Canadian Companies and the Effects of Foreign Operations Out of Sight Front of Mind

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As the domestic Canadian economy continues to mature, companies with a healthy appetite for risk can find themselves looking outside Canada to generate significant returns. Investments in foreign jurisdictions come with a myriad of challenges – uncertain legal structures and slow and cumbersome regulatory processes are just two of many, but the risk profile of these foreign adventures can be high for Canadian companies.

One issue Canadian companies often overlook in assessing the risk of an international venture is the effect Canadian domestic courts can have on the venture's success, notwithstanding the fact that the venture has little actual connection to Canada. Foreign litigants are increasingly using the Canadian court system to attempt to recover damages from Canadian parents or affiliates in cases where the claim arose from foreign operations entirely conducted by a foreign affiliate or subsidiary of the Canadian parent. A claim for negligence against the parent can give rise to damages under Canadian law, where such a claim might not be successful in the host country against the foreign affiliate actually undertaking the venture. Further, enforcement of foreign-obtained judgments against Canadian companies is relatively easy, in that Canadian courts are generally deferential to foreign courts' findings. Therefore, if a Canadian entity finds itself on the wrong end of a foreign judgment, it is relatively easy to enforce that judgment against the Canadian entity's assets in Canada. All this is to say that Canadian companies should include what Canadian courts might do when they are deciding whether to undertake foreign operations, and how to structure those operations.

There are two very recent high profile examples where lawsuits were brought in Canada against Canadian-domiciled companies but the matters actually being litigated had marginal connections to Canada. Because of of valuable Canadian-based assets, or because of the Canadian law of negligence, however, the plaintiffs asked Canadian courts to provide a remedy, as opposed to the court where the operations took place.

These cases highlight several key points:

- if the court system in the foreign jurisdiction is shown to be corrupt or dishonest, a Canadian court may be chosen as the court to decide the lawsuit, irrespective of limited connection to Canada;

- foreign litigants may argue that they are protected by Canadian negligence law for actions taking place in a foreign jurisdiction;
- statements about corporate social responsibility made by a Canadian parent might serve as an avenue for establishing a claim against the Canadian parent in a Canadian court;
- it is vitally important to construct and maintain a separate structure for international affiliates, to avoid a scenario where the corporate veil can be pierced; and;
- foreign litigants are often sympathetic (i.e. villagers who have been subject of environmental damage and poisoning, or protesters who have been shot by security personnel); therefore Canadian courts may wish to find a remedy for them out of a sense of doing what's right.

A Word on Process

Foreign actions brought in Canada invariably start with a fight about jurisdiction, and a determination of the most appropriate court to hear the action. The Canadian test is "*forum conveniens*" – a Canadian court would be asked if the foreign court (likely where the operation is located, or where the damages occurred) is the most appropriate forum to decide the action, or whether there are reasons why a Canadian court should take jurisdiction and decide the case.

If the foreign court is the most appropriate forum, the question then arises about enforcement of a judgment issued by the foreign court. It is relatively easy to enforce a foreign-obtained judgment against a Canadian company and this has led some litigants to attempt to enforce judgments against Canadian assets, even where the Canadian company or Canadian assets had nothing to do with the claim itself.

Forum Conveniens and Corporate Social Responsibility – BC Court of Appeal Lifts the Stay in *Garcia v Tahoe Resources Inc* .

The latest decision attempting to hold Canadian parent companies liable for the actions of foreign subsidiaries was released at the end of January by the BC Court of Appeal. Readers of the blog will be familiar with the case of *Garcia v Tahoe Resources Inc.* (2017 BCCA 39) (we have previously written about *Garcia v Tahoe Resources Inc. Dodging the Corporate Veil - Recent Attempts to Hold Companies Liable for the Actions of their Foreign Subsidiaries* and *Court Refuses to Hear Corporate-Veil Case*), filed in June 2014. The case concerns a claim for damages brought by Guatemalan plaintiffs against a Canadian parent company, Tahoe Resources Inc. (Tahoe), over the actions of mine security personnel at the Escobal mine in Guatemala. The mine is owned by two subsidiaries of Tahoe, and the Tahoe subsidiariessubsidiaries hired a private security contractor that shot Guatemalan protesters during a protest at the mine, killing one and injuring six others.

The case has been tied up in jurisdictional arguments since it was commenced. The chambers judge had at first instance held that Guatemala was the more appropriate jurisdiction to hear the case, as both a criminal proceeding and also a potential civil suit

in Guatemala were in process; accordingly, he stayed the Canadian court action. The chambers judge also found that the plaintiffs could obtain a fair trial in Guatemala.

Decision

The BC Court of Appeal overturned the stay and allowed the action to proceed against Tahoe in Canada, finding that there was a serious risk of unfair process in Guatemala. It held that the chambers judge had improperly framed the threshold question as whether Guatemalan courts were "capable" of providing justice; instead the Court held that the correct test is whether the evidence discloses **a real risk of an unfair trial process in the foreign court** .

With respect to the criminal proceedings in Guatemala, the Court of Appeal admitted new evidence showing that the Guatemalan criminal proceeding had been stayed as a result of the accused security personnel fleeing the country; this fact was critical in the Court's decision to lift the stay.

The Court considered several factors with respect to the Guatemalan civil action: the limitation period and discovery procedures for civil suits in Guatemala; the inherent difficulty in joining a Canadian entity to a Guatemalan civil action; and the expiry of the limitation period to bring a civil action in Guatemala. Tahoe argued that the failure to file suit in time was a failure of the plaintiffs to honour the governing law and their failure should not be visited on Tahoe, but the Court viewed this as one more reason why Guatemala was not the appropriate forum and that the Canadian action should proceed.

The risk of unfairness inherent in the Guatemalan justice system was also a deciding factor. Evidence of corruption in the Guatemalan justice system particularly with regard to criminal proceedings against "illegal security forces and clandestine security structures" was brought into evidence at the Court of Appeal. Also, the Court put more emphasis on the events of the shooting and the social conflict involving mining activity in Guatemala than did the chambers judge, who had treated the events as a personal injury case without considering the social context.

Analysis – Corporate Social Responsibility and the Corporate Veil

Canadian companies with foreign operations will be watching the proceedings in *Tahoe* with interest, now that the jurisdictional arguments have been resolved, because of the innovative claims that the Guatemalan plaintiffs have brought. Every corporate lawyer worth his or her salt has advised clients to ensure that operations in foreign jurisdictions are conducted by a subsidiary which has nothing connecting it to Canada, except potentially for board members and share ownership. In doing so, a "corporate veil," insulating the parent from liability for the actions of its subsidiaries, is established. This corporate veil would be pierced only in limited situations and this case does not seem at first blush to be one where the corporate veil is likely to be pierced.

The plaintiffs' claims in *Tahoe* are novel because they focus on the Canadian parent's public statements regarding its commitment to corporate social responsibility, thus avoiding the corporate veil issue altogether. The plaintiffs argue that Tahoe is directly liable in tort (specifically negligence, battery and conversion) as a result of (i) its public statements of oversight and maintenance of standards at the Escobal mine; and (ii) its

adoption of various international standards, such as the 2006 IFC standards on social and environmental performance and the Voluntary Principles on Security and Human Rights. The plaintiffs claim that the contractors' actions were in direct conflict with both Tahoe's public statements and the international standards it had ascribed to, and as Tahoe had acknowledged that it retained ultimate control over and had responsibility for operations in Guatemala, particularly security practices, it was responsible to the plaintiffs. Whether the operations were actually conducted by Tahoe or its Guatemalan subsidiary becomes irrelevant.

While there are challenges with this approach, including remoteness and reliance, the fact that the action is proceeding on the merits gives significant leverage to the Guatemalan plaintiffs to negotiate a settlement. The Court did not dismiss the action out of hand and a Canadian trial result where the plaintiffs were successful could have a material effect on Tahoe. In other words, watch this space.

Enforcement of Foreign Judgments against Unrelated Subsidiaries: the Latest Chapter in the Saga of the Ecuadoran Villagers

The latest chapter in *Yaiguaje v. Chevron Corporation* (2017 ONSC 135) (discussed in *Supreme Court of Canada confirms generous and liberal approach to the recognition and enforcement of foreign judgments*) was released on January 20, 2017. The case arises from environmental claims made by Ecuadoran townspeople against Texaco (now Chevron). Chevron conducted crude oil drilling and production in the Ecuadoran jungle between 1967 and 1992, and the plaintiffs sued Chevron in 1993 as a result of ongoing health problems and environmental damages they claimed arose from the operations. After an eighteen-year odyssey through the US and Ecuadoran court system, in 2011 the Ecuadoran plaintiffs were awarded $9 billion in damages against Chevron.[1]

The problem for the plaintiffs was collection of the Ecuadoran judgment. Chevron had left Ecuador in 1993, and there were no assets in Ecuador to be seized. Further complicating matters, there was evidence that the Ecuadoran judgment had been obtained by fraud and deceit. The strategy plaintiffs' counsel subsequently employed was to seek to enforce the judgment in foreign jurisdictions where Chevron did have assets – including Canada.

Part of the reason the plaintiffs chose Canada is its relatively low threshold for enforcement of foreign judgments. In *Beals v. Saldanha* ([2003] 3 S.C.R. 416), the Supreme Court of Canada expanded the *Morguard*[2] test for enforcement of inter-provincial judgments to include enforcement of judgments from foreign jurisdictions. In short, the test is that the subject-matter of the action must have a "real and substantial connection" to the jurisdiction where the action was brought; once that is shown, there are limited defences to the enforcement of the action. Generally speaking, in order for a judgment not to be enforced, it must be shown that the judgment was obtained fraudulently, that the judgment offends natural justice, or that the judgment is against public policy. Barring unique circumstances, no other defences are permitted.

The main hurdle for enforcing the judgment against Chevron in Canada, however, was not a conflict of laws issue; instead, it is a basic corporate law issue–corporate separateness. Chevron's assets in Canada were owned by Chevron Canada Limited and Chevron Canada Financial Limited (together, Chevron Canada), who were not party

to the Ecuadoran action and had no connection to Ecuador. Further, the shares of each were not owned by a party to the Ecuadoran action either; they were owned by a different Chevron subsidiary. Therefore, the shares of Chevron Canada and their respective assets would normally be immune from seizure to satisfy the judgment, unless the Chevron Canada "corporate veil was pierced" – that is, the Court found that Chevron Canada liable for the obligations of other entities in the Chevron conglomerate.

Once the plaintiffs brought their action to enforce the judgment in the Ontario Court, Chevron Canada sought summary judgment against the plaintiffs that Chevron Canada was not subject to the Ecuadoran judgment and therefore the enforcement action could never succeed; the plaintiffs by countermotion sought to have Chevron's entire defence struck out as being non-compliant with *Beals v. Saldanha*. It therefore rested with the plaintiffs to show how their action to enforce the Ecuadoran judgment could ever succeed under Ontario and Canadian law.

The plaintiffs' first argument arose pursuant to Section 18 of the *Execution Act* (Ontario), which permits the sheriff to "seize and sell any equitable or other right, property, interest or equity of redemption in or in respect of any goods, chattels, or personal property." Their argument stated that this language was broad enough to permit Chevron's interest in a subsidiary many levels down on the organizational chart to be seized.

Hainey J. rejected this argument out of hand, finding that the *Execution Act* was a procedural statute only, and that Chevron Corporation, the party to the Ecuadoran lawsuit, did not have any interest, beneficial or otherwise, in the shares or assets of Chevron Canada and hence the statute was inapplicable. Chevron Corporation might be the ultimate corporate owner of Chevron Canada, but the law does not recognize ultimate ownership as being actual ownership – each entity stands on its own as a distinct entity.

Second, and most importantly for Canadian corporate lawyers, Hainey J. did not find facts giving rise to a situation where piercing Chevron Canada's corporate veil was appropriate. In order for the corporate veil to be pierced, the plaintiffs were required to meet the two steps in the widely accepted *Transamerica* test[3]: that Chevron Canada was "completely controlled and dominated" by Chevron Corporation; and second that the corporate structure was being used as a shield for improper or fraudulent conduct. Hainey J. found instead that "Chevron and Chevron Canada are separate legal entities with separate rights and obligations," and that Chevron Corporation and Chevron Canada had a typical parent/subsidiary relationship. Therefore neither part of the test was met.

The plaintiffs offered several additional innovative arguments in order to persuade the Court to pierce the corporate veil. First, while they admitted that the Chevron structure was not fraudulent or as a result of wrongdoing, they argued that it was just and equitable to pierce the corporate veil where the result would be "too flagrantly opposed to justice."[4] Second, they argued that Chevron Canada's structure fell into one of two exceptions to the corporate veil jurisprudence: (a) that Chevron Canada was part of a group enterprise (i.e. the Chevron conglomerate) and therefore Chevron Corporation was liable for the debts of Chevron Canada[5]; and (b), they argued that the principle of corporate separateness does not apply to a subsidiary that may be liable to pay the debt of its parent[6].

Each of these arguments was strongly rejected by the Court. It held that the "just and equitable" line of cases arising from *Kosmopoulos* did not give rise to an independent "just and equitable" exception to the principle of corporate separateness. It also distinguished the group enterprise and inter-corporate debt cases described above on the facts, finding that those cases arose under unique circumstances and were thus of limited utility. Hainey J. therefore granted Chevron Canada's motion for summary judgment, as he found that the plaintiffs' case for enforcing the judgment against Chevron Canada could not succeed on the facts.

The plaintiffs had a modicum of success on their counter-application to strike Chevron's defences, in that the Court found that two of Chevron's defences were not compliant with the *Beals v. Saldanha* tests set out above. However, the meat of Chevron's defences, that the Ecuadoran court was corrupt and biased, passed the test and could therefore be brought by Chevron.

Analysis

The *Chevron* case is a dispassionate application of Canadian corporate law and conflict of laws rules to a charged fact situation, while the *Tahoe* case is less clear-cut. Both sets of plaintiffs paint sympathetic pictures: villagers poisoned by oil and gas operations and protesters shot by private security guards are media-friendly storylines, as are large corporations with unlimited resources. On the essential facts of each case, however, neither Chevron Canada nor Tahoe is the corporate actor causing the damage; the Canadian entities are affiliates only.

However, each of the Canadian entities has valuable assets and is subject to a Canadian court system that may in the right circumstances award damages and enforce judgments irrespective of the weak connection to Canada. This is the cautionary tale for Canadian companies doing business in foreign countries – it is essential to control those things you can and minimize the effect of liabilities beyond your control by ensuring the separateness of entities in a corporate structure. Canada is a relatively easy jurisdiction in which to maintain a lawsuit and enforce a judgment, but Chevron's strict adherence to its corporate structure ensured that any attempt to enforce a judgment against Chevron Canada would have a high likelihood of being dismissed. If the structure were impugned and Chevron Canada's assets were available for seizure, Chevron's ability to resist the judgment on its merits would be very limited. It is vital therefore for Canadian companies and their directors to avoid becoming involved in the operations of their foreign subsidiaries. If the Canadian entity was on the wrong end of a foreign judgment, the Canadian entity's assets would likely be available for seizure with the support of Canadian courts.

The *Tahoe* case should also be troubling for Canadian companies having foreign operations, particularly now that the action can proceed on its merits. Canadian companies, particularly public companies, are under constant pressure to adopt corporate responsibility standards, though those standards are not technically required by law. Agencies ranking corporate governance, for example, consider corporate social responsibility as a metric in assessing the entity's governance practices. Adoption of these standards has been viewed in the past as a relatively risk-free way of improving the company's social perception in the wider community.

In light of the *Tahoe* decision, however, companies might be well advised to stay silent on matters of corporate responsibility, notwithstanding the fact that it may make the company appear to be a good citizen. The internet has a compendious memory, and all those well-meaning statements to the press could come back to haunt management if a tragedy occurs. We also note that the taking of steps to avoid reasonably foreseeable harm is a defence to a claim for negligence. Therefore, corporations with foreign subsidiaries should ensure that reasonable steps are taken to implement and maintain corporate responsibility standards, if for no other reason than doing so helps establish a defence against later claims of negligence.

Both the Ecuadoran plaintiffs and the Guatemalan plaintiffs decided that Canada to be a useful forum to try to recover damages. The Ecuadorans haven't yet been successful; we'll see if the Guatemalans are.

[1] For a non-legal history of the case, see Patrick Radden Keefe, "Reversal of Fortune" The New Yorker, January 9, 2012, accessed at https://www.newyorker.com/magazine/2012/01/09/reversal-of-fortune-patrick-radden-keefe

[2] From *Morguard Investments Ltd. v. De Savoye* [1990] 3 S.C.R. 1077

[3] *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* (1996) 28 O.R. (3d) 423 (Gen. Div.); aff'd 1997 CarswellOnt 3496 (C.A.)

[4] This language is from Kosmopoulos v. Constitution Insurance Co. [1987] 1 S.C.R. 2

[5] Teti and ITET Corp. v. Mueller Water Products 2015 ONSC 4434

[6] *Christian Brothers of Ireland in Canada (Re)* (2000), 47 O.R. (3d) 674 (C.A.)

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