



SHAREHOLDER | PARTNER COUNSEL

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“Here comes the scary part. The trial court also found the company’s principal personally liable...”

THE GHOSTPINE CASE: A SCARY TALE FOR BUSINESS PRINCIPALS*

Alberta businesspeople recently saw a frightening turn of events in a case involving *Ghostpine Lake Golf & Country Resort*. The action was brought by members of a vacation resort time share scheme who were, understandably, disappointed and disgruntled because they did not get what they paid for. The resort was owned and operated by an Alberta numbered company.

The members alleged that Ghostpine was run poorly by the numbered company, and subject to “some of the worst management practices one could possibly imagine”. Other problems included a faulty sewage lagoon, which caused the health authorities to shut down the resort for an extended period spanning two summer seasons. Ultimately, the resort was ousted from the international organization through which the time share members could exchange their units for accommodation in other resorts.

The members collectively sued not only the numbered company, but also its principal, Sam Morrow, who had personally made all of the important decisions in respect of the resort.

The Alberta trial court found that the company’s actions, or inaction, had been the cause of the members’ financial losses, in that it had neglected to approve the construction of a new sewage lagoon. As well, it had taken no steps to satisfy the concerns of the international time share organization, resulting in the cancellation of the association between the organization and Ghostpine.

According to the trial judge, all of this amounted to negligence by the company.

A Court can only find negligence where it concludes that:

- (a) A duty of care is owed by the Defendant to the Plaintiff;
- (b) The Defendant has breached that duty of care; and
- (c) Foreseeable damages have arisen.

According to the trial court, the numbered company had owed a duty of care to the time share members to act in their best interest. Because it should have known that inaction would cause harm to these people, and because that harm was foreseeable, the numbered company was found to have been negligent and so was liable for the financial losses of the members. A very reasonable conclusion.

Here comes the scary part. The trial court also found Morrow personally liable for all of the economic losses sustained by the Plaintiffs. Now, uncover your eyes, read on and let us ease your minds. The finding of liability was overturned by Alberta’s Court of Appeal.

The appeal court answered “yes” to the question of whether corporate shareholders, directors or employees can be held personally liable - *even where their actions are performed in the course of their duties to the company*. But, the court went on to say that such a finding requires evidence that those people have exhibited an interest separate from that of the company. That is, their actions must reflect conduct by the individual and not the corporation.

*Mr. Prowse acknowledges the research and editorial assistance of Karen M. McDougall, BA, LLB in the publication of this newsletter.

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Alberta Court of Appeal

Based on this requirement, the Court of Appeal found that Morrow’s conduct did not make him personally liable in negligence. It found that he hadn’t been acting in his individual capacity when making decisions affecting the time share members. In any event, the Court found that Morrow’s actions, or his failure to act, did not pass the general test for a finding of negligence.

The Court also noted that the Plaintiffs’ damages in this case were all strictly economic (as opposed to, for example, physical). Courts will rarely find a duty against causing pure economic loss to someone else, and it refused to do so in this case.

The Court’s ultimate conclusion was that the company and its principal had not been negligent, and so were not liable to the time share members. They were guilty only of failing to spend money on large-ticket items that the company (seriously undercapitalized as it was) simply couldn’t afford. But, as the Court put it:

We know of no case which imposes personal liability on a shareholder of a corporation, much less an individual, to spend large sums like that, merely because one foresees that one’s “neighbors” will suffer loss if one does not.

The Court also threw out the additional argument that Morrow, in his capacity as a shareholder / director and manager, was personally liable for failing to inject additional funds into the corporation so that it could meet its financial obligations.

So, for all you directors, shareholders and

principals, sleep well — for now. It is still the law in Alberta that you will not be held liable for not pumping money into a failing corporation; nor because your company has caused financial damage to corporate customers.

However, the spectre of liability is never far away. So, we will continue to look under the bed (and in the legislation, regs and CCRA bulletins) for additions to the list of scenarios attracting shareholder and director personal liability.

Did you know...

Canada has a new personal information law. On January 1, 2001, Part 1 of the *Personal Information Protection and Electronic Documents Act* was proclaimed in force. Part 1 regulates the collection, use or disclosure, by federally-regulated private sector organizations, of personal information in the course of their business activities. Until 2004, this legislation applies only to federally-regulated private sector organizations (for example, banks and telecommunication organizations). On January 1, 2004 the net will widen.

In the next issue of *Shareholder / Partner Counsel...*

Arbitration clauses – those paragraphs with a punch. How they can help you and hurt you.

The legal professionals at Prowse Chowne LLP bring you *Shareholder / Partner Counsel*, dedicated to the discussion of issues particularly important to the small businessperson. Look for it bi-monthly for information and insight into the various legal remedies available to shareholders or partners with grievances; means available to resolve inter-shareholder disputes, including mediation; the oppression and derivative action remedies available through the Alberta *Business Corporation Act*; conflicts of interest; issues related to shareholder agreements; and much more.



LEGAL COUNSEL

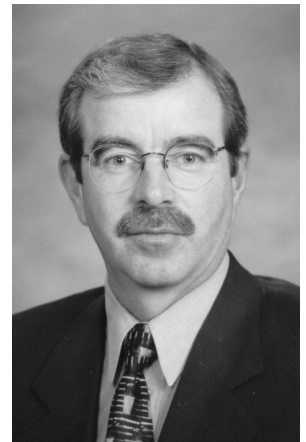
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J. Cameron Prowse, BA LLB, a managing partner in Prowse Chowne LLP, offers over 22 years of legal expertise to the Alberta and N.W.T. business communities. A recognized and practiced litigator, Cameron has a special interest in business law.



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