
DECISION IS WARNING TO SHAM CORPORATIONS

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A. INTRODUCTION

An Ontario appeal decision has provided useful guidelines for determining when the corporate veil can be pierced, leaving directors liable for costs in litigation. In reversing a lower court decision, the Ontario Court of Appeal in *The St. James' Preservation Society v. Toronto (City)*, 2007 ONCA 601, suggested that the determination that The St. James' Preservation Society (the "Society") was a sham or "man of straw" corporation resulting in the individual directors being held liable for court costs in excess of \$100,000 was premature and required a full hearing on the costs issue. Instead, the Court of Appeal concluded that the individual members of the Society did not receive adequate warning in this case that costs would be sought against them personally and that the exceptional circumstances did not exist for a personal costs award to be made against them. This *Charity Law Bulletin* will review the decision and discuss its implications for not-for-profit organizations and their directors.

B. BACKGROUND

The transaction at the centre of the dispute involved certain lands on which St. James' Cathedral is located in the City of Toronto. The land on which the cathedral is located was granted in trust in 1817. The trustees surrendered the 1817 patent in 1820 and a new patent was issued which divided the land in two separate parcels, each with a distinct trust. The Rector and Churchwardens of St. James' Cathedral is the corporation that holds title to the land as trustee ("St. James"). In 2002, St. James entered into an agreement with the City of Toronto and a developer to transfer some of the zoning density from the church lands to the developer's nearby condominium property. St. James would receive \$3.7 million for this transfer and intended to use the

funds to restore church buildings on the property. St. James also entered into a Heritage Easement agreement and a Section 37 *Planning Act* agreement (a Section 37 agreement is an agreement by the municipality to increase the height or density of a development in return for the land owner's provision of facilities, services or matters) with the City of Toronto (the "Transactions").

The Society was incorporated as a non-share capital corporation on August 7, 2003, with Peter Currie ("Currie") and Dougall Grange ("Grange") as two of the three first directors of the corporation and objects to "promote the preservation and protection of certain historical properties within the City of Toronto, more specifically ... part of the Episcopal Block A, on the Town of York Plan, municipally referred to as 106 King West, and locally known as St. James' Cathedral, and the associated burying ground and church yard." The Society objected to the Transactions and brought an application against the City of Toronto and St. James, seeking orders quashing the zoning by-laws, as well as declaratory relief with respect to the terms of the trust, the proper use of the land, and the proper use of the funds raised by the density transfer.

Although a partial settlement agreement was reached, the amended application proceeded with respect to five issues:

1. a declaration that the money St. James received on the density transfer was impressed with a trust;
2. a declaration that the funds cannot be used for the Diocesan Centre;
3. a determination of the identity of the beneficiaries;
4. an order that the funds remain in court until the *Planning Act* agreement conformed to the court's orders; and
5. an order that St. James report to the Society on the use of the funds.

C. THE LOWER COURT DECISION

On the issues presented by the Society, the lower court held that the funds received from the density transfer were impressed with a trust, but that the funds could be used for the Diocesan Centre. Further, the court held that the beneficiaries of the trust were the “parishioners of St. James’ Cathedral and the inhabitants of the City of Toronto”, a class that is to be understood disjunctively, thereby rejecting the position of the Society that the definition should be read conjunctively and requiring the use of the monies to benefit both parishioners and inhabitants. The court refused to grant any other relief sought.

On the issue of costs, the lower court held that St. James was entitled to its costs on this matter. One of the Society’s positions was that each party should bear their own costs, since the application was brought in the public interest and in light of the Society’s success. The Society further argued that the exception order of a personal award of costs was not appropriate because the Society was acting in the public interest.

The court examined five issues in determining whether an unsuccessful litigant should be excused from paying costs because it was acting in the public interest. These issues include the following:

1. the nature of the unsuccessful litigant;
2. the nature of the successful litigant;
3. the nature of the litigation – was it in the public interest;
4. whether the litigation had any adverse impact on the public interest; and
5. the financial consequences to both parties.

On the first issue, the court accepted that the Society was not acting to vindicate a private interest and did have a subjective belief in the issues raised. Further, the Society had a genuine interest in this litigation and that there were no other potential litigants who were better suited to have brought this application. However, the fact that St. James was a private corporation whose work is in the public interest and who was forced to participate in this litigation militated against an order forcing St. James to bear its own costs. In reviewing the third issue, although the court accepted there was some element of a public interest in the application, it concluded that the application was not in the public interest because many of the arguments advanced were totally devoid of merit and the Society had improperly tried to re-litigate matters that it had already settled by way of the partial settlement agreement. Further, the application had an adverse impact on the public interest

as St. James was forced to spend considerable funds in defending it that could have otherwise been used to benefit the public. Although a costs order against the Society would bankrupt it, the court concluded that there was no reason to refuse a costs order, especially because it was incorporated with a view to this litigation and had no prior history of public interest activity.

In order for St. James to obtain the non-party costs award (i.e. a personal award of costs against individuals that were not parties to the litigation) against the directors of the Society, it was necessary to demonstrate that the directors had status to bring the application themselves, the Society was not the “true applicant”, and the Society was a sham put forward to protect the true applicants from liability for costs. In this regard, the court concluded that the directors could have brought the application in their own names either as beneficiaries of the trust (i.e. inhabitants of the City of Toronto) or under the Charities Accounting Act (Ontario). Noting that there was no evidence that the Society had any other members or that it represented anyone else, the court concluded that the directors were the true applicant. In support of this contention, the court noted that Grange and Currie controlled the conduct of the litigation and participated fully throughout the process. Finally, the court concluded that the Society was “simply incorporated to protect the directors from personal liability ... precisely the type of improper conduct that justifies the making of a costs order against a non-party.”

D. COURT OF APPEAL DECISION

The Ontario Court of Appeal held that the lower court’s overall conclusion that the litigation was not public interest litigation justified an award of costs against the Society, but that it was not sufficient to justify an award of costs against the directors of the Society who were not parties to the litigation. In this regard, the court stated that “the trial judge’s clear findings that the Society and the appellants had a genuine interest in this case, that they were not acting to vindicate a private interest or for personal gain, that the issues extended beyond the immediate parties and that no other persons were better suited to raise the novel issues they did, are incompatible with his decision to award costs personally against the non parties.”

Looking at the procedural fairness issue of awarding costs personally against non parties, the Court of Appeal acknowledged that a settlement offer stated that if the offer was not accepted, St. James would seek costs against the directors of the Society personally, but described it as a common practice and an issue that was only raised shortly before the application proceeded. The Court of Appeal further suggested that had St.

James brought a motion for security for costs in advance of the application being heard, the issue of the directors' personal liability could have been raised at that time, but no such motion was brought. The Court of Appeal also rejected the conclusion that the Society was a sham corporation, noting that the lower court had affidavit evidence that suggested other parties, while not proclaiming to be members of the Society, had similar concerns with respect to the legality of the Transactions. As a result, it was the Court of Appeal's opinion that the lower court would have been in a better position to determine whether the Society was a sham after it had presided over a full hearing on the costs issue. Similarly, the court noted that issues of personal gain and an abuse of process did not appear to be present in this case like the precedents upon which St. James was relying. As such, the exceptional circumstances necessary to exist for a costs award against the directors personally did not exist according to the Court of Appeal.

E. COMMENTARY

Although the Court of Appeal did not find the exceptional circumstances present to warrant a personal costs award against Currie and Grange in this case, the decision should serve as a warning for others who seek to use the non-share capital corporation for the purposes of avoiding liability associated with their public interest litigation activities. The decision does not preclude a finding by the courts that individuals that are pursuing personal interests through a sham corporation will be held liable for costs on a personal basis, whether or not the litigation can be characterized as frivolous or vexatious or an abuse of process. In this regard, the decision suggests that organizations incorporated for the purpose of pursuing a public interest need to address a number of issues prior to engaging in costly litigation in order to protect directors from potential personal liability, including the ensuring the following:

- the organization has a genuine interest in the outcome of the litigation. A history of activity by the organization related to the public interest issue may help demonstrate this interest;
- the organization is not acting to vindicate a private interest, and the individual directors do not stand to gain personally from the litigation;
- the litigation involves novel issues that have not previously been interpreted by the courts and are not the subject of settlements; and
- no other potential litigants would be better suited to bring the litigation.

As the Court of Appeal noted, if these factors are present, it takes the litigation out of the realm of an abuse of process, a basis upon which the court may award costs personally against individual directors.

F. CONCLUSION

Public interest litigation has an important place in the legal system, providing an additional check and balance in society when issues fail to be addressed by the main parties in transactions. Yet, the practicalities involved with individuals personally commencing such litigation, i.e. the significant costs and demands on resources, makes the non-share capital corporation (either charities and not-for-profit organizations) a desirable structure, as it permits persons with common interests to join together for a common cause without exposure to personal liability for its members. However, it is clear that it is possible for individuals to abuse the sheltering effects of a non-share capital corporation for personal gain, as well as using the structure to commence frivolous or vexatious litigation while avoiding personal costs. The Ontario Court of Appeal's decision in *The St. James' Preservation Society v. Toronto (City)* provides some important guidance for groups who have a true interest in public interest litigation in order to ensure protection for the directors of these organizations.