

# KEEPING CURRENT

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## “The Total Fraud Test is Still Alive”

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The Supreme Court's recent decision in *Christine DeJong Medicine Professional Corporation v. DBDC Spadina Ltd.* (DBDC Spadina) clarified the law regarding whether corporations are civilly liable for the fraudulent actions of their director or officer. Ultimately, a corporation will be liable for the fraud of a director or officer if the actions 1) were designed or completed to the benefit or partial benefit of the corporation; and 2) the actions were done in the scope of the director or officer's authority.

### The Facts

In this case, the Christine DeJong Medicine Professional Corporation (“DeJong PC”) and DBDC Spadina Ltd. (“DBDC”) had both been defrauded as victims of real estate fraud at the hands of Norma and Ronauld Walton. The Waltons convinced the victims to invest with them equally in corporations for the purpose of buying, renovating, and maintaining commercial real estate properties in Toronto. The Waltons did not invest funds of their own, instead moving the investors' contributions through their own clearing house to further their own interests.

DBDC sued the Waltons directly. DBDC also sued the DeJong PC over priority in claiming the remaining proceeds from the sale of some properties acquired as part of the Waltons' fraud. In addition to

investing with the Waltons, De Jong PC had also entered into equal shareholder agreements with the Waltons for project corporations (the “DeJong project corporations”). DBDC claimed that the DeJong project corporations assisted in and received benefits from the Waltons' breach of fiduciary duty. Norma Walton was the directing and controlling mind of the DeJong project corporations at all material times.

The question at issue was whether Norma Walton's control over the DeJong companies made the DeJong companies civilly liable for the fraud as well.

### Corporate Civil Liability

The rules for corporate liability in civil cases were laid out in *Canadian Dredge and Dock Co. v. The Queen*. The corporation may be liable if the action taken by the directing mind:

1. Was within the field of operation assigned to him
2. Was not totally in fraud of the corporation
3. Was by design or result partly for the benefit of the company.

The second requirement of *Canadian Dredge* is commonly referred to as the “total fraud doctrine.” The total fraud doctrine specifies that the actions of

the directing mind will not be attributed to the corporation if the corporation was a total victim of the scheme. In other words, if the directing mind of a corporation was acting within their capacity and attempted to secure any benefit – partial or full – for the corporation through fraudulent means, then corporate attribution can occur.

In *DBDC Spadina*, the majority at the Court of Appeal was prepared to lower the burden to meet the *Canadian Dredge* test in civil cases. The Supreme Court of Canada overturned the majority decision of the Ontario Court of Appeal, instead adopting the dissent of Justice van Rensburg in its entirety. Unlike the Court of Appeal, the Supreme Court did not find the DeJong project corporations liable because the lost DBDC funds could not be directly traced back to the DeJong project corporations' accounts.

### Insights

The Supreme Court's judgement in *DBDC Spadina Ltd.* confirms that the total fraud test is still alive, and the *Canadian Dredge* requirements should not be loosened to find corporate liability in civil cases. Rather, the *Canadian Dredge* test enumerates a minimum threshold of requirements which must be met to attribute corporate liability.

The Supreme Court's decision follows the *Canadian Dredge* reasoning that if there is total fraud of the corporation, the actions of a senior official or directing mind cannot be attributed to the corporation. If the corporation is entirely a victim of the fraudulent scheme, the corporation of course gained no benefit from the actions of the directing mind. Thus, the directing mind was acting alone and for their own benefit – meaning that the corporation attribution should not occur.

Along the same vein, if the corporation benefitted even partially from the fraudulent actions of the directing mind, the corporation will be found liable for the fraud based on corporate attribution. The Supreme Court also added a nuance not previously part of the case law in attributing corporate liability. The Court stated that "What the Court directed in *Livent*, at para. 104, was that even where those criteria

are satisfied, "courts retain the discretion to refrain from applying [corporate attribution] where, in the circumstances of the case, it would not be in the public interest to do so" (emphasis added). In other words, while the presence of public interest concerns may heighten the burden on the party seeking to have the actions of a directing mind attributed to a corporation, *Canadian Dredge* states minimal criteria that must always be met."

Despite the above, the Supreme Court's decision has not meaningfully parted from the thresholds of the total fraud doctrine. As such, corporations should protect themselves against being implicated in fraudulent schemes because a directing mind or senior official took action to partially or fully benefit the corporation. Corporations should develop or enhance internal compliance programs and mechanisms to counter against fraudulent activity within organizations.

The Gardiner Roberts LLP Compliance Risk Solutions Group is able to advise on compliance and regulation matters. Given the judgment from the Supreme Court confirming that corporate liability standards will not be loosened in civil cases, our team is able to help your organization develop the necessary internal mechanisms and risk matrixes to counter fraudulent activity.

Please do not hesitate to contact us if you have questions or concerns regarding these developments or the Supreme Court judgment, and how they may affect your business operations.