existence of a duty of care of a director or officer towards a third party. For the generally problematic issue of the recovery of pure economic loss, the House of Lords has introduced a specific test to determine whether a duty of care exists, the "assumption of responsibility" test. Canadian courts have not followed the English jurisprudence in this area and are still applying the two-stages *Anns* test, first referring to "neighbourhood" or "proximity" as the criteria to inquire about the existence of a duty of care and then, secondly, considering policy concerns with regard to the particular case in order to limit the scope of liability where it is deemed necessary. The *Anns* test has lately been more and more extended by the Supreme Court of Canada to become a more general test of

[267] This seems to be the opinion of Feasby, *supra* note 82 at 306-07, who suggests that the principles of corporate law should be used to define a solution with regard to the issue of directors' and officers' liability. He proposes to go back to the example of Salomon and to re-conceive problems as if they were the problems of a one-person company.

the duty of care. A recent tendency in Canadian law is to combine the standard *Anns* test with a reliance-based approach which can also be found as an element in the "assumption of responsibility" test introduced by the House of Lords as well as in La Forest J.'s dissenting opinion in *London Drugs*. Reasonable and foreseeable reliance (in the case of economic loss) or just foreseeable reliance (in the case of property or physical damage) has become a factor to determine sufficient proximity to give rise to a duty of care.

Since the Ontario Court of Appeal's decision in *ADGA*, it is not sure whether acting within the scope of authority in the best interests of the corporation may still provide a valid defence for a director or officer confronted with a claim for personal liability for negligent torts. In fact, it seems more likely that the court in *ADGA* intended to exclude this argument in general as a defence in the context of all kinds of torts (except the one of inducing breach of contract). This, however, leads for now to a very broad scope of liability and may even prevent corporations from functioning effectively since it may inhibit directors and officers from taking those risks which actually need to be taken for the successful running of the business.[268] In addition, the wide risk of liability is likely to increase premiums of D&O insurances, therefore creating greater costs for corporations. It may also be that D&O insurances will try to protect themselves by including more and more clauses in their contracts to exclude coverage for risky situation. One might also argue that a too broad personal liability of the people acting on behalf of the corporation runs counter the original purpose of incorporation. The solution already pointed at by the Ontario Court of Appeal in *ADGA* seems to be the official adoption of La Forest's J. distinction between

[268] The argument in how far it may be economically desirable to limit the personal liability of directors will be taken up and further analysed in the final conclusions, see Chapter 4 at 107-14, below.

voluntary and involuntary creditors.[269] The adoption of La Forest's J. scheme will exempt directors and officers from personal liability where the commitment of the negligent tort occurs in the context of a contractual relationship with the third party, the reason for this being that the third party here can be said to have voluntarily chosen to accept the ambit of risk of a limited liability company. Where the commission of the negligent tort is unrelated to the contract or where the tort victim is a stranger to the corporation, personal liability will continue to attach. Until the official adoption of this principled and well-balanced liability scheme, directors and officers can only hope that courts may already deny the existence of a duty of care or limit the scope of liability for policy considerations in the particular case. This way, however, results may not be very predictable, therefore giving rise to more uncertainty in this area of law.

D. Conclusion on Common Law

The personal liability of directors and officers for intentional torts depends on the degree of his or her personal involvement. Where the director or officer has performed, ordered or procured the action causing the tort, he or she is likely to be found liable.[270] On the contrary, where an individual has only general management responsibilities in the area of the corporation's activities in which the tort was committed, but neither knows about nor is involved in the actions resulting in the tort, he or she is unlikely to be found personally liable. Directors and officers generally will not be found liable for the corporation's torts simply because of their positions

[269] See also Anne Marie Frauts and Adrien P. Cameron, "Officers' and Directors' Liability – Lessons from the Court" (2003) 27 Advocates' Quaterly 155 at 172 who argue in favour of personal liability except for the case of the tort of inducing breach of contract (*Said v. Butt* exception) and the case of a creditor choosing voluntarily to deal with a corporation when he or she can be assumed to be able to protect him- or herself adequately against the limited liability (The criteria suggested by Frauts and Cameron is that of „equal bargaining power".).

[270] See above at 32.

within the corporation.[271] At the same time, directors and officers are responsible for their tortious conduct even though the conduct was directed in a *bona fide* manner in the best interests of the corporation and within the scope of their authority.[272] This is subject only to the exception set out in *Said v. Butt* for the narrow case of the tort of inducing breach of contract.[273]

The personal liability of directors and officers for negligent torts depends on the existence of a duty of care between them and the third party as tort victim. In general, the "neighbour" or "proximity" test serves as a means to decide on the existence of a duty of care of a director or officer towards a third party.[274] For the generally problematic issue of the recovery of pure economic loss, the House of Lords has introduced a specific test to determine whether a duty of care exists, the "assumption of responsibility" test. Canadian courts have not followed the English jurisprudence in this area and are still applying the two-stage *Anns* test, first referring to "neighbourhood" or "proximity" as the criteria to inquire about the existence of a duty of care and then, secondly, considering policy concerns with regard to the particular case in order to limit the scope of liability where it is deemed necessary.[275] The *Anns* test has lately been more and more extended by the Supreme Court of Canada to become a more general test of the duty of care.[276] A recent tendency in Canadian law is to combine the standard *Anns* test with a reliance-based approach which can also be found as an element in the "assumption of responsibility" test introduced by the House of Lords as well as in La Forest J.'s dissenting opinion in *London Drugs*. Reasonable

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[271] See above at 32-3.
[272] See above at 29.
[273] *Ibid.*.
[274] See above at 49.
[275] See above at 54.
[276] *Ibid.*.

and foreseeable reliance (in the case of economic loss) or just foreseeable reliance (in the case of property or physical damage) has become a factor to determine sufficient proximity to give rise to a duty of care.[277] Since the Ontario Court of Appeal's decision in *ADGA*, it is not clear whether acting within the scope of authority in the best interests of the corporation may still provide a valid defence for a director or officer confronted with a claim for personal liability for negligent torts. In fact, it seems more likely that the court in *ADGA* intended to exclude this argument in general as a defence in the context of all kinds of torts (except the one of inducing breach of contract).[278]

The result of what has been said is a broad personal liability of directors and officers in tort. This may change again if ever the alternative liability framework of La Forest J. is adopted officially by the Supreme Court of Canada. In this case, voluntary creditors who contracted with a corporation would be limited to a claim against the legal entity as long as the tort is committed in the context of the performance of the contractual obligations. Even if the present broad liability concept remains unchanged, it is at least consistent with the idea that those who cause harm to others should be held responsible. Directors and officers acting on behalf of the corporation are treated just as any other agents with regard to their liability for torts. There have been many, however, who have criticized this new broad approach to liability of corporate managers. One criticism has been that the extended personal liability of directors and officers as agents of the corporation would interfere with its separate legal identity.[279] Since it would be the tort of the corporation, it is said that only the corporation could be held liable. Yet, this does not follow because the separate existence of the principal

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[277] *Ibid.*.
[278] See above at 56-60.

does not excuse the personal liability of an agent for tort in any other context.[280] Incorporation should not change this result for directors. The only effect of incorporation is to replace the corporation for the shareholders as principals.[281] Without the separate existence of the corporation, the directors would be the agents of the shareholders. With incorporation, they become agents of the corporate entity while the shareholders, who are not any more the principals, accept a new legal position defined by statue in relation to the corporation and to each other.[282] To consider this to involve a conflict with tort law would mean that there ought to be a deeper conflict between tort law and the general law of agency.[283] Another criticism has been that the broad concept of personal liability of corporate managers would eventually annul limited liability, in particular in the case of one-person corporations.[284] Yet, it has to be kept in mind that personal liability will not be attached to directors and officers merely because of their position within the corporation and that they cannot be held responsible for the torts of other employees unless they participate in, order or procure the tortious act.[285] Since these rules apply to all corporations no matter their size, they are all exposed to liability in the same way.[286] Directors of one-man corporations may only have a greater chances of being found liable since the low number of personnel makes it more likely that they are themselves participating in or ordering the tort.[287] To establish some exception with regard to the liability standard for directors of one-man corporations or to conclude from their situation that there should be a special liability standard for directors in general, would be to discriminate in their favour as

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[279] Feasby, *supra* note 82 at 307; Grantham & Rickett, *supra* note 134 at 137, 139.
[280] See also Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 281.
[281] *Ibid.*.
[282] *Ibid.*.
[283] *Ibid.*.
[284] Feasby, *supra* note 82 at 307.
[285] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 281.
[286] *Ibid.*.
[287] *Ibid.*.

against to all other actors in society. This, however, cannot be really considered socially desirable, especially since it is often one-man corporations that do not have adequate insurance to satisfy the claims of third party tort creditors.[288] In addition, the fact that directors take active part in the decision-making process as well as in the running of business and are not just passive investors as are shareholders in large corporations further justifies holding them liable in a wider range of circumstances.[289] On the contrary, restricting the personal liability of directors may encourage excessive risk taking on their part and the mechanisms within the corporation to dismiss and replace such directors may only be activated when much damage has already been done.[290] Claims against directors and officers which are made only for strategic reasons and to create pressure may already be sorted out by the requirement that the tortious allegations need to be specifically and properly pleaded.[291] However, there still remain some economic arguments (in particular, the ideas of risk aversion and overcompliance) that support a more restricted approach to directors' and officers' liability.[292]

CHAPTER 3: THE CIVIL LAW APPROACH: THE EXAMPLE OF GERMANY

After having explored under what circumstances directors and officers may be held personally liable according to the law of Ontario, a Common Law jurisdiction, this part will consist of a presentation of the circumstances which may provoke liability of the equivalent personnel under German Law as an example of a Civil Law jurisdiction (B.). The study will be preceded by a short definition of the terms of "director" and

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[288] *Ibid.*.
[289] Sarra, *supra* note 27 at 57.
[290] *Ibid.* at 57/58.
[291] This objection that claims may often be made just for strategic reasons has been f. ex. expressed by Feasby, *supra* note 82 at 293.
[292] See for a further analysis of these arguments the final conclusions, Chapter 4 at 107-14, below.

"officer" in German law (A.). While the preceding part describing the law of Ontario focussed on the personal liability of a director or officer of a corporation, the following part on German law will include observations about personal liability of directors of a corporation (the Aktiengesellschaft (AG)), and as well as of a limited liability company (the Gesellschaft mit beschränkter Haftung (GmbH)). The GmbH will also be taken into consideration because of the practical importance of the GmbH in the economic landscape of Germany. Also, both AG and GmbH raise the same issue of personal liability of those acting as agents on behalf of the business association while the association itself is considered as a separate legal entity. This is also the reason why the question of personal tort liability is answered identically in almost all the cases for directors and officers acting on behalf of one of these two business associations.[293] As long as not pointed out explicitly, the results presented in this study are valid for both forms of business associations, the AG and the GmbH.

A. Definition of "Director" and "Officer" under German Law

The following statements concerning the issue of personal liability of executives under German tort law will include observations about directors of a corporation as well as managing directors of a limited liability company.

With regard to large public companies, German law provides for a two-tier board structure.[294] The general idea is that the non-executive directors form a separate board, known as the "supervisory board" or "Aufsichtsrat".[295] The board of executive

[293] Holger Fleischer, "Frankreich: Außenhaftung der Geschäftsleiter" (1999) RIW 576 at 577; Dieter Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen im Zusammenhang mit Produktmängeln" (2002) GmbHR 809 [Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen"] at 809, note 1.
[294] Mayson, French & Ryan, *supra* note 11 at 451.
[295] *Ibid.*.

directors is referred to as the "management board" or "Vorstand".[296] The directors of the supervisory board have certain statutory functions, for example to appoint the members of the management board and to determine their remuneration.[297] The functions of the members of the management board include the organization of the running of business and the representation of the corporation.[298] Their position therefore is similar to that of an officer under Canadian law. For a limited liability company, the director's functions are the management of business and the representation of the association in and out of court.[299]

Generally, the explanations made hereafter will refer both to the directors of a corporation as well as to the managing director of a limited liability company. They will be referred to together as directors, executives or as management.

B. The Issue of Tort Liability of Directors towards Third Parties in German Law

In the following, it will be examined in how far directors can be held personally liable for the commission of a tort according to German Law. While Common Law seems to distinguish with regard to the character of the particular tort, asking for different conditions to be fulfilled for directors to be personally liable for intentional and negligent torts, the main distinction in German Law is between torts which a director committed directly (I.) and those torts in which he only can be said to have been indirectly involved in (II.).

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[296] *Ibid.*.
[297] *Ibid.* at 452.
[298] Burkhardt W. Meister & Martin H. Heidenhain, *The German Limited Liability Company*, 5th ed. (Frankfuhrt am Main: Fritz Knapp Verlag, 1988) note 5 at 20.
[299] *Ibid.* at 46.

I. Liability for the Direct Commission of a Tort

In German law, the case where a director has directly committed a tort is an unproblematic one. The director will be held liable personally for any conduct resulting directly in a tort.[300] The outcome is the same if the director has acted within the scope of his or her duties when he or she committed the tort: Acting within the scope of duties clearly is not considered to be a shield against personal liability under German Law.[301]

In the same way, where the liability of the legal entity he or she is representing could be established according to § 31 Bürgerliches Gesetzbuch[302], the director is not exempted from personal liability.[303] Instead, the director and the legal entity will be jointly liable according to § 840 BGB. Even if the contract of the director with the legal entity includes an exemption of liability clause, this is without effect considering the personal liability towards a third party. Such a clause will only have an internal impact in the way that the director can recover the damages paid to third parties from the corporation or limited liability company afterwards.[304]

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[300] Fleischer, *supra* note 293 at 582; Marcus Lutter, "Haftungsrisiken des Geschäftsführers einer GmbH" (1997) GmbHR 329 [Lutter, "Haftungsrisiken des Geschäftsführers einer GmbH"] at 334; Werner Groß, "Deliktische Außenhaftung des GmbH-Geschäftsführers" (1998) ZGR 551 at 552; Bernd Sandmann, *Die Haftung von Arbeitnehmern, Geschäftsführern und leitenden Angestellten* (Tübingen: Mohr Siebeck, 2001) at 428.

[301] Sandmann, *ibid.*.

[302] Version from 2nd Jan. 2002, BGBl. I at 42 (as amended) [BGB]. For the English translation of the norms, see Simon L. Goren, *The German Civil Code* (Littleton, Colorado: Fred B. Rothmann & Co., 1994).

[303] Groß, *supra* note 300 at 553; Marcus Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden im Unternehmen" (1993) 157 ZHR 464 [Lutter, "Zur persönlichen Haftung des Geschäftsführers im Unternehmen"] at 468. Whether the liability of the corporation or the limited liability partnership according to § 31 BGB presupposes the personal liabiliy of one of its directors or managing directors will be discussed in Part II.2.a. at 82-6, below.

[304] Dieter Medicus, "Zur deliktischen Eigenhaftung von Organpersonen" in: Bernhard Pfister, Michael R. Will, eds., *Festschrift für Werner Lorenz zum 70. Geburtstag* (Tübingen: Mohr, 1991) [Medicus, „Zur deliktischen Eigenhaftung von Organpersonen"] 155 at 156/157; Groß, *supra* note 300 at 554.

As a consequence of what has been said above, the director of a legal entity can be held personally liable for directly committing a tort, in particular, according to §§ 823 I, 823 II, 826 BGB presuming, of course, that all the circumstances set out in these norms are given.

1. Liability according to § 823 I BGB

In order to be liable according to § 823 I BGB, the director must have violated one of the enumerated rights or interests of the norm, namely, life, body, health, freedom, property, or any "other right" ("sonstiges Recht") in an unlawful and culpable (intentional or negligent) way, and there must be a causal link between the defendant's conduct and the plaintiff's harm. The kind of harm not protected by § 823 I is economic loss (unless it is consequential upon physical damage).[305] Examples of situations where managing directors were held liable personally according to § 823 I BGB by the courts are: The case where a managing director wrote a letter as reader of a newspaper making untrue allegations of facts concerning a third person adding that he was talking "on behalf of the direction of the GmbH";[306] the case where a managing director sold an object serving as security of a bank to someone else so that the bank lost the possibility to satisfy its claim against the limited liability company;[307] the case where a managing director fraudulently purchased petrol on behalf of the GmbH reselling and mixing it with other petrol to the effect that the previous title holder lost his property;[308] the case where a managing director unlawfully took away appurtenances from a piece of land although these were also

[305] B. S. Markesinis, *The German Law of Obligations (Vol. II): The Law of Torts: A Comparative Introduction*, 3rd ed. (Oxford. Clarendon Press, 1997) [Markesinis, *Law of Torts*] at 35.
[306] OLG Koblenz (1991) DB 2651.
[307] LG Lübeck (1994) WM 457.
[308] BGH 56 BGHZ 73.

seized by the mortgage;[309] the case where a managing director, without being entitled to do so, decided to sell the replica of a "Lamborghini" constructed by order of the plaintiff to another person, therefore violating the plaintiff's property rights.[310]

In so far as it is possible to additionally hold the corporation or limited liability company liable via § 31 BGB for the committed tort, both, the legal entity and the director will be jointly liable to the third party.[311]

2. Liability according to § 823 II BGB

In the same way as set out above, a director will be found liable according to § 823 II BGB if he or she infringes a statue or other enactment intended for the protection of others, a so-called protective law ("Schutzgesetz"). In practice, the greatest obstacle proves to be that the violated norm must be a protective statute, so that a civil remedy under § 823 II BGB can be granted.[312] It means that the plaintiff must show that the mischief that occurred was in fact the one that the legislator wished to avoid by enacting the norm in question. Moreover, the plaintiff must show that he himself belongs to the class of persons to which the legislator intended to grant a civil remedy when he created the violated norm.[313] With respect to a third party claim under § 823 II BGB against managing directors of a GmbH, the following provisions of the German Limited Liability Company Act (GmbH-Gesetz) have been discussed to be protective statutes: The protective character is being denied by the courts for § 30 I GmbH-Gesetz which states that the assets of the limited liability company required for

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[309] BGH (1991) VersR 232.
[310] BGH (1996) ZIP 786.
[311] Groß, *supra* note 300 at 553.
[312] Markesinis, *Law of Torts*, *supra* note 305 at 891.
[313] *Ibid.* at 654, 656; Otto Palandt (ed.), *Kommentar zum Bürgerlichen Gesetzbuch*, 55th ed. (München: Beck, 1996) § 823 BGB (commented by Heinz Thomas), note 141.

the preservation of the original opening capital may not be paid out to the partners.[314] While the norm is considered to be also in the interest of third party creditors, it is only the limited liability partnership itself which is granted a direct claim against the managing director acting contrary to the provision. Third party creditors only have the possibility to garnish this claim of the GmbH against the managing director.[315] The protective character had originally also been denied for § 41 I GmbH-Gesetz which stipulates the obligation of the managing director to ensure that the limited liability partnership keeps proper books and accounts, where the incorrect presentation of the pecuniary circumstances led to the advancement of a loan which normally would not have been granted.[316] In recent years, however, the courts have started to leave this question unanswered while pointing out that books and accounts in today's business world are relied upon in much broader circumstances than in earlier times and that therefore also the role of the duty to ensure the keeping of proper books and accounts of the managing director might have changed. It therefore is likely that § 41 I GmbH-Gesetz represents nowadays a protective law under § 823 II BGB for creditors.[317] As for the duty of the managing director to employ the diligence of an orderly businessman in the matters of the limited liability partnership (§ 43 GmbH-Gesetz), this duty is considered only to be an internal one. § 43 GmbH-Gesetz stipulating this duty is therefore not considered a protective law under § 823 II BGB.[318] On the contrary, § 64 I GmbH-Gesetz introducing the circumstances under which a managing director has the obligation to file a bankruptcy petition, is recognized as a protective law under § 823 II BGB with respect to third party creditors.[319] For § 68 II GmbH-

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[314] Groß, *supra* note 300 at 554.
[315] *Ibid.*.
[316] *Ibid.* at 555.
[317] *Ibid.*.
[318] *Ibid.*.
[319] *Ibid.* at 556.

Gesetz („Signatures of the Liquidators"), this is likely to be the same.[320] With respect to a third party claim under § 823 II BGB against directors of an AG, the following provisions have been affirmed to be protective statues: § 92, para. II and para. III stipulating the duties of the board of directors in the case of overindebtedness or insolvency[321] as well as § 401 I Nr. 2, II AktG stipulating the punishment of a member of the board of directors in case that he or she violates one of these duties.[322] The protective character under § 823 II BGB is being denied, in particular, for the provision of § 93 I, II AktG obliging directors to employ the diligence of an orderly and conscientious manager in their management of the corporation.[323] This is considered solely an internal duty of the directors towards the corporation.[324]

In so far as the protective law in question imposes liability irrespective of fault, additional civil liability according to § 823 II BGB will not be engendered unless the defendant was also guilty of fault.[325] However, the case-law has inverted the onus of proof and placed it on the defendant. This means that fault will be presumed unless the defendant can positively disprove any fault on his part.[326] The most important advantage of § 823 II BGB in comparison with § 823 I BGB is that the second paragraph of the norm recognizes the compensability of purely economic loss.[327]

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[320] *Ibid.* at 557.
[321] Wolfgang Zöllner (ed.), *Kölner Kommentar zum Aktiengesetz (Vol. 1: §§ 1-147 AktG)* (Köln, Berlin, Bonn, München: Carl Heymanns Verlag, 1985) [Zöllner, *Kölner Kommentar zum AktG, Vol 1*] § 92 (commented by Hans-Joachim Mertens), n. 33.
[322] Wolfgang Zöllner (ed.), *Kölner Kommentar zum Aktiengesetz (Vol. 3: §§ 291-410 AktG)* (Köln, Berlin, Bonn, München: Carl Heymanns Verlag, 1985), § 401 (commented by Gerd Geilen), n. 4, 5.
[323] Zöllner, *Kölner Kommentar zum AktG, Vol. 1*, § 93 (commented by Hans-Joachim Mertens), n. 85.
[324] Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden", *supra* note 303 at 470.
[325] Markesinis, *Law of Torts*, *supra* note 305 at 35, 891.
[326] *Ibid.* at 891.
[327] *Ibid.*.

3. Liability according to § 826 BGB

Personal liability of a director for directly committing a tort may also arise under § 826 BGB. The norm obliges a person who willfully causes damage to another in a manner contrary to public policy to compensate this other person for the damage. The norm, as § 823 II BGB, also acknowledges the compensability of pure economic loss, in fact, claims for economic loss are the most usual claims brought under § 826 BGB.[328] While on the one hand, the ambit of § 826 BGB is broader compared to § 823 I BGB since there is no limitation to certain enumerated interest, it is, on the other hand, narrower because of limitation of the scope of § 826 BGB to intentional activities which, in addition, have to be *contra bonos mores*.[329] Intention is taken to include *dolus directus* and *dolus eventualis*.[330] An example of the former can be found whenever the defendant knows the consequences of his conduct and wishes to bring them about; an illustration of the latter can be seen where the defendant is aware of the consequences of his conduct which he accepts as inevitable even though he may not specifically desire them.[331] What has to be intended is the damage in suit although its full extent and the precise way it is realized need not have been specifically anticipated.[332] In order to assess whether an action is *contra bonos mores*, "the standard of all good and right-thinking members of society" has often been quoted as the decisive criteria.[333] In the end, the result of this very open test will depend largely on the facts of the particular case the court is dealing with as well as the case-law that has been established in this area.[334] In practice, claims under § 826 BGB for the personal liability of a director may include behaviour like misstatements and inducing

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[328] *Ibid.* at 32.
[329] *Ibid.*.
[330] Palandt, *supra* note 313, § 826 BGB (commented by Heinz Thomas), note 10.
[331] Markesinis, *Law of Torts*, *supra* note 305 at 895.
[332] *Ibid.*; Groß, *supra* note 300 at 562.
[333] Palandt, *supra* note 313, § 826 BGB (commented by Heinz Thomas), note 2.
[334] Markesinis, *Law of Torts*, *supra* note 305 at 896-98; Groß, *supra* note 300 at 561/562.

breach of contract as well as the failure to introduce the bankruptcy proceedings without undue delay.[335] § 826 BGB summarizes under one heading conduct which in Common law is actionable in the form of separate torts like deceit, passing off, intimidation, procuring a breach of contract, unfair competition, malicious prosecution, etc..[336]

4. Some Reference to Contractual Remedies

It is important to point out that some conduct which in Common law is covered by tort law, in German law will (also) give rise to a contractual claim. The expansion of contractual remedies in German law can be seen to be due to "insufficiencies" in the area of tort law.[337] For example, cases dealing with economic loss caused by negligent statements pose a problem under German law. Because loss can be widespread in such cases, German law, like Common law, is cautious with respect to the question of liability.[338] § 676 BGB stipulates that a person who gives advice or a recommendation to another is not bound to compensate for any damage arising from following the advice or recommendation, without prejudice to his responsibility resulting from a contract or delict. A tort claim in the situation described here can principally only be based on § 826 BGB because pure economic loss is not recoverable under § 823 I BGB and because a claim under § 823 II BGB presupposes the violation of a protective law which is unlikely to have happened in a case like this. However, § 826 BGB is not applicable either, since the norm requires intentional conduct. A claim under tort law is therefore impossible. The pressure to establish liability anyhow,

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[335] Markesinis, *Law of Torts, supra* note 305 at 895; Groß, *supra* note 300 at 561.
[336] Markesinis, *ibid.*.
[337] See f. ex. Christian von Bar, „Liability for Information and Opinions Causing Pure Economic Loss to Third Parties: A Comparison of English and German Case Law" in B. S. Markesinis (ed.), *The Gradual Convergence: Foreign Ideas, Foreign Influences and English Law on the Eve of the 21st Century* (Oxford: Clarendon Press, 1994) 98 at 112.
[338] Markesinis, *Law of Torts*, *supra* note 305 at 43, 687.

increased by the growth of insurance, has provoked, once again, a recourse to the law of contract.[339] Accordingly, liability for negligent misstatements causing pure economic loss may be established making use of expansions of the law of contract like *culpa in contrahendo*[340] in the pre-contractual sphere and *Vertrag mit Schutzwirkung zugunsten Dritter*, implying a wide interpretation of the notion of contract with protective effect for the benefit of third parties.[341] As a consequence, from the perspective of German lawyers, the problem in this area has often been described as being one of "expanding contract", while the main issue for Common lawyers has been one of "controlling tort".[342] However, in most cases, a claim under expansions of contractual law will only succeed against the legal entity, not against the director personally. Yet, a personal claim under *culpa in contrahendo* against the executive may succeed, for example for negligent misstatement, where the third party has

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[339] *Ibid.* at 46, 687.

[340] See *ibid.* at 688: The concept of *culpa in contrahendo*, initiated by Rudolf v. Jhering, extends contractual remedies to the precontractual phase of negotiations. While *culpa in contrahendo* may provide a remedy in cases of negligent misstatement (see also *Palandt, supra* note 313, § 276 BGB (commented by Helmut Heinrichs), note 24), it may also serve to establish a claim seeking the recovery of damages resulting from bodily harm caused in the pre-contractual sphere: One example was a case where the prospective purchaser entered the store, asked to inspect some carpets and, while doing so, was injured by two rolls which fell from the shelf. The same contractual protection will not only be granted to the prospective purchaser who, f. ex., is queing up to pay for the goods he has already selected, but also to the „potential purchaser" who enters the store „to look around" but has not yet the intention to purchase anything in particular. There exists detailed case law with regard to all the situations where a claim under *culpa in contrahendo* may apply, see *Palandt, supra* note 313, § 276 BGB (commented by Helmut Heinrichs), note 71-90.

[341] Werner Lorenz, „Contracts and Third-Party Rights in German and English Law" in B.S. Markesinis (ed.), *The Gradual Convergence: Foreign Ideas, Foreign Influences and English Law on the Eve of the 21st Century* (Oxford: Clarendon Press, 1994) 65 at 70/71: The concept of the *Vertrag mit Schutzwirkung zugunsten Dritter* extends the scope of the contract to include persons other than the immediate contracting parties. It grants the persons falling under its protection an action for breach of certain secondary duties (f. ex. duties of protection or *Schutzpflichten*). The decisive criterion for such a claim is some special relationship with the promisee described as „proximity of the performance" (*Leistungsnähe*). This requirement serves to limit the number of potential claimants. Moreover, the promisor must have been able to foresee that the third party (claimant) is likely to suffer damage in case of bad performance. An example where the *Vertrag mit Schutzwirkung zugunsten Dritter* is considered to provide a remedy for the recovery of economic loss resulting from nelgigent statements is the case where a bank supplies inaccurate information concerning the creditworthiness of one of its customers and the broker, to whom this information was given, passes it on to the potential investors, see BGH in NJW 1979, 1595.

[342] Markesinis, *Law of Torts, supra* note 305 at 43.

explicitly relied on the expertise of that very person.[343] This rule developed by the courts has been reconfirmed by the corresponding formulation in para. III of the new § 311 BGB which officially acknowledges the existence of the figure of *culpa in contrahendo* in German law.

II. Liability for Indirect Involvement in a Tort

In German law, the problematic cases of personal liability are those where the director is only indirectly involved in the commitment of a tort, that is where the tort was actively committed only by another employee. As long as an executive, as instigator or joint actor, gives instructions for or, as an accomplice, assists in the commission of a tort, he will be liable in the same way as set out above.[344] Following § 830 BGB, he will be considered to be directly involved in the tort and will therefore be held personally liable.[345]

The question of personal liability is more critical for directors in the case of omissions on their part. It is a long- and well-established principle that liability for an omission can only be imposed if there exists a previous duty to act.[346] In the following, it will first be explored what sources for duties of affirmative action there are (1.). The special focus in this part will be on the so-called *Verkehrssicherungspflichten* since they have become of great significance in the context of directors' personal tort liability. Afterwards, it will be studied under what circumstances *Verkehrssicherungspflichten* or duties to take care of directors may be assumed to

[343] Sandmann, *supra* note 300 at 420.
[344] Medicus, "Zur deliktischen Eigenhaftung von Organpersonen", *supra* note 304 at 165, 169.
[345] *Ibid.*.
[346] Markesinis, *Law of Torts*, *supra* note 305 at 74-75.

exist towards third parties or in how far these duties will only be owed by the legal entity (2.).

1. Verkehrssicherungspflichten and Other Sources of Duties of Affirmative Action

While originally statute and contract were the main sources for duties of affirmative action, the area of liability for omissions was widened later on: In German law, the development of the idea that "a preceding dangerous (or potentially dangerous) activity or state of affairs should give rise to a duty of care" led to an important expansion of liability for omissions, thereby broadening the ambit of the law of torts as a whole.[347] From this new starting point for establishing liability for omissions, it was just one step further for German courts to develop the so-called *Verkehrssicherungspflichten*.[348] Their meaning is complex but has been summarized by saying that "whoever by his activity or through his property establishes in everyday life a source of potential danger which is likely to affect the interests and rights of others, is obliged to ensure their protection against the risks thus created by him".[349] This has been the test generally applied in German law in order to determine whether the relationship between parties may put one of them under a duty of care towards the other.[350]

With regard to an executive acting within the scope of his or her duties for the AG or the GmbH, the particular problem is to decide when the legal duty to maintain safety of the legal entity can also be considered to be at the same time that of the director

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[347] *Ibid.* at 75.
[348] Markesinis, *ibid.*, considers it difficult to find an adequate translation of the term "Verkehrssicherungspflichten". In the following, the terms "legal duty to maintain safety", "duty to take care" or simply "duty of care" will be used to refer to a "Verkehrssicherungspflicht".
[349] *Ibid.*.
[350] Palandt, *supra* note 313, § 823 BGB (commented by Heinz Thomas), note 58.

personally.[351] As the AG or GmbH is a separate legal entity, it is this entity which becomes a party to contracts, which engages in risks and profits from them in the end. This is why it seems natural that it should also be first of all the corporation or limited liability company which has a duty to ensure the protection of those who are likely to be affected by the sources of potential dangers it has established by its activity.[352] However, since the legal entity depends on natural persons to act on behalf of it, a personal duty of affirmative action of the individual director may be assumed where this duty results from his or her position within his or her area of responsibility.[353] This has been acknowledged for cases where executives knowingly neglected to prevent the commission of a tort in their area of responsibility. Here, the default to prevent the tort is equivalent to a positive action so that directors and managing directors will be personally liable according to §§ 823 I or II or 826 and 830 BGB as a joint actor.[354] The courts have confirmed this solution on several occasions, for violations of intellectual property as well as in other situations; one example is the case where a managing director knew about the toxic impact of substances in a spray for leather and the consequences this might possibly have on consumers' health without recalling the product from the market.[355] The true problem is if and under what circumstances a personal duty to take care may be assumed where the director in charge is not aware of the wrongful conduct causing the tort. As long as the director knows about the tort and neglects to prevent it, he or she will usually be held liable as joint actor.

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[351] Dieter Medicus, "Deliktische Außenhaftung der Vorstandsmitglieder und Geschäftsführer" (1998) ZGR 570 [Medicus, "Deliktische Außenhaftung"] at 573.
[352] *Ibid.* at 572-73.
[353] Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden", *supra* note 303 at 469.
[354] *Ibid.*.

2. The Circumstances under which Personal Duties to Take Care (Verkehrssicherungspflichten) of Directors May Be Assumed to Exist Towards Third Parties

Where a director has not deliberately neglected the prevention of a tort in his or her area of responsibility, the question becomes whether he or she may be under a general obligation - not only internally, but also externally - to organize the course of business in a way that no torts are committed. This would imply that a director automatically assumes personal liability for all duties existing on the part of the AG or GmbH towards third parties in his or her area of responsibility when taking on his or her functions.

In fact, it is sometimes argued that this would have to be the case already because of the provision of § 31 BGB. The norm serves to establish the liability of the legal entity for the actions of its board members giving rise to a claim for the recovery of damages. Liability for the actions of normal employees causing damage (vicarious liability) may only be established under a different norm, § 831 BGB. A more or less expansive approach with regard to the assumption of personal duties of care on the part of directors could have an impact also on the liability of the legal entity under § 31 BGB, at least in so far as this liability presupposes the personal liability of a natural person. Whether this is the case or whether the liability of the legal entity is an issue of its own will be shortly discussed in the following (a.).

Afterwards, it will be explored under what circumstances German courts are willing to assume a general personal duty of care of executives towards third parties for the

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[355] Lutter, "Haftungsrisiken des Geschäftsführers einer GmbH", *supra* note 300 at 334. For the decision of the BGH concerning the leather spray, see BGH (1990) ZIP 1413 or BGH (1990) GmbHR 501.

running of business in their field of responsibility (b.). This will then be compared to some of the solutions proposed by legal scholars to the problem (c.). The last part will be a short conclusion (d.).

a. Directors' Personal Liability and the Liability of the Legal Entity under § 31 BGB

The extent to which personal duties of care of directors are assumed to exist towards third parties may be indirectly influenced by the provision of § 31 BGB. In the case that the liability of the legal entity presupposes the personal liability of a natural person, there would be a great incentive to assume personal duties of care of directors towards third parties under a wide range of circumstances in order to prevent the legal entity to escape from liability. After shortly describing the scope of § 31 BGB (Liability of the Association for Executive Organs) and § 831 BGB (Liability for Employees), there will follow a brief discussion of the question in how far the liability of the legal entity does or does not depend on the personal liability of one of its board members.

§ 31 BGB is part of the chapter on legal entities in the book of general provisions in the BGB (Book 1, Allgemeiner Teil). The norm states that the association is liable for any damage which the board, a member of the board, or other duly appointed representative may, in carrying out his duty, cause to a third party, if the act obliges the making of compensation. It is assumed to be sufficient to hold an association liable if the board member or other official representative acts within some context of his or her duty.[356] Even if the board member or other representative exceeds the scope of his or her authority, the association can still be held liable for his or her acts as long

[356] Sandmann, *supra* note 300 at 428.

as it has not been obvious to the third party that the executive in question was acting outside the scope of his or her duties.[357]

While § 31 BGB deals with the liability of the legal entity for its executive organs, liability for employees (vicarious liability) is covered by a separate norm, § 831 BGB. According to the first sentence of § 831 I BGB, a person (also meaning a legal entity)[358] who employs another to do any work is bound to compensate for any damage which the other unlawfully causes to a third party in the performance of his work. The main difference when compared to § 31 BGB or to vicarious liability under Common law is that under § 831 BGB the employer has the possibility to provide exculpatory proof.[359] The employer's duty to compensate does not arise where he can produce evidence that he has exercised necessary care in the selection of the employee, and, where he has to supply apparatus or equipment or has to supervise the work, has also exercised ordinary care as regards such supply or supervision (second sentence of § 831 I BGB). In the same way, the employer will not be found liable where he can prove that the damage would have arisen notwithstanding the exercise of the necessary care (second sentence of § 831 I BGB).

As already mentioned above, there would be a great incentive to assume personal duties of care of directors under a wide range of circumstances if the liability of the legal entity under § 31 BGB presupposed the personal liability of one of its board members. There are principally two different point of views concerning this question:

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[357] *Ibid.*.
[358] Palandt, *supra* note 313, § 831 BGB (commented by Heinz Thomas), note 4.
[359] Markesinis, *Law of Torts*, *supra* note 305 at 684.

On the one hand, there are those who follow the so-called representation theory ("Vertretungstheorie") of von Savigny.[360] Even though they do acknowledge the separate character and independence of the legal entity, they put at the same time special emphasis on the fact that the legal entity can, indeed, only act through its official representatives.[361] It is because of § 31 BGB that the conduct of the executive organs may then be attributed to the legal entity itself, therefore also rendering it responsible.[362] As a consequence, those in support of the representation theory of Savigny consider the personal tort liability of a director to be a necessary condition for the liability of the legal entity itself. This means that according to them, there is a great incentive to assume personal duties of care of directors on a large scale, at least if one desires to prevent the legal entity from escaping liability completely.

On the other hand, there are those who follow the so-called theory of executive organs ("Organtheorie") of von Gierke.[363] They consider the actions and omissions, the knowledge, the intentions and the fault of the executive organs to be those of the legal entity itself.[364] As a consequence, it is possible to add up the different elements necessary to establish tort liability even though some elements may have been realized by the executive organs and others only by the legal entity.[365] The result is the liability

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[360] See f. ex.: Gert Brüggemeier, „Organisationshaftung" (1991) 191 AcP 33 at 64-65; Holger Altmeppen, "Haftung der Geschäftsleiter einer Kapitalgesellschaft für Verletzung von Verkehrssicherungspflichten" (1995) ZIP 881 at 887.
[361] Sandmann, *supra* note 300 at 435.
[362] *Ibid.*.
[363] See f. ex.: Karsten Schmidt, *Gesellschaftsrecht*, 4th ed. (Köln: Carl Heymanns Verlag, 2002) §10 IV 2 at 283 ; Detlef Kleindieck, *Deliktshaftung und juristische Person* (Tübingen: Mohr, 1997); Sandmann, *supra* note 300 at 438; Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 810; Medicus, "Deliktische Außenhaftung", *supra* note 351 at 576. The theory of executive organs has some similarity with the so-called identification theory in Common Law that was developed for cases where the doctrine of vicarious liability was inoperable, in particular, for cases of corporate criminal liability in order to be able to impute *mens rea* where necessary. Without the identification theory, corporations could only be made criminally liable for offences which do not require *mens rea*. See VanDuzer, *supra* note 1 at 171-72.
[364] Medicus, "Deliktische Außenhaftung", *supra* note 351 at 576.
[365] *Ibid.*.

of the legal entity according to § 31 BGB without necessarily being able to establish at the same time the personal liability of the directors who fulfilled only some of the criteria for being responsible.[366] Since the liability of the legal entity, according to this opinion, is independent from the liability of its executive organs, there is now need to construct fictions about the assumption of personal responsibility of directors for all kinds of duties of care owed by the legal entity to third parties just to arrive at its liability. This represents one of the main advantages of this view, in particular, when one recalls the criteria generally required to be able to assume a duty of care in the first place, criteria like causing and being in control of a certain risk or a potential danger which in many cases will only fit the legal entity but not its directors.[367] It seems adequate that it should be first of all the legal entity that bears the risks connected to its activities since it is also the one that mainly profits from them.[368] While the liability of the legal entity is an issue of its own, it is possible, at the same time, to attach personal liability to one of its executives where there is reason to assume the existence of a separate personal duty of care of the director towards a third party.[369]

To conclude, the question to what extent personal duties of care of directors should be assumed to exist towards third parties is not necessarily linked to the liability of the legal entity under § 31 BGB. The liability of the legal entity and the personal liability of its directors are two different issues. The circumstances under which personal duties of care of directors towards third parties should be assumed can be considered on its own, without this having an impact also on the liability of the legal entity.

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[366] Fleischer, *supra* note 293 at 582.
[367] Medicus, "Deliktische Außenhaftung", *supra* note 351 at 572.
[368] *Ibid.* at 576.
[369] *Ibid.* at 577.

b. The Assumption of a Personal Duty of Care by the Courts

The courts have not always followed a consistent line with regard to the issue of when to establish personal tort liability of an executive for the violation of a duty to take care[370]:

In 1975, the Federal High Court of Justice, the *Bundesgerichtshof*, in a case challenging the liability of an executive of a limited partnership ("*Kommanditgesellschaft*") in tort came to the conclusion that a personal duty of care towards third parties could be derived already from the fact that an executive is assigned the general responsibility for a certain section of the business.[371]

In another case (the so-called "sport trousers case"), the Bundesgerichtshof, however, rejected the personal tort liability of a managing director for a trade mark violation actively committed only by some subordinate employees with the reasoning that the executive did neither directly participate nor knew about the commission of the tort.[372] That the managing director could be reproached not to having taken all necessary measures to prevent such torts was held to be irrelevant.[373] This case therefore seems to argue against the assumption of a duty of care of an executive towards third parties just because of his or her internal responsibility for a certain area.

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[370] Altmeppen, *supra* note 360 at 881, 884.
[371] *Ibid.*; see for the judgement of the Bundesgerichtshof (1975) NJW 1827.
[372] Altmeppen, *supra* note 360 at 885; see also the judgement of the Bundesgerichtshof (1986) ZIP 183 at 186/187.
[373] Bundesgerichtshof, *ibid.*.

In 1989, however, there was again a case which seems to prove the opposite: In the so-called "building material case"[374], a managing director was held personally liable because he carelessly failed to organize the part of business for which he was responsible in the way that would have prevented the commission of the tort in question. The tort that occurred in the area of responsibility of the managing director for which he was judged to be personally liable was a negligent violation of property under § 823 I BGB. Building material had been sold to the limited liability partnership by one of its suppliers with a reservation of the right of disposal until the price would be paid completely. However, because of a lack of communication between the purchasing and the sales department due to the way the managing director in question had organized the business, it was afterwards possible that the building material in disregard of the reservation of property was being resold under a covenant not to assign and installed into a house owned by someone else which led to the transfer of ownership and therefore to the violation of the property right of the supplier as previous title holder.[375] The fact that the limited liability partnership itself could already be found liable for the negligent violation of property via § 31 BGB was considered irrelevant by the Bundesgerichtshof with respect to the question whether personal liability should attach to the managing director.[376] The court did concede, however, that, in principal, managing directors will only be liable to the limited liability partnership for the breach of their duties according to § 43 II GmbH-Gesetz. In most of the cases, it is therefore only the GmbH as legal entity which will be held liable for the violation of duties to third party creditors.[377] On the contrary, personal external liability is estimated by the court to attach where the managing director under

[374] Altmeppen, *supra* note 360 at 885; see also the judgement of the Bundesgerichtshof in 109 BGHZ 297.
[375] See for the facts Bundesgerichtshof in 109 BGHZ 297 at 298.
[376] Bundesgerichtshof in 109 BGHZ 297 at 303.

special circumstances can be considered to have personally assumed a duty of care towards a third party.[378] According to the court, a personal duty of care may already be assumed where a managing director because of the internal allocation of tasks or because of the de facto situation occupies a position where he or she finally has the control over an object which the third party has confided to the care of the limited liability partnership.[379] The only additional condition named by the court for the assumption of a personal duty of care on the part of the managing director is that the prevention of damage to the object of the third party has to lie in the field of his or her competency.[380] Although this test whether there was a personal assumption of a duty of care towards a third party on the part of the director resembles the test established in *Natural Life Health Foods*,[381] it is important to note that in German law the test is generally applicable and is not reserved to cases dealing with pure economic loss. Under German law, the test serves as a means to establish the personal liability of a director in all cases where he or she has not participated in the tort, but where the tort was committed by a subordinate employee in his or her field of responsibility.

In 1994, there was again a case where the managing director of a limited liability partnership was sued personally in tort by a third party for failing to supervise subordinate employees in a sufficient manner to make sure that they would not engage in criminal conduct.[382] The Bundesgerichtshof this time rejected the assumption of a personal duty of care towards the third party emphasizing that the position of executive usually could only give rise to a duty of care to properly organize the

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[377] *Ibid.*.
[378] *Ibid.*.
[379] *Ibid.*.
[380] *Ibid.* at 304.
[381] See Chapter 2, C. II.1.b. at 52, above.
[382] See the judgement of the Bundesgerichtshof in (1994) ZIP 867.

business towards the legal entity.[383] The claim for liability of the managing director was therefore dismissed by the court.

While the Federal High Court of Justice has not always followed a consistent line with regard to the question of when to attach personal liability in tort to executives of limited liability partnerships, there have been cases where the court did derive a personal duty of care towards third parties from the general duty of a managing director to organize the running of business in his or her area of responsibility. The same can also be assumed with regard to directors of a corporation for the reasons set out above in the introductory part.[384] Especially, the "building material" case from 1989 has attracted much criticism from legal scholarship which has tried to develop alternative solutions for the problems at issue.

c. Solutions Developed in Legal Scholarship

While some have approved of the assumption of a personal duty of care on the part of executives towards third parties derived from their obligation to organize a certain part of business (1), the majority of legal scholars has been very sceptical of such a broad approach (2).[385]

(1) For the Assumption of a Duty of Care in a Wider Range of Circumstances

For the legal scholars who do agree with the assumption of a personal duty of care in a wider range of circumstances, there also seems to be some diversion with respect to the question what particular circumstances should be required for it.

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[383] Bundesgerichtshof in (1994) ZIP 867 at 870.
[384] See above at 68.

According to the most far-reaching point of view, a personal duty of care towards third parties should, indeed, be already derived from the allocation of responsibility to the director or managing director for a part of the business.[386] Those in favour of this approach argue that the executive of a legal entity should be seen as an independent actor who in his field of competency assumes personal responsibility for all the duties of care which exist towards third parties.[387] The result of this approach is that a personal duty of care will be found in almost all cases as long as there is some connection to the sphere of functions of the executive.[388] Personal liability in tort will therefore attach very widely where the director does not act according to these duties. This is considered just, because it guarantees that, in case of insolvency, it will not be the tort victim who bears the costs but the executive who engaged in wrongful conduct.[389] The claim for personal tort liability against the director or managing director is assumed to be successful, no matter if his or her behaviour was intentional or negligent. The argument supplied is that § 823 I BGB means to include both, intention as well as negligence, and that there is no obvious reason to deviate from this principle where the tortfeasor was only indirectly involved in the tort.[390] Even in the case where the third party simultaneously happens to have a contractual claim against the legal entity, the tort claim against the executive is not to be dismissed according to the approach presented here.[391]

Similar to this approach is the idea not to derive a personal duty of care already from the allocation of responsibility for a certain area but from the general confidence that

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[385] Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 818.
[386] Brüggemeier, *supra* note 360 at 64/65; Altmeppen, *supra* note 360 at 887.
[387] Altmeppen, *ibid.*.
[388] *Ibid.*.
[389] *Ibid.* at 890.
[390] *Ibid.*.
[391] *Ibid.*.

third parties will put in the individual executive because of his or her position.[392] The background to this suggestion is that a legal entity will always depend upon natural persons to incur and control risks on its behalf and that it is therefore these individuals who third parties will personally rely on for the prevention of damages.[393] Because of this reliance, it is considered justifiable to also hold the individual director personally liable in tort when a damage occurs.[394]

Further ideas are to derive the personal duty of care of an executive from his general professional duties or to distinguish as to the significance of the endangered right in order to decide whether or not to impose a duty of care in the case at hand.[395] Those who want to derive a personal duty of care from the general professional duties of the executive reason with the important part that he or she is taking in the organization of the business.[396] Those who put emphasis on the legal significance of the particular right involved, actually limit the assumption of a duty of care to cases where life or physical integrity is endangered.[397] As far as this is the case, personal liability will, however, even attach where the executive unconsciously neglected to observe his duties of organization which might have prevented the tort in question.[398]

While the "building material" case is often cited as promoting a maybe even too broad solution for the assumption of personal duties of care on the part of executives, there

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[392] Karl Larenz & Claus-Wilhelm Canaris, *Lehrbuch des Schuldrechts (Vol. II 2)*, 13th ed. (München: Beck, 1994) at 410.
[393] *Ibid.* at 422.
[394] *Ibid.*.
[395] Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 817, 818.
[396] Christian von Bar, "Wege zum japanischen Recht" in: Hans G. Leser & Tamotso Isomura, eds., *Festschrift für Zenturo Kitagawa zum 60. Geburtstag* (Berlin: Duncker & Humboldt, 1992) 279 at 295.
[397] Alfred Hueck & Lorenz Fastrich, *Baumbach: Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, 17th ed. (München: Beck, 2000) § 43 (commented by Wolfgang Zöllner), note 59-60.
[398] *Ibid.*.

are others who see it differently. Instead of deploring, like the majority does, that the Bundesgerichtshof in this case failed to take the opportunity to clearly limit the elements which could give rise to a duty of care and therefore provoke personal liability, they, in fact, manage to derive from the judgement what they consider as "some restrictive criteria".[399] According to them, the assumption of a personal duty of care on the part of the executive is only possible where the endangered right is a right or interest enumerated in § 823 I BGB and, in addition, has been confided to the care of the legal entity.[400] In practice, these conditions will, however, often be given so that personal liability will still attach in a significant number of cases. In addition, this approach does not exclude personal liability in the case where it actually may seem the most suitable, that is where the executive indirectly "contributes" to the commission of a tort without being aware of it by not observing in a sufficient manner his or her duty to organize the business.[401] While § 43 GmbH-Gesetz and § 93 Aktiengesetz are conceded to create solely obligations towards the limited liability partnership or the corporation, it is being emphasized that these norms, at the same time, do not exclude the possibility of personal liability towards third parties based on other provisions.[402]

(2) For a More Restrictive Approach Concerning the Assumption of a Personal Duty of Care

As already mentioned above, the majority seems to be rather sceptical of the judgement of the Bundesgerichtshof in the "building material" case in particular and the broad assumption of a personal duty of care on the part of the executive towards

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[399] See f. ex. Groß, *supra* note 300 at 567.
[400] *Ibid.* at 568.
[401] That the executive is considered to be personally liable no matter whether he knew about the tort or not is clearly stated by Groß, *ibid.*.
[402] *Ibid.* at 567.

third parties in general.[403] In the following, the main arguments against the assumption of a personal duty of care in a wide range of circumstances will be outlined. Afterwards, alternative solutions to determine the existence of a personal duty of care towards a third party under restrictive and special circumstances will be presented.

One of the main arguments against a too broad assumption of duties of care on the part of an executive that has been put forward is that the statuary provisions of § 43 GmbH-Gesetz and § 93 Aktiengesetz describe the obligations of this staff to be of an internal character only. This means that an executive in breach of his or her duties according to the law will first of all be liable to the limited liability company or the corporation on behalf of which he or she is acting. To start to establish now an additional external liability of the executive in almost all the cases would reverse the principle of concentration of liability on the separate legal entity, one of the main pillars of company law.[404] The concept of concentration of liability on the legal entity, also referred to as "limited liability", in German law is set out for the limited liability partnership in § 13 II GmbH-Gesetz and for the corporation in § 1 I 2 Aktiengesetz. The argument offered here by legal scholars that a too broad approach to external liability of the executive would conflict with the principle of concentration of liability on the legal entity resembles the discussion concerning the law of Ontario about a maybe too extensive "piercing of the corporate veil", only that the discussion there is being led already with regard to cases where the director has directly been involved in a tort. In Germany, as in Canada, this is perceived to hinder economic activity because of the wide threat of personal liability to directors and managing directors who run the

[403] Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 818; Medicus, "Zur deliktischen Eigenhaftung von Organpersonen", *supra* note 304 at 161.

business on behalf of the limited liability partnerships and corporations.[405] There is a fear that it will be difficult to find qualified people who will still be willing to take the position of an executive given the high risks of personal liability.[406] Although there remains the possibility to continue to attract personnel if wide indemnification clauses will be included in contracts with directors, it is feared that this will increase insurance premiums, imposing new financial burdens on limited liability partnerships and corporations as well as the economy as a whole.[407] Another argument against the broad personal liability of executives towards third parties is that the imposition of such liability would be clearly contrary to the general will of directors.[408] It is argued that at the time when someone joins a limited liability partnership or a corporation as director, he or she will only assume to take over obligations to organize and supervise the functioning of business towards the legal entity. The assumption of personal responsibility for these obligations also towards any third party would, however, be out of the scope of his or her mind.[409] At the same time, a broad approach to the question of personal liability of executives is also not considered to be in the interests of the limited liability company or corporation because such an approach would be likely to bring about an increase in insurance premiums while liability would still continue to be attached also to the legal entity itself.[410] Furthermore, it is being deplored that the broad assumption of personal liability for directors would transfer the risk of insolvency to these executives while it would be not them but mainly the partners or shareholders who benefit most from the limited liability attached to limited

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[404] Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden", *supra* note 303 at 473; Barbara Grunewald, "Die Haftung von Organmitgliedern nach Deliktsrecht" (1993) 157 ZHR 451 at 458; Medicus, "Zur deliktischen Eigenhaftung von Organpersonen", *supra* note 304 at 163.
[405] Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden", *supra* note 303 at 473.
[406] *Ibid.*.
[407] *Ibid.*; Medicus, "Deliktische Außenhaftung", *supra* note 351 at 585.
[408] Sandmann, *supra* note 300 at 442.
[409] *Ibid.*.

liability companies and corporations.[411] In addition, it is also the partners, not the managing directors, who are responsible for the raising of capital to start a limited liability partnership under German law.[412] Accordingly, it is claimed that it should be the partners and shareholders who should be confronted with more personal liability.[413]

For all the reasons outlined above, it has been stated that an external duty of care of an executive for organization and supervision of his or her area of responsibility should only be assumed under limited and special circumstances.[414] The alternative solutions proposed for the exceptional assumption of a personal duty of care on the part of the executive towards a third party are as diverse as the different approaches presented above in favour of a far-reaching concept.

Some generally deny that the failure of executives to observe duties of organization and supervision may provoke personal liability towards third parties. They are only willing to accept the existence of a personal duty of care where the executive has assumed personal responsibility and the third party has specifically relied on his or her individual expertise or opinion.[415] Apart from this situation, an executive is only considered to be personally liable towards a third party where he or she has been directly involved in the commission of a tort as (joint) tortfeasor, instigator or

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[410] Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 814.
[411] *Ibid.* at 814.
[412] Sandmann, *supra* note 300 at 442; Medicus, "Zur deliktischen Eigenhaftung von Organpersonen", *supra* note 304 at 164.
[413] Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 814.
[414] Medicus, "Zur deliktischen Eigenhaftung von Organpersonen", *supra* note 304 at 161, 166; Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden", *supra* note 303 at 481; Meinrad Dreher, "Die persönliche Verantwortlichkeit von Geschäftsleitern nach außen und die innergesellschaftliche Aufgabenteilung" (1992) ZGR 22 at 39, 41.
[415] Medicus, "Zur deliktischen Eigenhaftung von Organpersonen", *supra* note 304 at 166, 169; Dreher, *ibid.*.

accomplice.[416] In all other cases, the executive will only be liable towards the limited liability partnership or the corporation for a breach of his or her duties.

Others want to distinguish between the intentional and the negligent violation of duties by the executive. The executive will only be liable towards third parties where he intentionally fails to observe one of his or her duties, indirectly creating the possibility for the tort being committed.[417] Holding the executive personally liable towards third parties also for negligent breaches of their duties to organize and supervise the running of business would entail unlimited and unbearable on directors and managers in today's mutually linked economy.[418]

According to yet another approach, the distinction which needs to be made in order to decide on the existence of a personal duty of care of the executive towards third parties is that between duties of care owed towards the general public and duties of care which are only created because of a contractual relationship. Where the duty of care that has been violated is owed to the general public, the third party is considered to have a valid personal claim against the executive involved (the example mentioned is the general duty to clear the sidewalk of the property one is responsible for of snow in the winter).[419] Where, however, the duty of care is actually only that of the legal entity, meaning that it exists only because of a contractual relationship between the legal entity and the third party, the executive acting on behalf of the GmbH or AG to perform its contractual obligations is not considered to be personally liable in tort.[420]

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[416] Medicus, *ibid.* at 165, 169.
[417] Lutter, "Zur persönlichen Haftung des Geschäftsführers aus deliktischen Schäden", *supra* note 303 at 479, 480.
[418] *Ibid.* at 478.
[419] Grunewald, *supra* note 404 at 454-56.
[420] *Ibid.* at 454-55, 458.

The reasoning behind this model is that it is estimated to be justified to hold the executive personally liable only where the duty of care is independent of the existence of the legal entity and is owed by the executive to any stranger crossing his or her way.[421] This approach, in fact, resembles that of La Forest J. developed in *London Drugs* although for German law, it is only used to solve the question of personal liability where the executive has not been directly involved in the tort. In cases where the executive has directly caused a tort, no matter if his or her conduct was intentional or negligent, personal liability will always attach under German law.

Another idea, similar to this last approach, is to distinguish between duties of care that are already originally owed by the executive personally and those duties which are originally only owed by the legal entity to the third party.[422] In the latter case, executives will only be personally liable to third parties if they demonstrate that they intend to assume personal responsibility for the duties of the legal entity.[423] In all other cases, they will only be liable to the legal entity for their breach of duties.

d. Conclusions

To conclude, the arguments in support of an assumption of a personal duty of care only under restrictive, special circumstances seem more convincing. Where the executive has assumed personal responsibility and has been individually relied on by the third party, where he or she has deliberately neglected to observe his or her duties of organization and supervision although he or she knew that this might entail the commission of a particular tort, it appears justified to hold the executive personally liable. The idea of an automatic assumption of personal liability with regard to any

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[421] *Ibid.* at 456.
[422] Sandmann, *supra* note 300 at 431, 446.

duty of care of the legal entity towards the third party just because of the internal allocation of responsibility to the executive for a certain part of the business, however, goes too far.

Furthermore, some of the models outlined above which favour the assumption of a personal duty of care of executives towards third parties under a wide range of circumstances may be reproached for being unrealistic or even artificial. In particular the model which broadly derives personal duties of care of executives towards third parties from the general faith that these would put in the director individually because of his or her position does not seem to correspond well with today's business realities. In fact, third parties will usually not even know who is the individual natural person carrying out the decisions in a certain section of the corporation.[424] Instead, the tendency nowadays seems more to rather rely on trademarks than on individual natural persons performing particular functions within a corporation.[425] Personal reliance will therefore only exist between a third party and an executive under special and limited circumstances.

The argument that a restrictive approach towards personal duties of care of executives would leave third parties without defence in an important number of cases can also be refuted: The personal liability of executives is practically relevant in cases where the limited liability partnership or corporation has become insolvent. In these situations, however, there is already a chance that third parties may have a claim against the

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[423] *Ibid.*.
[424] See also Medicus, "Die Außenhaftung des Führungspersonals juristischer Personen", *supra* note 293 at 817.
[425] *Ibid.*.

executive for a delay in filing the bankruptcy petition for the legal entity.[426] The claim then results from the violation of a protective law under § 823 II BGB in combination with respective norms of the GmbH-Gesetz and the Aktiengesetz. Where there is no delay in filing the bankruptcy petition, the insolvency of the limited liability partnership or the corporation is not any different from that of a natural person, therefore not justifying any particular additional claim against the executive personally.[427] Also according to the restrictive models concerning the assumption of personal duties of care, executives will still be held individually liable in an important number of cases where they have been indirectly involved as joint tortfeasors, instigators or accomplices under §§ 830, 840 BGB. But even in the cases where personal liability towards third parties will not attach because the executive had no idea about the likelihood of the tort being committed, the neglect of duties of organization and supervision on behalf of the director will still have consequences in relation to the limited liability partnership or corporation. The executive will be held liable by the GmbH or AG and may even be dismissed.[428]

C. General Conclusions on German Law as an Example of a Civil Law Jurisdiction

Under German Law, executives will be personally liable to third parties where they have been directly involved in the tort. Having acted within the scope of his or her duties to the limited liability partnership or the corporation is not accepted as a defence. Liability may attach under § 823 I BGB, § 823 II BGB in combination with a violated "protective law" and § 826 BGB. The recovery of pure economic loss under tort law is only possible according to § 823 II BGB or § 826 BGB. Since the

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[426] *Ibid.*.
[427] *Ibid.*.

conditions set out in these provisions are not so easily satisfied, German law has expanded contractual remedies to arrive at the compensability of pure economic loss in some other circumstances as well.

Holding an executive liable under German law becomes problematic where he or she has only indirectly contributed to the tort in question. In this case, executives will be held personally liable where they can be considered to be joint tortfeasors, instigators or accomplices of the tort (§§ 830, 840 BGB). This also covers the situation where an executive deliberately omits to observe the duties of care in his or her area of responsibility knowing that this is likely to allow the commission of a particular tort. It is unclear, however, if personal liability to third parties can also be attached in cases where the executive negligently fails to comply with his or her duties and where he or she is unaware of the possibility that this will allow the commission of a tort.

The only way to arrive at personal liability towards third parties in these cases is basically to generally assume that an executive undertakes personal responsibility for all duties of care that may exist between the legal entity on behalf of which he or she is acting and the third party in his or her field of competency. German courts have not followed a consistent line with regard to the question of liability in these cases. There has been in particular one case, however, the "building material" case, where a managing director negligently failed to comply with his duties of organization, thereby indirectly contributing to the violation of the property of a third party creditor, where the Bundesgerichtshof did establish the personal liability of this executive in tort.

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[428] *Ibid.*.

This case has been subject to a lot of criticism on the part of legal scholarship. While some legal scholars have approved of the broad assumption of personal duties of care of executives towards third parties, the majority has rejected such a broad approach trying to limit the imposition of personal duties of care to special circumstances like particular personal reliance of the third party on the executive. Another approach has been to distinguish between duties of care which the executive owes to the public in general and duties of care which actually only exist because of a contractual relationship between the limited liability company or the corporation and the third party. While the executive will be personally liable when he or she violates a duty of care owed to the public in general, he will only be liable for the duty of care resulting from the contractual relationship between the legal entity on behalf of which he or she is acting and the third party where he or she has clearly stated the intention to assume personal responsibility for it.

This approach actually resembles that of La Forest J. in *London Drugs* with the important difference that in German law it is only discussed with regard to the indirect involvement of executives in torts. Whether the Bundesgerichtshof will take up the arguments and solutions by legal scholarship promoting a more restrictive approach to the question of liability of executives considering their indirect involvement in a tort remains to be seen. The case decided by the Bundesgerichtshof in 1994 seems to be a first step into this direction.[429]

CHAPTER 4: FINAL ANALYSIS AND CONCLUSIONS

In the following, the solutions presented above with regard to the issue of directors' and officers' liability in Common Law (with special focus on the law of Ontario) and

German law as a civil law jurisdiction will be summarized. Afterwards, the results will be analysed from different angles to try to see in how far the present solutions make sense or could be improved in the future.

For common law, the personal liability of directors and officers depends on the degree of his or her personal involvement. A director or officer who has performed, ordered or procured the action causing the tort will be found liable.[430] On the contrary, personal liability does not result from plain general management responsibilities in the area of the corporation's activities in which the tort was committed, provided that he or she neither knows about nor is involved in the actions that bring about the tort. At the same time, directors and officers are responsible for their tortious conduct even if the course of action was directed in a *bona fide* manner in the best interests of the corporation and within the scope of their authority. This is subject only to the exception presented in *Said v. Butt* for the narrow case of the tort of inducing breach of contract.

The personal liability of directors and officers for negligent torts depends on the existence of a duty of care between them and the tort victim, generally established by the "neighbour" or "proximity" test.[431] For the recovery of pure economic loss, the House of Lords has specifically introduced the "assumption of responsibility" test. Canadian courts have not followed the English jurisprudence. They apply the two-stages *Anns* test, first inquiring about a duty of care by referring to "neighbourhood" or "proximity" and then, secondly, limiting the scope of liability where it is deemed necessary by considering policy concerns with regard to the particular case. Whether

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[429] See above at 88-89.
[430] See Chapter 2, Part C.I.2 at 32, above.

acting within the scope of authority in the best interests of the corporation may still provide a valid defence is not sure anymore since the Ontario Court of Appeal's decision in *ADGA*. As a matter of fact, it seems more likely that the court in *ADGA* aimed at generally excluding this argument as a defence in the context of all sorts of torts (aside from the one of inducing breach of contract).

Under German law, executives will similarly be personally liable to third parties where they have been directly involved in the commission of a tort.[432] However, unlike in common law, acting within the scope of his or her duties to the limited liability partnership or the corporation is not accepted as a defence. Liability may attach for willful or negligent injury of certain rights (§ 823 I BGB), infringement of a statute intended for the protection of others (§ 823 II BGB in combination with a violated "protective law") and willful damage contrary to public policy (§ 826 BGB). Under German tort law, only § 823 II BGB or § 826 BGB allow for the recovery of pure economic loss. The conditions set out in these provisions are not easily satisfied. In response, German law has expanded contractual remedies to arrive at the compensability of pure economic loss in some other settings as well.

When an executive liable has only indirectly contributed to the tort in question, it becomes problematic to hold him or her liable under German law .[433] In this case, executives will be held personally liable where they can be considered to be joint tortfeasors, instigators or accomplices of the tort (§§ 830, 840 BGB). This also applies to the situation of deliberately neglecting duties of care in an area of responsibility knowing that this is likely to allow the commission of a particular tort.

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[431] See Chapter 2, Part C.II.1.a. at 44, above.
[432] See Chapter 3, Part B.I. at 70, above.

If, however, the executive negligently fails to comply with his or her duties and if he or she is unaware of the possibility that this will allow the commission of a tort, it remains still unsettled if personal liability to third parties can attach. The only way to arrive at personal liability in these cases is basically to assume that an executive is personally responsible for all duties of care that may exist between the legal entity and the third party in matters pertaining to his or her field of competency.

German courts have not followed a consistent line as to the question of liability in these cases. In the "building material" case, however, where a managing director negligently failed to comply with his duties of organization and this indirectly contributed to the violation of the property of a third party creditor, the Bundesgerichtshof did establish the personal liability of this executive in tort. This case was criticized by a substantial part of legal scholarship. Some legal scholars approved of the broad assumption of personal duties of care of executives towards third parties, yet the majority rejected such a broad approach in order to limit the imposition of personal duties of care to particular circumstances such as individual reliance of the third party on the executive in person. Another approach has been to differentiate between duties of care owed by the executive owes to the public in general and duties of care which stem from a contractual relationship between the limited liability partnership or the corporation and the third party. There will be liability under tort law in the first case, but not in the second, which is subject to contract law, unless the tortfeasor has explicitly assumed personal liability for the duty of care in question.

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[433] See Chapter 3, Part B.II. at 78, above.

Looking at these results, it appears that the differences between the jurisdictions are of rather minor importance. Under the law of Ontario as well as under English and German law, directors and officers are held personally liable where they have performed, ordered or procured the action causing the tort. It will be harder under common law, however, to hold directors and officers personally liable for negligent behaviour resulting in a tort. The reason for this is that common law requires the existence of a special relationship giving rise to a duty of care between the executive and the third party tort victim in order for liability to attach. The requirements for such a duty of care to be assumed are again stricter when cases involve the recovery of pure economic loss.[434] The recovery of pure economic loss is also not easy under German law, though (there is basically only the possibility of recovery under § 826 BGB or under *culpa in contrahendo* (§ 311 II, III BGB), a pre-contractual remedy).

According German law, it has never been assumed that acting within the scope of duties in the best interest of the legal entity could excuse a director or officer from personal liability in tort. In German law, this is not even a valid defence for the tort of inducing breach of contract which is anyway not as frequently appearing in German as in Canadian or English law since a claim is principally only possible under § 826 BGB which includes conditions that may be hard to satisfy. For the law of Ontario, the Court of Appeal's decision in *ADGA* has narrowed down the application of the exception set out in *Said v. Butt* to the case of the tort of inducing breach of contract. It seems that for all other torts, acting within the scope of duties in the best interest of the corporation does not provide any more a defence against personal liability to directors and officers. The law of Ontario since *ADGA* therefore seems to head into

[434] See for all the different tests developed in the context of pure economic loss, Chapter 2, Part C.II.1.b. at 50-55, above.

the same direction as German law with regard to this aspect. The only situation for which it is not sure that German law proposes the same solution as Common law is concerning cases where the director has no knowledge about the tort that is committed in his area of responsibility by a subordinate employee but where he or she has neglected some duty of organization or supervision that if properly observed may have prevented the tort.

Under the law of Ontario as well as under English law, it is unlikely that the director will be held liable in such circumstances since general management responsibilities alone or the mere position as an executive are not considered sufficient factors to attach liability.[435] For German law, the Federal High Court of Justice (BGH) has not always followed a consistent line when deciding about personal liability in such cases. In the "building material" case, the court held a managing director liable where he had no knowledge about the tort being committed but did negligently fail to organize the section of business for which he was responsible in the way that probably would have prevented the tort.[436] The decision of the BGH in this case has been subject to overwhelming criticism by legal scholars who have proposed different alternative solutions.[437] The main point has been to ask for the existence of a special relationship build on personal reliance between the executive and the third party tort victim in order for liability to attach. This means to reject, like Common law does, the idea that personal liability could already be derived from general management responsibilities

[435] See Chapter 2, Part C.I.2. at 32-33, above. It needs to be mentioned, however, that there was also one Canadian case, *Berger v. Willowdale A.M.C.*, which attracted in particular the criticism of Welling because he considered the judgement to propose the derivation of the director's duty of care already from the corporation having a duty arising out of its relationship to the plaintiff and the tortious actions occurring in the general area of the director's responsibility. Instead, Welling insisted that there would have to be a separate special relationship between the director and the third party for personal tort liability to be attached, see at 45-46, above.
[436] See Chapter 3, Part B.II.b. at 87-88, above.
[437] See Chapter 3, Part B.II.c.(2) at 92-97, above.

for a certain section of business. Whether the BGH will take up this approach will have to be awaited.

What has been set out above, amounts to a broad approach to the issue of directors' and officers' personal liability to third parties in tort. This is with some minor differences true for Common law (focussing here on the law of Ontario and, to a certain extent, English law) as well as for German law as a Civil law jurisdiction. For the law of Ontario, the broader approach is a more modern trend, basically since the judgement of the Ontario Court of Appeal in *ADGA*. For German law, the scope of tort liability for the management of legal entities has always been broad. The question becomes whether the new trend in the law of Ontario since *ADGA* makes sense, meaning whether a broad approach to personal liability of directors and officers in tort is a good one or whether there should be more restrictions in the future.

For the law of Ontario, this could mean a revision of *ADGA* or a clarification that the decision was not intended to be applicable in cases involving negligent torts. For German law, this could for example suggest the introduction of certain liability exceptions for managers acting in the scope of their duties when working on a common tort law liability regime within the framework of the European Union. Although one may think that the present general trend to more accountability and liability for corporate managers means that there are only arguments in favour of this approach, there are actually many economic reasons to limit the personal tort liability of this class of the personnel. In addition, there are also some arguments from the legal point of view which seem to argue against a broad scope of personal liability for executives. Many of these arguments can, however, be refuted or, in the case of the

economic arguments, lack empirical evidence. In addition, there are also good reasons for holding executives personally liable for the commission of a tort as will be shown. The different arguments will be presented in the following.

One of the arguments against assuming personal liability of directors and officers on a large scale is that this may hinder the effective functioning of business. It is argued that executives may be too afraid of the consequences of personal liability to take certain business decisions that would, in fact, be in the best economic interests of the corporation.[438] A broad scope of liability may cause phenomena like overdeterrence, risk aversion and overcompliance on the part of directors and officers:

Individuals acting as executives of a corporation receive the benefits of any action only in proportion to the profits that accrue to their shares.[439] In particular in widely held corporations, the number of shares owed by directors and officers is likely to be rather small. If an executive knows or fears that he or she may be confronted with personal liability in tort when taking certain decisions, he or she has to deal with the following conflict of interests: The first possibility is that the executive decides to take the business decision anyway, running the risk to be held liable personally, while only realizing a part of the potential benefits of that decision.[440] The second possibility of the executive is not to take the business decision in order to completely avoid to pay damages from a tort claim against him or her personally, while only missing out on a fraction of the total potential benefits that might have resulted from the decision.[441]

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[438] Ronald J. Daniels, "Must Boards Go Overboard? An Economic Analysis of the Effects of Burgeoning Statuary Liability on the Role of Directors in Corporate Governance" (1994-95) 24 Can. Bus. L.J. 229 at 237.
[439] Iacobucci, *supra* note 26 at 46.
[440] *Ibid.*.
[441] *Ibid.*.

Looking at these possible consequences, the risk of personal liability creates a strong disincentive to take business decisions which may economically be attractive but which may entail a personal tort claim against the director or officer involved.[442]

Furthermore, because of the risk of personal liability combined with sometimes uncertain tort standards, directors and officers may tend to take more care than is efficient.[443] Because the average executive will personally realize only a small part of the returns from the corporation's profits while having to bear the costs of a tort judgement in full, he or she may be inclined to make use of significant corporate resources to avoid the commission of torts.[444] The director or officer may in this way manage to shift the costs of precautions to the corporation in order to avoid personal liability.[445] Because the executive as holder of a small number of shares will only have to bear a small portion of the costs of precautions while having to bear the costs of a tort judgement in full, he or she will rather chose to take maybe too much care when there are any uncertainties about tort standards.[446]

The costs from overcompliance may be the result of actual investments in a high level of care-taking or they may be the result of measures taken to restrict the personal liability facing directors. In order to reduce the impact of personal liability, the corporation may offer to incorporate indemnification clauses in employment contracts with directors and officers or it may offer to purchase insurance on the executive's behalf. It will be in the interest of the corporation to take such steps because of the

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[442] *Ibid.*.
[443] Bruce Chapman, "Corporate Tort Liability and the Problem of Overcompliance" (1996) 69 S. Cal. L. Rev. 1679 at 1685, 1689; Daniels, *supra* note 438 at 233.
[444] Iacobucci, *supra* note 26 at 47.
[445] Chapman, *supra* note 443 at 1693.
[446] Iacobucci, *supra* note 26 at 47/48.

overcompliance concern and the even higher costs which would result from excessive care-taking by executives who are not offered insurance or indemnification.[447] In the worst case, corporations might not even be able to recruit individuals as directors or officers any more without the promise of indemnification or insurance because of the extensive risk of personal liability these people would have to face.[448]

However, the negotiation of indemnification clauses and insurance contracts as well as the payment of indemnification and insurance premiums are also costly for the corporation.[449] In addition, a simple indemnification clause is not of any help to an executive in the situation where it actually the most likely that he or she will be confronted with a personal claim, that is in the situation where the corporation is insolvent or is in the danger of becoming so.[450] Furthermore, in the case that corporations purchase insurance on their directors' or officers' behalf there is the concern about moral hazard, meaning that an executive who is insured may be inclined to neglect to take sufficient precautions to prevent torts.[451]

To address this concern, insurance contracts would have to impose some costs on the executives. It has been doubted, however, that an insurance contract could ever arrive at disciplining an executive to take sufficient care to prevent torts in the same way that this would be achieved within the corporation in the absence of personal liability when excessive risk taking on the part of directors might cause shareholders to replace

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[447] Chapman, *supra* note 443 at 1689.
[448] H. J. Glasbeek, "More Direct Director Responsibility: Much Ado About ... What?" (1995) 25 Can. Bus. L.J. 416 at 447.
[449] Sarra, *supra* note 27 at 67.
[450] Iacobucci, *supra* note 26 at 48.
[451] Paul Halpern, Michael Trebilcock, Stuart Turnbull, "An Economic Analysis of Limited Liability in Corporation Law" (1980) 30 U.T.L.J. 117 at 140; Chapman, *supra* note 443 at 1693.

them eventually.[452] In the case that the damages awarded for the commission of a tort are covered by insurance, directors and officers do not even have to fear a loss in reputation because they will not be perceived as having harmed the corporation.[453] If executives are fully insured against the risk of personal liability, there may also be a risk that they become even more attractive defendants to tort plaintiffs.[454]

Yet, executives may still try to practically escape liability by transferring all of their assets to family members before taking on a job in the management of a corporation even though this creates further costs.[455] At the same time, there has always been the concern that if the tort standards are too uncertain, insurance contracts may not be available any more for directors and officers or corporation would at least have to pay very high premiums.[456]

As an alternative to the personal liability of executives which has been associated with the problems mentioned above, some have come to ask for an extension of the personal liability of shareholders. There has been, in particular, one suggestion that shareholders ought to be liable on a pro rata basis for unsatisfied tort judgements.[457] It has been argued that there would be reasons to believe that at least the overcompliance concerns connected to holding directors personally liable would be limited if shareholders were hold liable.[458] Because, unlike directors, shareholders would

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[452] *Ibid.* at 1696; Sarra, *supra* note 27 at 58.
[453] Iacobucci, *supra* note 26 at 48.
[454] *Ibid.*.
[455] *Ibid.* at 49, 54.
[456] This could be observed in parts already during the 1980s when the market for directors' and officers' (D & O) insurance was about to collapse in North America. See also Ronald J. Daniels & Susan M. Hutton, "The Capricious Cushion: The Implications of the Directors' and Officers' Insurance Liability Crisis on Canadian Corporate Governance" (1993) 22 Can. Bus. L.J. 182 at 190.
[457] Henry Hansmann and Reinier Kraakman, "Toward Unlimited Shareholder Liability" (1991) 100 Yale L.J. 1879 at 1917.
[458] *Ibid.*.

collectively bear the costs of precautions, they would have all the same incentive not to take too much care.[459]

The legal criticism has been focussed on the arguments that the open personal tort liability of directors and officers would interfere with the separate legal identity of the corporation and would furthermore contradict the principle of limited liability. [460]

As already mentioned above, many of the economic arguments which seem to argue in favour of a limited liability of directors and officers for torts lack empirical evidence or have not themselves proven to be true in reality. In addition, it should be kept in mind that the economic analysis of liability assignments generally confirms the efficiency of the risk regulation norm.[461] Directors and officers are in a different position than most of the shareholders who function mainly as passive investors and whose liability is generally regulated in statues.[462] Executives take an active part in the every day decisions of the running of business and therefore have a much greater influence on what risks are being taken. Accordingly, it seems justifiable in their case to also hold them liable under the general law when they participate in or order the commission of a tort. When compared to third party tort victims, their position within the corporation gives directors and officers superior information for the purposes of risk-bearing and risk-shifting.[463] It is easier for them to bear or arrange for the costs of insurance and indemnification to be covered than it is for third party tort victims. Tort claimants are not efficient insurers since the fact whether and the way how they will

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[459] Iacobucci, *supra* note 26 at 53.
[460] Feasby, *supra* note 82 at 307; Grantham & Rickett, *supra* note 140 at 137, 139.
[461] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 312.
[462] *Ibid.*.
[463] *Ibid.*.

be harmed by the tort as well as the scope of potential harm are unknown prior to the wrongful conduct.[464]

Considering it from this angle, the open tort liability of directors and officers does actually seem consistent with economic principles. It also seems doubtful that there may be compelling economic arguments that would suggest a special treatment of directors and officers concerning their liability in tort. Those who come up with the concern of moral hazard because of executives being insured against the risk of liability by their corporation seem to forget that insurance will cover only the good faith but negligent acts while there will be personal consequences for wrongful conduct outside of that standard.[465] Apart from that, the availability or non-availability of insurance should actually not be the reason for assuming or rejecting personal liability for a certain behaviour. The question of whether insurance will be offered should adjust itself to the law and not vice versa.[466] In any case, the availability of D & O insurance in a way refutes the claim for a special treatment of executives.[467]

As for the argument that it may become difficult if not impossible to recruit new directors and officers if the broad approach to liability should prevail, this has not yet proved itself to be of too much practical relevance. In addition, many corporations and, in particular, also the German limited liability partnerships are small or family undertakings where the major shareholder necessarily assumes the management functions. The argument therefore mainly serves to protect larger corporations that

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[464] Sarra, *supra* note 27 at 69/70.
[465] *Ibid.* at 70.
[466] "Insurance follows liability: it can hardly be used to create or justify liability.", see Robert Flannigan, "Enterprise Control: The Servant – Independent Contractor Distinction" (1987) 37 U.T.L.J. 25 at 35.

will search for executive and independent directors.[468] The law should not be formed in accordance to the needs of these corporations and their executives.[469] Those reasoning that directors who have to face open tort law liability will be put under extreme pressure when having to take business decisions again forget that there is insurance available for good faith but negligent acts. For acts that do not fall under this category, it may, in fact, correspond to the purpose of tort law to put the executive under pressure not to carry it out.[470]

Furthermore, all other directors and other members of society deal with the same tort law standards. Given that everyone is equally constrained, one may not be able to talk about a constraint at all any more.[471] On the international level, it may be that the tort standards in Canadian, English or German law are higher than elsewhere. However, to conclude from this that the tort standards in these jurisdictions should be lowered to the lowest standard that exists in the world does not look like the preferable solution, especially since states first of all have the task to protect their own citizens in the best way from torts.[472] Apart from that, it will not be so easy for corporations to get around the tort standard in another state once they operate their business there.[473]

The last main argument against the open tort law liability of directors and officers that has been presented is that the market would already without interference sufficiently

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[467] The D & O insurance crises proved itself to be only temporary. While prices may change reflecting the expected damages the market for insurance remains, see Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 312.
[468] *Ibid.* at 313.
[469] *Ibid.* at 314.
[470] *Ibid.* at 317.
[471] Glasbeek, *supra* note 448 at 449.
[472] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 320.
[473] *Ibid.*.

regulate the conduct of executives.[474] Although shareholders may eventually dismiss a director who is involved in the commission of torts, causing the corporation to having to pay damages, this may often only happen when a lot of damage has already been done.[475] Furthermore, in order for shareholders to react to potential losses imposed on them by holding the corporation, rather than the director or officer liable, these must outweigh the potential profits from the conduct carried out by these agents.[476] To expect shareholders to discipline directors and officers may also be unrealistic since what they lose in one investment may be compensated by a gain elsewhere.[477] It may therefore sometimes be difficult to motivate shareholders to act against their delinquent executives.[478]

It therefore looks like the general principle of tort law that those who cause harm to others should be held responsible is also valid for directors and officers. Directors and officers acting on behalf of the corporation are treated just as any other agents with regard to their liability for torts. However, as already mentioned above, the legal argument has sometimes been presented that the personal liability of directors and officers as agents of the corporation would interfere with its separate legal identity.

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[474] *Ibid.*.
[475] Sarra, *supra* note 27 at 58; Daniels, *supra* note 438 at 238.
[476] Glasbeek, *supra* note 448 at 432.
[477] *Ibid.* at 435.
[478] *Ibid.*.

Yet, as already pointed out earlier, this does not follow because the separate existence of the principal does not excuse the personal liability of an agent for tort in any other context.[479] Incorporation does not change this result for directors. The only effect of incorporation is to replace the corporation for the shareholders as principals.[480] Without the separate existence of the corporation, the directors would be the agents of the shareholders. With incorporation, they become agents of the corporate entity while the shareholders, who are not any more the principals, accept a new legal position defined by statue in relation to the corporation and to each other.[481] To consider this to involve a conflict with tort law would mean that there ought to be a deeper conflict between tort law and the general law of agency.[482] Another legal criticism has been that the broad concept of personal liability of corporate managers would eventually annul limited liability, in particular in the case of one-person corporations.[483] Yet, it has to be kept in mind that personal liability will not be attached to directors and officers merely because of their position within the corporation and that they cannot be held responsible for the torts of other employees unless they participate in, order or procure the tortious act.[484]

As these rules apply to all corporations no matter their seize, they principally are all exposed to liability in the same way.[485] Directors of one-man corporations may only have higher chances to be found liable since the low number of personnel makes it more likely that they are themselves participating in or ordering the tort.[486] To

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[479] See also Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 281. See Chapter 2, Part D. at 66, above.
[480] Flannigan, *ibid.*.
[481] *Ibid.*.
[482] *Ibid.*.
[483] Feasby, *supra* note 82 at 307. See Chapter 2, Part D. at 66.
[484] Flannigan, "Personal Tort Law Liability of Directors", *supra* note 21 at 281.
[485] *Ibid.*.
[486] *Ibid.*.

establish some exception with regard to the liability standard for directors of one-man corporations or to conclude from their situation that there should be a special liability standard for directors in general, would mean to discriminate in their favour as against to all other actors in society. This, however, cannot be really considered socially desirable, especially since it is often one-man corporations that do not have adequate insurance to satisfy the claims of third party tort creditors.[487]

Since there are no reasons which could justify a special treatment, directors and officers as agents of the corporation should be held liable for the commissions of a tort just as any other agent. The current state of law in Ontario (after *ADGA*), England and Germany therefore can be considered to take the correct approach. Yet, no liability should be attached to them in the case of the tort of inducing breach. The exception for this tort seems justified because a corporation should be allowed to choose to pay damages instead of performing a contract if it is in its best interests to do so.[488] This should be possible for the corporation to do without the consequences being visited upon their agents.[489] Furthermore, no liability should be attached to a director just because of him or her having general management responsibilities for a certain section of the business.

Such an assumption would extend the scope of liability too far. The German Federal High Court of Justice (BGH) should therefore listen to the critics of such an extension of liability and follow the approach taken in Canadian law already. Directors and officers should have to live up to the same tort standard as any other agent, not a more favourable but also not a stricter one (following the BGH decision in the "building

[487] Glasbeek, *supra* 448 note at 445.
[488] Feasby, *supra* note 82 at 297.

material" case would mean to apply a stricter tort standard to executives of legal entities). If a director or officer neglects his organizational duties, he or she should only be liable to the corporation. Duties of organization are owed to the corporation or the limited liability partnership, they should not be turned to also establish liability towards third parties outside of the legal entity.

[489] *Ibid.* at 298.

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LIST OF ABBREVIATIONS FOR PERIODICALS

AcP = Archiv für die civilistische Praxis

Can. Bar Rev. = Canadian Bar Review

Can. Bus. L.J. = Canadian Business Law Journal

DB = Der Betrieb

GmbHR = GmbH-Rundschau

Mod. L. Rev. = Modern Law Review

NJW = Neue Juristische Wochenschrift

RIW = Recht der internationalen Wirtschaft

S. Cal. L. Rev. = Southern California Law Review

S.C.L.R. = Supreme Court Law Review

U.T.L.J. = University of Toronto Law Review

VersR = Versicherungsrecht

WM = Wertpapier-Mitteilungen

Yale L.J. = Yale Law Journal

ZGR = Zeitschrift für Unternehmens- und Gesellschaftsrecht

ZHR = Zeitschrift für das gesamte Handelsrecht

ZIP = Zeitschrift für Wirtschaftsrecht