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Director personally liable for arbitration award

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The Ontario Superior Court of Justice found an officer and director of a company personally liable for an arbitration award that was based on oppressive conduct and breach of trust.

In *T. Films SA v. Cinemavault Releasing International Inc.*, the Ontario Superior Court of Justice found an officer and director of a company personally liable for an arbitration award

against that company. In particular, the court found that the President of Cinemavault Releasing International Inc. (“CRI”), who was also a director, personally benefitted from the oppressive conduct of CRI and its affiliated companies (of which he was also president and director).

The basis for liability was both the oppression remedy and breach of trust. This was the case even though there was no privity of contract between the applicant and the President, or any of the corporate affiliates.

Oppression remedy

The *Canada Business Corporations Act* and its provincial counterparts provide

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WHITE COLLAR CRIME

Cybercrime increasing in quantity, complexity and sophistication

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Many varieties of cybercrime, which is on the rise in Canada, target businesses and corporations.

Technology creates new opportunities for criminals; as technology evolves, so, too, do the potential criminal uses for it. The criminal exploitation of

new and emerging technologies – such as cloud computing, anonymous online networks and virtual currency schemes – requires businesses to be proactive to protect themselves in a digital era.

In Canada, cybercrime is increasing in quantity as well as in technical complexity and sophistication. The increasing dangers of cybercrime were highlighted in December 2014, when the RCMP released its first ever report on cybercrime.

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Punishment is justice for the unjust.

~ Saint Augustine
(354 AD – 430 AD)

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WHITE COLLAR CRIME

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Directors' and Officers' Liability

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that directors may be personally liable for conduct which is found to be

oppressive or unfairly prejudicial to or that unfairly disregards the interests of ... [any] security holder, creditor, director or officer

of the company.

In *Budd v. Gentra Inc.*, the Court of Appeal for Ontario concluded that a director should only face personal liability for oppressive conduct if it can be alleged that specific acts or omissions by the director led to the corporation acting oppressively and the appropriate remedy is a monetary order against a director personally.

Generally, courts have found this test to be more easily satisfied when the corporation is closely-held, such that the director's acts are directly connected with the oppression, and where the director personally benefited from the oppressive conduct of the corporation.

However, in widely-held corporations, and those situations where the director has not personally benefitted, directors are not immune from a finding of personal liability.

Arbitral award

In 2004, T. Films, the owner of a movie (entitled "Three"), and CRI, a sales agent and distributor of films, entered into a 25-year sales agency agreement ("SAA"). As a result, CRI became the exclusive agent for the distribution of "Three."

Under the SAA, CRI was obliged to collect gross receipts from the movie's sales, which were to be paid out according to a prescribed methodology.

The SAA provided that any claims arising out of the SAA were to be resolved by arbitration. In 2012, T. Films commenced arbitral proceedings seeking unpaid distribution revenues and other relief. Ultimately, the arbitration proceeded on an undefended basis.

CRI was found to have failed to disclose the existence and extent of various distribution activities, amongst other things. The arbitrator ordered CRI to pay damages and costs totalling just under US\$500,000. However, CRI did not pay the amount awarded.

Asset transfer

As it happened, CRI had ceased carrying on business prior to the commencement of the arbitration and had no assets to pay the arbitral award. The evidence established that its President had transferred all of its assets and distribution business to its affiliated corporations. Further, without any notice to T. Films, CRI had assigned its rights under the SAA to an affiliate company.

The President acted in a manner which was oppressive and unfairly prejudicial to CRI's creditors and was therefore found to be personally liable for the arbitration award.

Enforcement of award

T. Films commenced an application seeking an order enforcing the arbitration award in Ontario and an order declaring that the President and CRI had acted oppressively in connection with the corporate transactions involving CRI and its affiliates. T. Films also sought compensation in the amount of the arbitration award and related relief.

Based on the evidence, the court concluded that CRI's right to distribute the movie and collect the associated revenue stream had been diverted to an affiliated corporation without consideration, leaving CRI with nothing, the purpose of which was to render CRI incapable of paying the arbitration award.

The court held that the President could not treat his corporations'

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Directors' and Officers' Liability *continued from page 10*

contractual and financial obligations like an elaborate shell game where, unless the pea happens to sit under the shell selected by a creditor, [the President] and his companies are judgment proof.

As there was no way that the applicants could have foreseen CRI's conduct, nor any way that they could have protected themselves, the court held that CRI's affiliated corporations acted in a manner that was oppressive and unfairly prejudicial to the applicants. The court therefore held that CRI and its affiliates were liable for the award.

Personal liability

In addition, the court noted that directors have been found personally liable in oppression remedy cases where the corporation is a small, closely-held entity. This has been the case where the director, whose conduct is attacked, is the controlling owner and directing mind of the corporation; and the conduct in question has redounded directly to the benefit of that individual.

Directing mind

In this case, the court found that the President was the directing mind of CRI and the affiliated corporations, and funds that ought to have been paid to the applicants were diverted from CRI to affiliated corporations for the President's benefit.

As such, acting *qua* director, the President acted in a manner which was oppressive and unfairly prejudicial to CRI's creditors and was therefore found to be personally liable for the arbitration award.

Breach of trust

The Applicants also alleged that the funds received from the distribution of "Three," the unpaid portion of which was represented by the arbitration award, were trust funds in CRI's hands.

They claimed that, in knowingly receiving those funds and failing to remit them, the affiliated corporations and the President actively and knowingly participated in a breach of trust.

Directors and officers may be found personally liable for the obligations of a corporation where they have acted in a manner which unfairly disregards the interests of stakeholders in the company, or for breach of trust.

To constitute a trust, an arrangement must have certainty of intention, subject matter and object. The court held that the agency relationship between CRI and T. Films, as well as the provisions of the SAA, led to the conclusion that CRI was a trustee and fiduciary to the extent that it collected revenues from the sale and distribution of the movie. As such, CRI was liable to the Applicants for those revenues.

Clarity of intentions

Further, the provisions of the SAA made the subject matter of the trust "absolutely clear," and the beneficiaries of the trust were clearly set forth, such that there was no doubt about the objects of the trust.

As a result, the court held that the amount held by CRI, excluding the arbitrator's award of costs, were trust funds for which CRI was liable.

The President and CRI's affiliated corporations were found to have knowingly participated in the breach of trust and knowingly received trust funds which they knew to be the rightful property of the applicants. As such, both the President and CRI's affiliated corporations were found liable for the arbitrator's award for knowing participation in a breach of trust.

Significance

Directors and officers are not immune from liability imposed upon the companies they serve, irrespective of whether that liability arises in the context of civil or arbitral proceedings.

They may be found personally liable for the obligations of a corporation where they have acted in a manner which unfairly disregards the interests of stakeholders in the company, or for breach of trust.

This liability may arise even where there is no direct relationship between the director and the stakeholder. In the result, directors and officers should be mindful of the rights and interests of stakeholders in the companies for which they serve.

REFERENCES: *T. Films S.A. v. Cinemavault Releasing International Inc.*, 2015 ONSC 6608, 2015 CarswellOnt 112 (Ont. S.C.J.); *Canada Business Corporations Act*, R.S.C., 1985, c. C-44; *Budd v. Gentra Inc.*, 1998 CarswellOnt 3069, 43 B.L.R. (2d) 27, 111 O.A.C. 288, 69 O.T.C. 159, [1998] O.J. No. 3109 (Ont. C.A.).

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Definition

Broadly defined, cybercrime is a criminal offence involving a computer as the object of the crime (i.e., hacking,

phishing, and spamming), or as the tool used to commit a material component of the offence (i.e., identity theft, intellectual property infringement, money

laundering, child sexual exploitation and cyber bullying).

Cybercrimes do not always come from the outside. Companies may

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