

COURT OF APPEAL FOR ONTARIO

IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C. 1985, c. B-3, as amended

**IN THE MATTER OF THE NOTICES OF INTENTION
TO MAKE A PROPOSAL OF
YG LIMITED PARTNERSHIP AND YSL RESIDENCES INC.**

B E T W E E N:

**BOOK OF AUTHORITIES OF THE APPELLANTS
THE CLASS A LPs**

May 7, 2024

THORNTON GROUT FINNIGAN LLP
100 Wellington Street West
Suite 3200
Toronto ON M5K 1K7

D.J. Miller LSO#: 343939P
djmill@tgf.ca
Tel: 416 304 0559

Alexander Soutter LSO#: 72403T
asoutter@tgf.ca
Tel: 416 304 059

Lawyers for the Appellants, YongeSL
Investment Limited Partnership,
2124093 Ontario Inc., SixOne Investment
Ltd., E&B Investment Corporation,
and TaiHe International Group Inc.

LAX O'SULLIVAN LISUS GOTTLIEB LLP
Counsel
Suite 2750, 145 King Street West
Toronto ON M5H 1J8

Shaun Laubman LSO#: 51068B
slaubman@lolg.ca
Tel: 416 360 8481

Xin Lu (Crystal) Li LSO#: 76667O
cli@lolg.ca
Tel: 416 956 0112

Lawyers for the Appellants, 2504670 Ontario Inc.,
8451761 Canada Inc. and Chi Long Inc.

TO: **GOODMANS LLP**
Barristers and Solicitors
Bay Adelaide Centre
333 Bay Street, Suite 3400
Toronto ON M5H 2S7

Mark Dunn LSO#: 55510L
mdunn@goodmans.ca
Tel: 416 849 6895

Sarah Stothart LSO#: 73068O
sstothart@goodmans.ca
Tel: 416 597 4200

Lawyers for Maria Athanasoulis

AND TO: **DAVIES WARD PHILLIPS & VINEBERG LLP**
Barristers and Solicitors
155 Wellington Street West
37th Floor
Toronto ON M5V 3J7

Matthew Milne-Smith LSO#: 44266P
mmilne-smith@dwpv.com
Tel: 416 863 5595

Robin Schwill LSO#: 38452I
rschwill@dwpv.com
Tel: 416 863 5502

Chenyang Li LSO#: 73249C
cli@dwpv.com
Tel: 416 367 7623

Lawyers for the Proposal Trustee,
KSV Restructuring Inc.

AND TO: **BENNETT JONES LLP**
Barristers and Solicitors
1 First Canadian Place
Suite 3400
P.O. Box 130
Toronto ON M5X 1A4

Jesse Mighton
mightonj@bennettjones.com
Tel: 416 777 6255

Lawyers for the Sponsor,
Concord Properties Developments Corp.

AND TO: **AIRD & BERLIS LLP**
Brookfield Place
1800-181 Bay Street
Toronto, ON M5J 2T9

Harry Fogul
Tel No: 416-865-7773
Email: hfogul@airdberlis.com

Lawyers for YSL Residences Inc. and YG Limited Partnership

AND TO: **KSV RESTRUCTURING INC.**
150 King Street West, Suite 2308
Toronto, ON M5H 1J9

Bobby Kofman
Tel No.: 416-932-6228
Email: bkofman@ksvadvisory.com

Mitch Vininsky
Tel No.: 416-932-6013
Email: mvininsky@ksvadvisory.com

Proposal Trustee for YSL Residences Inc. and YG Limited Partnership

AND TO: **OFFICE OF THE SUPERINDENDENT OF BANKRUPTCY**
151 Yonge Street
4th Floor
Toronto ON M5C 2W7

Tel: 416 973 6441

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TAB 1

At para(s) 11, 34-36, 44-47, 69

YG Limited Partnership and YSL Residences (Re), 2021 ONSC 4178 (CanLII)

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DATE: 20210629

SUPERIOR COURT OF JUSTICE – ONTARIO (COMMERCIAL LIST)

RE: IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, C. B-3, AS
AMENDED

AND:

IN THE MATTER OF THE NOTICES OF INTENTION TO MAKE A PROPOSAL OF YG LIMITED
PARTNERSHIP AND YSL RESIDENCES

APPLICATION UNDER THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, C. B-3, AS
AMENDED

AND RE: 2504670 CANADA INC., 8451761 CANADA INC. and CHI LONG INC., Applicants

AND

CRESFORD CAPITAL CORPORATION, YSL RESIDENCES INC, 9615334 CANADA INC., YG
LIMITED PARTNERSHIP and DANIEL CASEY, Respondents

AND RE: 2583019 ONTARIO INCORPORATED AS GENERAL PARTNER OF YONGESL INVESTMENT
LIMITED PARTNERSHIP, 2124093 ONTARIO INC., SIXONE INVESTMENT LTD., E&B
INVESTMENT CORPORATION and TAIHE INTERNATIONAL GROUP INC., Applicants

AND

9615334 CANADA INC. AS GENERAL PARTNER OF YG LIMITED PARTNERSHIP and YSL RESIDENCES INC., Respondents

BEFORE: S.F. Dunphy J.

COUNSEL: *Harry Fogul and Miranda Spence*, for YG Limited Partnership and YSL Residences Inc.

Shaun Laubman and Sapna Thakker, for 2504670 Canada Inc., 8451761 Canada Inc., and Chi Long Inc.

Alexander Soutter, for YongeSL Investment Limited Partnership, 2124093 Ontario Inc., SixOne Investment Ltd., E&B Investment Corporation, and TaiHe International Group Inc.

David Gruber, Jesse Mighton, and Benjamin Reedijk, for Concord Properties Developments Corp. and its affiliates

Jane Dietrich and Michael Wunder, for 2292912 Ontario Inc. and Timbercreek Mortgage Servicing Inc.

Robin B. Schwill, for KSV Restructuring Inc. in its capacity as the proposal trustee

Roger Gillot and Justin Kanji, for Kohn Pedersen Fox Associates PC

Reuben S. Botnick, for Royal Excavating & Grading Limited COB as Michael Bros. Excavation

Daniel Naymark and Jamie Gibson, for Sarven Cicekian, Mike Catsiliras, Ryan Millar and Marco Mancuso

Brendan Bowles and John Paul Ventrella, for GFL Infrastructure Group Inc.

Mark Dunn and Carlie Fox, for Maria Athanasoulis

George Benchetrit, for 2576725 Ontario Inc.

Joshua B. Sugar, for R. Avis Surveying Inc.

Paul Conrod, for Restoration Hardware Inc.

James MacLellan and Jonathan Rosenstein, for Westmount Guarantee Services Inc.

Albert Engle, for Priestly Demolition Inc.

HEARD at Toronto: June 23, 2021

AMENDED REASONS FOR INTERIM DECISION

Note: these reasons were amended on July 2, 2021 as more fully described in the in the concluding paragraphs hereof.

[1] The debtors are seeking approval of a bankruptcy proposal that has obtained the near unanimous approval of those affected creditors who cast a vote. Two groups of limited partnership unitholders have challenged the actions of the General Partner of the debtor YG Limited Partnership for much of the past year and urge me to annul the bankruptcy entirely or to reject the proposal and, if need be, to allow a Receiver or Trustee in bankruptcy to canvass the market fairly and objectively. Another unsecured creditor urges me to disregard much of the appraisal evidence tendered because she has been excluded from examining it and the result is a record that casts grave doubt as to whether fair value for stakeholders is being realized by this process.

[2] For the reasons that follow, I have decided that I will not approve the Proposal in the form it has been presented to me. The Proposal is yet able to be amended pursuant to art. 3.01 thereof and it is possible that an amendment may be formulated to address the concerns raised by the findings I outline below before a final decision on the fate of the Proposal is made.

Background facts

[3] A central issue in this case is the value of the “YSL Project” – the property owned by the debtor YSL as bare trustee for the limited partnership (the debtor YG LP) charged with developing it. Valuation is an area on which I must tread lightly in terms of what I can record in writing so as not to impact adversely any potential sale process that may be necessary in future.

[4] What follows is a general description of the capital structure of the debtors and the project sufficient to permit an understanding of the issues. For comparison purposes, it is relevant to consider the size of the project. There is no dispute that the “as if completed” value of the project is above \$1 billion. How much above and based on which assumptions is an issue, but I provide the round figure solely for comparison purposes relative to the debt and equity interests discussed.

[5] The project is fully zoned and permitted for construction of an 85-story retail and condominium complex planned for the corner of Yonge St. and Gerard in downtown Toronto. Substantial pre-sales have been made. Demolition of the old structures and shoring up of the excavation have been largely completed. Unfortunately, things ground to halt in March of 2020 and the project has been stuck in the “hole in the ground” stage ever since.

The project ownership structure

[6] YP GP has a General Partner with nominal capital and a nominal interest in the limited partnership. The “equity” in the partnership effectively resides in the “A” units with approximately \$14.8 million in capital but a capped right to return on that capital equivalent to interest (12.25% per year rate of return) and the “B” units who alone receive all of the residual profits from the project without limit.

[7] The owner of the “B” units and the General Partner are under common control within the Cresford group of companies as are the parties recorded as payees of the \$38.3 million related party debt to which I shall refer.

The project debt structure

[8] The secured debt – including registered mortgages and construction liens – stands at about \$160 million. The figure for secured debt is slightly misleading. There is just over \$100 million in deposits from condominium pre-sales made for the most part prior to 2019. These are insured by the second secured creditor whose claim would increase dollar for dollar if the relevant purchase agreements were repudiated and the deposits had to be returned. For this reason and to have an “apples to apples” idea of the debt structure, a figure of about \$260 million in secured debt is appropriate.

[9] The third-party unsecured debt that has been identified by the Trustee is in the range of approximately \$20 million plus or minus a few million dollars depending upon reserves allowed for claims yet to be filed or finalized. There are also various litigation claims outstanding the largest of which is from a former officer claiming that the limited partnership was a common employer and seeking, among other things, to enforce oral profit-sharing agreements. I have reviewed the Trustee’s report and in particular the Trustee’s reasoned conclusion that these claims are too contingent to be considered valid for voting purposes. I concur in that assessment. A conservative and prudent assessment of potential total unsecured claims is thus in the range of about \$25 million – a figure advanced with full knowledge that the total of all contingent claims identified could be in the same order of magnitude again. For the purposes of this motion, I find the figures estimated by me above are reasonable – those findings are, of course, without prejudice to the creditors holding such claims proving them in due course.

[10] There is also \$38.3 million in outstanding advances to YG LP recorded on its books from related parties. I have found those claims to be equity claims for all purposes relevant to this hearing for reasons I shall expand upon below.

[11] In round figures, one can thus consider there to be approximately \$260 million of secured debt and about \$20-\$25 million of unsecured debt outstanding. The Proposal assumes all of the former and would pay 58% of the latter when finalized. The “fulcrum” stakeholders in this case are thus the unsecured creditors to the extent of the 42% of their claims that are compromised (\$8.4 to \$10.5 million) plus the “A” limited partners in YG LP (\$14.8 million plus accrued “interest” entitlements) – such figures based upon the estimates and rulings that I have made and explained herein.

Summary of nine findings made

[12] The process of sifting through the mountains of evidence presented to me by the parties has been made exceptionally time-consuming and tedious by reason of the lack of usable electronic indexing in much of the materials filed. Tabs or electronic hyperlinks within compilations of electronically filed documents are non-existent in all but the most recently filed documents and there are many, many thousands of pages of documents presented. The profession is going to need to get on top of this problem as judges cannot and will not in future undertake such gargantuan efforts to sift through a case when a few moments of care and attention at the front end could simplify it to such a great degree.

[13] Time does not permit me to set forth in writing a complete account of my review of the evidence and my conclusions – a written summary of which I was about 75% through before the impossibility of completing it in the form intended within the time available became obvious. I shall instead present below nine conclusions which encapsulate my reasons for finding that the Proposal as it currently stands has failed to satisfy me of the matters required by s. 59(2) of the BIA or the common law test of good faith.

(i) The McCracken Affidavit is inadmissible

[14] As is often the case in Commercial Court matters, this case proceeded on a “real time” schedule. In addition to the bankruptcy case that was commenced with an NOI filed on behalf of the debtors on April 30, 2021, there were two applications commenced the day before by two groups of YG LP limited partners seeking, among other things, the removal of the General Partner and various declarations challenging the authority of the General Partner to act on behalf of the partnership in any capacity and alleging breaches of fiduciary duty by the General Partner. The Proposal itself was filed on May 27, 2021 working towards a scheduled June 10, 2021 creditor meeting. On June 1, 2021 I issued directions for the conduct of all three proceedings with a view to having the sanction hearing ready to proceed on June 23, 2021.

[15] The Proposal Sponsor is Concord Properties. Concord is not a party to any of these proceedings although it is central to all three. Concord sponsored the Proposal and is bearing all the costs of it under a Proposal Sponsor Agreement dated April 30, 2021.

[16] The limited partner applicants issued subpoenas to Mr. McCracken – apparently the officer of Concord responsible for this Proposal. On the advice of counsel, Mr. McCracken declined to appear absent an order compelling him to do so. Counsel took the position that leave was required under the Bankruptcy Rules to compel him to appear in the bankruptcy proceeding and declined to produce him.

[17] The position taken was a curious one given my specific direction on June 1 that I was *not* applying the BIA stay to the two applications and that specific aspects of both applications would be heard and decided together on June 23, 2021 when the fairness hearing was conducted. The case timetable made specific allowances for responding records with respect to the limited partner applications and facts in relation to them. My ruling on June 1, 2021 was in both the civil and bankruptcy proceedings and bore the style of cause of both.

[18] Whether leave was or was not formally required to *compel* Mr. McCracken to appear, his failure has consequences in terms of the fairness of the process leading to the approval motion in front of me. The opponents of the Proposal were deprived of the opportunity to explore aspects of the unfairness or unreasonableness of the Proposal that they had raised. There was insufficient time available in the tight timetable to drop everything and bring a leave application. The position taken ran utterly contrary to the spirit and intent of my ruling on June 1, 2021 at which Concord's counsel appeared *and made submissions*. This is the sort of issue that counsel applying the "three C's" of the Commercial List ought to have agreed to disagree upon and produced the witness without prejudice to objections that might be raised.

[19] It is against the foregoing backdrop that the affidavit of Mr. McCracken – delivered the day prior to the fairness hearing – must be considered.

[20] The affidavit was filed far too late to permit any interested party to respond to it effectively or to cross-examine upon it. None of the subject-matter of the affidavit was new information. The affidavit was entirely devoted to providing responses to various issues seen in written arguments or that arose on the cross-examination of other witnesses.

[21] Concord appeared to consider itself sufficiently at interest to appear through counsel on June 1, 2021 while declining to submit to examination because of its non-party status when preparations for this hearing were in full swing a few days later. Permitting the admission of this affidavit at this juncture would be to sanction unfairness of the highest order. A timetable was worked out for the hearing of this motion – worked out, I might add, at a motion that Concord was present at through counsel. Whether or not Concord had the *right* to insist upon a further motion to compel its attendance during the pre-hearing procedures, it certainly knew that taking that position when there was no time available to challenge it in court would have the practical effect that it did.

[22] Lying in the weeds is a strategy, but it does not confer the right to spring out of them at will. I find the McCracken affidavit to be inadmissible and attach no weight to it.

(ii) No weight can be attached to the CBR April 2021 Appraisal

[23] The parties have very hotly debated the valuation evidence that is on the record before me. A portion of that valuation evidence has been sealed. My reason for doing so is straightforward: the approval of the Proposal cannot be taken for granted and it is thus reasonably foreseeable that the project may have to be sold by a Trustee or Receiver in the near future and the ability of whichever court officer is charged with undertaking that sale to achieve the highest and best price available ought not to be impaired more than the circumstances already have by the disclosure of appraisals that may serve to skew market expectations. A significant portion of such evidence is part of the public record and between the public information and the use of carefully-framed circumlocutions I believe that I can convey my conclusions and reasons for them regarding the valuation evidence with reasonable clarity.

[24] Two of the appraisals before me, both from CBRE, are the most central to the questions I must determine. The first in time is dated August 8, 2019 providing CBRE's opinion of value as at July 30, 2019. This appraisal was prepared for the parent company of the debtors within the Cresford group and is based on the particular assumptions set out therein, including some supplied by Cresford. The second in time, also by CBRE, is dated April 30, 2021 as of March 16, 2021. This latter appraisal was prepared for Concord based on the assumptions set out therein, including some supplied by Concord. I shall not discuss in a public document the actual appraisal amounts in either, focusing instead on the differences between them.

[25] For present purposes, it is sufficient for me to observe that the 2021 CBRE appraisal is lower than the 2019 CBRE appraisal and lower by an amount that is significantly higher than the sum of the compromised amount of unsecured claims under the Proposal plus the total capital of the "B" unitholders in YG LP.

[26] I find that I can attach little weight to the 2021 CBRE appraisal in these circumstances because:

- a. The assumptions given to CBRE by Concord were materially different than those used in the 2019 CBRE appraisal including as to such things as leasable square footage of residential and retail space;
- b. When it formulated the instructions to CBRE, Concord was in the process of attempting to negotiate a Proposal to acquire the property through the bankruptcy process given lack of limited partner consents and was being commissioned at a time when Concord had a clear and obvious interest in having appraisal evidence suggesting that the project was at least partly underwater;
- c. The downward alterations made by Concord to the square footage assumptions used by CBRE are unexplained, untested and appear to be admitted as having been quite preliminary at all events;
- d. Concord did not submit Mr. McCracken to cross-examination to examine in depth the reasons for the significant negative difference between the two instructions given to CBRE on the conflicting appraisals;
- e. The differences between the two have not been reasonably or adequately reconciled. There has been no general downward correction to residential real estate in Toronto that has been brought to the court's attention nor can the difference between the two appraisals reasonably be attributed solely to pandemic-induced alterations to the retail environment.

(iii) ALL Construction Lien Claims are Unaffected Creditors under the Proposal

[27] Under the Proposal, Construction Lien Claims are defined as “Unaffected Creditors”. The Trustee indicates that the total amount of such claims is \$11.865 million. Of this total, fifteen lien claimants with \$9.19 million in lien claims outstanding entered into assignment agreements with the Proposal Sponsor. As these are non-voting Unaffected Creditors under the Proposal, Concord required them to file claims as Affected Creditors in order to acquire the right to vote and to name a proxy designated by Concord.

[28] There was some controversy about what precisely the lien claimants received in return for agreeing to convert claims that were to be paid \$1.00 per \$1.00 of valid claims under the Proposal into claims receiving no more than \$0.58 per dollar of claim value. The Trustee-reported second-hand information from Concord denying any “side” deals does little to address this concern. Assurances as to the lack of a side deal do not serve the purpose of permitting a reasonable understanding of the main deal. None of them have been disclosed beyond a skeletal summary and Concord declined to permit a representative to be examined prior to the hearing.

[29] It is of course open to the Proposal Sponsor to make any proposal that satisfies the formal requirements of the BIA if the debtor is prepared to adopt it and submit it to the creditors and the creditors are willing to accept it with their eyes open. In this case however the Proposal Sponsor has induced \$9.19 million of otherwise Unaffected Creditors to file claims as something they are not by definition (i.e. Affected Creditors) thereby effectively reducing the size of the cap from \$65 million to \$55.8 million and the maximum pool of funds available to the actual Affected Creditors described by the Proposal from \$37.7 million to \$32.4 million. These are material changes impacting all Affected Creditors that follow from arrangements made by the Proposal Sponsor outside the terms of the Proposal.

[30] The Proposal makes no provision for creditors “downshifting” their claims voluntarily. Lien claims are defined as “Unaffected Claims” and I see no basis for them to be accepted under the Proposal on any other basis particularly where doing so operates to the obvious detriment of the affected class members. This is not a case of a secured creditor valuing its security and filing an unsecured claim for the shortfall. There are consequences to such a valuation exercise that are absent here.

[31] The “electing” lien claimants have little in common with the actual Affected Creditors who had no election to make. Despite having made the election, assuming there was any basis in the Proposal to make such an election (and it appears to me that there was not), such creditors retained their security intact. Pursuant to art. 9.01 of the Proposal, the Proposal would have “no effect upon Unsecured Creditors” which definition does not cease to apply to them by virtue of a make-shift “election” for which the Proposal makes no provision. They did not agree to surrender their security nor even to value it in the bankruptcy process. They agreed to sell their claims on whatever terms they chose to accept from the Proposal Sponsor secure in the knowledge that if, for any reason, the Proposal does not move forward, their security remains intact and unaffected.

[32] This is an element of unfairness in this that I find particularly disturbing. It is all the more disturbing when I am not at all persuaded that the unsecured creditors face the spectre of near certain annihilation in the event of a bankruptcy or receivership but face the very real prospect of additional and illegitimate dilution of their claim value were I to approve the Proposal as presented with the presence of lien claimants in the Affected Creditor pool.

(iv) The related party claims must be treated as equity

[33] A fundamental principle of the BIA is that equity claims are subordinate to debt claims. This principle is voiced in s. 60(1.7) of the BIA that provides quite simply that "[n]o proposal that provides for the payment of an equity claim is to be approved by the court unless the proposal provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid". Section 140.1 expresses a similar requirement in respect of dividends more generally. While there is some similarity behind the concept of "equity claims" in Canadian insolvency law and that of "equitable subordination" the two are separate and one and must not be confused with the other: *U.S. Steel Canada Inc. (Re)*, 2016 ONCA 662 (CanLII) at para. 101.

[34] The limited partner applicants submit that the intercompany advances appearing in the general ledger of YG LP should be treated as equity claims within the meaning of the BIA. The debtors on the other hand urge me to pass over this issue entirely arguing that approval of the proposal does not entail approval of any payment of intercompany claims. Such claims will ultimately be determined by the Trustee and if disallowed for any reason will receive no distribution.

[35] I cannot accept the debtors' argument that I should sweep the equity claims under the carpet to be dealt with another day in another forum. This is so for the following reasons:

- a. The applicant limited partners have no standing to challenge the proof of the related party claims within the bankruptcy process even if their claims against related parties are not themselves released by the Proposal.
- b. On June 1, 2021 I directed that issues raised in the two applications would be dealt with on June 23. A theme in those applications was, among others, the allegation that the General Partner had been seeking to divert substantial payments to Cresford from various investor proposals negotiated by the Cresford group ahead of limited partners, the allegations that representations had been made in the Subscription Documents and elsewhere that Cresford entities would be paid out of distribution after the "A" unit limited partners, that counsel for Cresford had confirmed that the intercompany loans were subordinated to the limited partners, that the General Partner had acted in breach of its fiduciary duties and that the Proposal was not being advanced in good faith; and
- c. The timetable I approved on June 1 specifically contemplated the foregoing aspects of those applications being dealt with on June 23, 2021.

[36] If the related party claims are equity claims under the BIA, then it is also highly likely that the notional purchase price for the project being paid by the Proposal Sponsor under the Proposal must be viewed as being \$22 million less than it might otherwise appear, a fact that is also material to the matters I must consider on this motion.

[37] The allegations of the applicant limited partners in the two outstanding applications challenge the good faith with which the Proposal has been advanced by the General Partner in part on the theory that the Proposal has in fact been advanced to secure payment of the related party claims in priority to the “A” unitholders and without securing their consent.

[38] For the foregoing reasons, I cannot avoid a consideration of whether the related party claims are equity claims. My conclusions on that subject are an integral part of any conclusion I must make on the subject of good faith or the criteria to be considered under s. 59(2) of the BIA.

[39] Are the related party claims identified by the Trustee in this case “equity claims”?

[40] The BIA contains a definition of “equity claims” that is deliberately non-exhaustive. In *Sino-Forest Corporation (Re)*, 2012 ONCA 816 (CanLII) (at para. 44) the Court of Appeal found that the term should be given an expansive meaning to best secure the remedial intentions of Parliament.

[41] Subsequent cases have explored the concept of “equity claim” with a view to fleshing out its parameters. Some of the guidelines that can be distilled from that jurisprudence include the following:

- a. Neither the “intention of the parties” as between non-arm’s length parties nor the formal characterization they apply is conclusive as to the true nature of the transaction: *Tudor Sales Ltd. (Re)*, 2017 BCSC 119 (CanLII) at para. 35 and *Alberta Energy Regulator v Lexin Resources Ltd*, 2018 ABQB 590 (CanLII) at para. 37.
- b. The manner in which the transaction was implemented, and the economic reality of the surrounding circumstances must be examined to determine the true nature of the transaction with the form selected being merely the “point of departure” of the examination: *Lexin* at para. 37.
- c. It is helpful to consider whether the parties to the transaction had a subjective intent to repay principal or interest on the alleged loan from the cash flows of the alleged borrower and, if so, was that expectation reasonable: *Lexin* at para. 41.
- d. It is also helpful to consider the “list of factors” that courts have looked at in such cases – being careful not to apply them in a mechanical way or as a definitive checklist: *Lexin* at paras. 42-43.
- e. Among the factors to examine are:
 - i. the presence or absence of a fixed maturity date and schedule of payments (absence of such terms being a potential indicator of equity);

- ii. the presence or absence of a fixed rate of interest and interest payments. Again, it is suggested that the absence of a fixed rate of interest and interest payments is a strong indication that the advances were capital contributions rather than loans;
- iii. the source of repayments. If the expectation of repayment depends solely on the success of the borrower's business, the cases suggest that the transaction has the appearance of a capital contribution;
- iv. the security, if any, for advances; and
- v. the extent to which the advances were used to acquire capital assets. The use of the advance to meet the daily operating needs for the corporation, rather than to purchase capital assets, is arguably indicative of bona fide indebtedness: *Lexin* at paras. 42-43.

[42] The related party claims may be broken down into different buckets for the purposes of this analysis. The first one consists of payments that were made to retire loans taken out for the specific purpose of financing equity interests in YG LP. This involved loans used to buy out the \$15 million investment of a former limited partner, loans used to finance the Cresford group of companies' \$15 million equity investment in Class B units as well as interest paid on both of these loans some or all of which has been recorded as obligations of YG LP on its books.

[43] Clearly advances made or charged to YG LP for the direct or indirect purpose of financing the purchase of an equity interest in YG LP are likely to the point of certainly to be characterized as equity claims of YG LP for the purposes of insolvency law. The evidence to this point supports the reasonable inference that a very substantial portion of the advances charged to YG LP by non-arm's length parties can be so characterized.

[44] A second category of advances made can only be described as "miscellaneous" comprised of various sporadic payments made by members of the Cresford group of companies that were recorded in the ledger of the limited partnership net of other payments made by the limited partnership to the Cresford group.

[45] The terms of the intercompany advances recorded on the general ledger of the limited partnership share the following characteristics:

- a. They were all non-interest bearing without any defined term or maturity date; and
- b. There are no loan documents evidencing any of them.

[46] Such payments as there were from YG LP on account of these advances were sporadic. The nature of the YG LP project is such that there is no cash flow nor any expectation of cash flow being available to repay the intercompany advances recorded until project completion when deposits and

sales proceeds become available. The evidence does not suggest that intercompany advances were primarily short-term bridge advances pending the receipt of project financing that was to be used to repay them.

[47] There is substantial evidence that the related party advances were intended to be subordinated to holders of “A” units of YG LP and are thus equity claims. In the interest of time, I shall only summarize this evidence:

- a. Direct written representations were made to the investors in YG LP “A” units as part of the subscription process that after payment of “project expenses” only “external lenders” debt would be repaid ahead of them and that distributions to “Cresford” – unambiguously referencing the group of companies rather than one entity – would come after repayment of invested capital and the agreed return on investment to the limited partner investors;
- b. Cresford’s communications to the limited partners never disclosed the existence of any “debt” owed to Cresford even when portraying “current debt” in various discussions with or disclosures made to them until very recently (and long after the advances in question were recorded on YG LP’s books);
- c. Other Cresford group projects with similar capital structures also made representations that intercompany advances were treated as equity;
- d. There was a direct, written representations made by prior counsel to the General Partner in October 2020 that such intercompany advances were “subsequent in priority” to the YG LP “A” unit investors – that admission has since been retracted without an adequate explanation for why it was an alleged error; and
- e. Cresford’s CFO also advised that the YG LP “A” unitholders would be paid in priority to “Cresford” a term used to describe the related group of Cresford companies under common control.

[48] A review of the foregoing factors in light of the jurisprudence leads me to the conclusion that the related party advances must be considered as equity claims for the purposes of this motion at least. Virtually all indicators reviewed point towards equity and there is little to no evidence leaning the other way.

(v) The implied value of the Proposal is \$22 million less than assumed

[49] The Proposal operates to reduce the payments made to unsecured creditors if claims are lower than the \$65 million cap. The converse is not the case. Absent the lien claims and the intercompany claims there is no mathematical prospect of the \$65 million cap being operative unless the contingent

and late-filed claims are resolved at levels far in excess of any reasonable estimate. This means that the consideration paid by Concord under the Proposal must be considered to be worth \$22 million less than it might have been had the related party claims not been equity claims.

(vi) The general partner had authority to file the NOI

[50] The two groups of limited partners have raised three broad categories of objections to the capacity of the general partner to have filed the NOI and sought approval of the Revised Proposal: (i) as a matter of law, all partners including limited partners, must approve filing for bankruptcy; (ii) pursuant to the Limited Partnership Agreement, the general partner lacked the authority to file for bankruptcy; and (iii) the general partner ceased to be general partner prior to the filing. I shall consider each of these in turn.

S. 85(1) of the BIA

[51] Section 85(1) of the BIA provides that it “applies to limited partnerships in like manner as if limited partnerships were ordinary partnerships, and, on all the general partners of a limited partnership becoming bankrupt, the property of the limited partnership vests in the trustee.”

[52] The limited partners’ position was that since all partners of a general partnership must authorize a bankruptcy filing and since s. 85(1) of the BIA applies the law in relation to general partnerships to limited partnerships in “like manner”, it follows that an NOI must be authorized by all limited partners in addition to the general partner. In support of this interpretation they cite the case of *Aquaculture component Plant V Limited Partnership (Re)*, 1995 CanLII 9324 (NS SC) where two NOI’s filed on behalf of limited partnerships were annulled on this basis.

[53] While the decision of Hamilton J. in the *Aquaculture* case is entitled to deference, it is not binding upon me. I find that I am unable to agree with its reasoning.

[54] The *Aquaculture* case stands quite alone in the jurisprudence on this topic – alone in the sense that none appear to have followed *or* disagreed with it as far as the research conducted by the parties has been able to determine. In the 26 years since it was decided, a significant number of limited partnerships have passed through our bankruptcy courts either for proposals or liquidations without apparent objection on this score. That practice of course does not have the effect of altering the law but it is at least a factor to consider given the number of times since then that Parliament has examined the BIA including with the addition of s. 59(4) that authorized changes to the constating documents of a debtor including a limited partnership.

[55] I reach a different conclusion than was reached in *Aquaculture* for the following reasons:

- a. The use of general “in like manner” language in s. 85(1) of the BIA is intended to ensure that the provision is interpreted consistent with the objects of the BIA and not in a manner as to defeat those objects or render the benefits of the BIA largely inaccessible to limited partnerships. The procedure for filing an NOI was intended to offer debtors a

swift and relatively low cost means of seeking creditor protection after a secured creditor gives the required ten-day notice of its intention to enforce. Requiring unanimous consent for filing of an NOI would have the practical effect of making the benefits of bankruptcy law unavailable to limited partnerships in practice in a large number of cases. Limited partnerships often have large numbers of limited partners and the time required to convene a meeting and obtain unanimous consent would require more time than secured creditors are required by law to give in the way of notice.

- b. Provincial law generally provides that only general partners may bind a limited partnership (in Manitoba, s. 54(1) of the *The Partnership Act*, CCSM c P30) and the BIA treats partnerships and limited partnerships as a full “debtor”. The policy behind requiring all *general* partners to authorize a bankruptcy filing is obvious – all are liable without limit for the liabilities of the partnership. The same is not the case with a limited partnership.
- c. Section 59 of *The Partnership Act* also provides that actions or suits in relation to the limited partnership may be brought and conducted by and against the general partners as if there were no limited partners. This too supports the proposition that the consent of limited partners is not required for the filing of an NOI on behalf of the partnership.

[56] I find that s. 85(1) of the BIA did not require the asset of each limited partner to the filing of an NOI.

[57] The limited partners also pointed to provisions of the Limited Partnership Agreement to allege that the General Partner had automatically ceased to be general partner of the partnership by reason of certain actions or that that it lacked the authority to file on behalf of the partnership.

Did the General Partner cease to be a general partner of YG LP at any time?

[58] The Proposal Sponsor Agreement is dated April 30, 2021 and was entered into between Concord as Proposal Sponsor and YG LP acting through the General Partner. It was executed prior to filing the NOI but *after* the two limited partner groups had filed their separate applications seeking, among other things, to remove the General Partner. To the extent it is relevant, there can be no question but that Concord was aware of the terms of the Limited Partnership Agreement at all relevant times when negotiating and entering into the Proposal Sponsor Agreement.

[59] Pursuant to s. 1.1 of the Proposal Sponsor Agreement, YG LP agreed to “use commercially reasonable efforts to effect a financial restructuring of [YG LP] that will result in the acquisition of the Property by the Proposal Sponsor together with [YG LP’s] rights, title and interests in and to such Project-related contracts as may be stipulated”. A draft of a proposal, substantially similar to the

Proposal before this court for approval, was appended as a schedule to the Proposal Sponsor Agreement. The agreement was signed by Mr. Daniel Casey on behalf of each of the Cresford companies named as parties including YG LP.

[60] Section 10.14 of the YG LP Limited Partnership Agreement provides that “None of the following actions shall be taken unless it has *first* been approved by Special Resolution: (a) approving or disapproving the sale or exchange of all or substantially all of the business or assets of the Partnership”(emphasis added).

[61] The Proposal contemplated by the Proposal Sponsor Agreement clearly provides for the sale or exchange of all or substantially all of the business or assets of the Partnership. Section 1.1 of the Proposal Sponsor Agreement obliged YG LP to “use commercially reasonable efforts” to cause this to occur, including by filing the NOI and to requesting court approval of the Proposal. As obliged by the Proposal Sponsor Agreement, YG LP filed an NOI, filed the Proposal and subsequently sought court approval of the Proposal.

[62] Entering into the Proposal Sponsor Agreement constituted the “approval” of YG LP to the sale or exchange of all or substantially all of the business or assets of the Partnership” even if approvals of other parties were also required in order to *complete* the transaction. The prohibition in art. 10.14(a) attaches to the approval of the action and not its completion.

[63] Section 7.1(c) of the Limited Partnership Agreement creates an Event of Default if the General Partner “becomes insolvent ... consents to or acquiesces in the benefit of [the BIA]”. By filing the NOI as a general partner of YG LP, the General Partner necessarily admitted to being insolvent at the time the NOI was filled out. There is no evidence that such state of insolvency arrived suddenly that day. The General Partner has accordingly admitted to the existence of an insolvency default under s. 7.1(c) of the Limited Partnership Agreement at some time prior to filing the NOI failing which no NOI would have been possible. By signing the Proposal Sponsor Agreement and agreeing to file the NOI to advance the Proposal, the General Partner also consented to the receiving the benefit of the BIA proposal provisions.

[64] For all of the foregoing reasons, the signing of the Proposal Sponsor Agreement amounts to an admission of further breaches of the Limited Partnership Agreement.

[65] Do such breaches entail the automatic removal of the authority of the General Partner to act as such at the time the NOI was actually filed? The answer in my view is that none of them have that effect.

[66] Section 11.2 of the Limited Partnership Agreement concerns the removal of the General Partner. Pursuant to s. 11.2(a), the General Partner “may be removed” by a court of competent jurisdiction on certain named grounds. That has not occurred. Section 11.2(b) provides that the General Partner “shall cease to be general partner” if any of the named events occurs. None of the agreement to file an NOI, the state of being insolvent or the signing of the Proposal Sponsor Agreement can be read to be included

in the list of events listed in s. 11.2(b). The *aftermath* of the filing of the NOI may well be such a trigger but the answer to that question would require me to contend with the effects of the automatic stay which has not been raised before me.

[67] Accordingly, I find that the NOI filed by the General Partner was not void or subject to any similar infirmity. The foregoing conclusion refers only to the actual filing of the NOI and specifically does not apply to the breaches of the Limited Partnership Agreement consequent upon entering into the Proposal Sponsorship Agreement discussed above.

(vii) The Proposal was the product of a flawed process and breaches of fiduciary duty by the General Partner

[68] There are two aspects to this part of the objections raised by the objecting limited partners. First, it is alleged that during the year leading up to the Proposal Sponsor Agreement, the General Partner breached its fiduciary duty to act in the best interests of the partnership by seeking to advance the interests of non-arm's length parties to the detriment of the limited partners while simultaneously frustrating every effort of the limited partners to access the information that the Limited Partnership Agreement and the Manitoba *Partnership Act* gave them the rights to see. Second, it is alleged that negotiating and entering into the Proposal Sponsor Agreement was a breach of fiduciary duties of the General Partner in that this was nothing less than deliberately negotiating and entering into an agreement to breach the Limited Partnership Agreement.

[69] As the sole general partner of YG LP, the General Partner was responsible for the management of the affairs of the limited partnership and was the only one able to bind the partnership. The General Partner owed a fiduciary duty to all of the partners of the firm in discharging that role and pursuant to s. 64 of *The Partnership Act*, is liable to account, both at law and in equity to the limited partners for its management of the firm.

[70] As I have outlined above, entering into the Proposal Sponsor Agreement was a clear violation of s. 10.14 of the Limited Partnership Agreement as it agreed to a process whereby substantially all of the property of the firm would be conveyed to a third party without the assent of the limited partners. The fact that the BIA stay of proceeding may impede or prevent the limited partners from seeking a direct remedy for that breach when the agreement was subsequently put into action by filing the NOI does not detract from the existence of a present breach the moment pen was put to paper. Further, whether the negotiations of the Proposal Sponsor Agreement consumed two weeks or two months, it was a breach of fiduciary duty to plan and then put into execution a deliberate breach of the Limited Partnership Agreement and doing so in the teeth of a pending application to stop the General Partner adds further weight to that conclusion.

[71] The debtors suggested that being in the proximity of insolvency dissolved or altered the fiduciary duties of the general partner owed to the limited partners. It is true that the law recognizes that the interests of creditors assume a greater weight the closer to insolvency the enterprise approaches. None of this dissolves the fiduciary obligations of the General Partner so much as it adds to them. It is at this point that the other aspect of the complaint of the limited partners enters the analysis.

[72] Nothing in what I have written suggests that a general partner cannot file an NOI where doing so appears on all of the facts and in the good faith exercise of the best business judgment of the general partner to be in the best interests of the enterprise as a whole to do so – a judgment that necessarily accounts for the obligations of the firm owed to its creditors.

[73] This filing was different because it came with strings attached: a binding Proposal Sponsor Agreement that granted exclusivity to a single party and obliged the General Partner to pursue one path and one path only to emerge from the process. Those strings did not get attached as a result of a process which itself discharged faithfully the fiduciary duties of the General Partner. Rather they were attached as the culmination of almost a year of battling to keep information away from limited partners that they had a right to access (in most cases at least) and the squandering of an expensively purchased window of restructuring breathing room looking not for the solution best able to discharge all of the obligations of the partnership but rather looking for the investor best able to secure the optimal outcome for the Cresford group of companies generally. In that process the limited partners were an obstacle to be circumvented and bankruptcy provided a possible key.

[74] Good faith in such circumstances is not assumed but must be shown. The evidence presented to me has rather persuasively convinced me that good faith took a back seat to self-interest.

[75] The parties have expended considerable effort in outlining the details of what occurred in that time frame. In the interests of time, I shall summarize the important take-aways from those events:

- a. Until the Proposal Sponsor Agreement and the April 2021 CBRE report prepared for Concord, *all* appraisal evidence showed a profitable project likely to result in full coverage for all of the outstanding third-party debt obligations plus all of the obligations owed to limited partners;
- b. The General Partner presented two potential transactions to the “A” unit limited partners in the second half of 2020 that provided for the full payment of all debt, the payment of approximately \$38 million to non-arm’s length parties related to the General Partner and payment of obligations owed to the limited partners at a discount – the latter of the two proposals emanated from Concord;
- c. The two proposals failed to proceed primarily because the General Partner was unable to provide a satisfactory explanation as to why Cresford related parties were to receive a substantial payment when limited partners were asked to accept a compromise the

obligations due to them and limited partners had been assured that Cresford group obligations ranked behind them both when they made their investment and as late as October 2020 in a letter from counsel the debtors; and

- d. The limited partners were in a continual tug-of-war trying to pry information out of the General Partner having had to resort to a court order at the beginning of this year to obtain access to information that should have been available to them as of right.

[76] Few things are more precious in the restructuring business than time. YG LP was able to “purchase” more than a year of time with the forbearance arrangements that it worked out. That precious time appears to have been devoted solely to finding transactions that offered the greatest level of benefits for the Cresford group of companies. There is no evidence that any canvassing of the market – however constrained the market of developers capable of undertaking the completion of an 85-story mixed use tower in downtown Toronto may be – took place that was not indelibly tainted by the imperative of finding value for the Cresford group of companies rather than for the partnership itself.

(viii) The Affected Creditor vote was unanimous

[77] Despite the fact that I have found that fifteen of the forty-six votes cast in favour of the Proposal ought not to have been considered because they came from Unaffected Creditors, that determination does not impact the conclusion of the Trustee that the required statutory majorities voted in favour of the Proposal. There was but one negative vote cast and the Trustee disallowed that vote as being contingent. I have reviewed the Trustee’s reasons for so ruling and find no fault with them. The removal of fifteen creditors and just over \$9 million in claims does not detract from the fact that thirty-one creditors holding approximately \$9 million in other claims cast votes in favour.

[78] While I am prepared to consider to some degree the impact of the assignment agreements negotiated by Concord (see below), I do not view such agreements as impacting the formal validity of the votes cast.

[79] I find that the Proposal received the required majority of two-thirds in value and over 50% in number of creditors voting in person or by proxy.

(ix) The probative value of most of the Affected Creditor vote is attenuated

[80] In the normal course, the agreement of a broad group of creditors to accept less than 100% of what they are owed is cogent evidence of the fairness and reasonable nature of a proposal. This is so as a matter of common sense and by a very long tradition in our law. It is not an indicator lightly to be ignored.

[81] I must also recognize that whatever doubts the evidence may raise as to the insolvency of the debtors in terms of the realizable value of their assets, there can be little doubt that the liquidity test for insolvency is met. The lien claimants have been unpaid for a year or more without any formal forbearance agreement. The first mortgagee has entered into a forbearance agreements but this expires on June 30, 2021.

[82] There was a window of time to find an out-of-court solution, but it would appear that the debtors have squandered it.

[83] The vote of the Affected Creditors is probative of fairness, but I find that its weight is attenuated in this case by the following circumstances:

- a. Only a relatively small minority voted who did not also enter into assignment agreements;
- b. The evidence is equivocal about precisely what consideration was received by those who entered into such assignment agreements – a relayed denial of “side-deals” without more adds little to the equation particularly when the deal itself is not disclosed;
- c. Clearly if assigning creditors received or stand to receive more than the value allocated to them under the Proposal, their positive vote says little about the business judgment of the creditors at large to accept the value offered to satisfy their claims but says more about the willingness of the Proposal Sponsor to pay more than has been reflected in the Proposal itself.
- d. This last-in-line class of creditors did not have available to it the range of information produced in connection with this approval motion.

Disposition

[84] I will not approve the Proposal in its present form. I have concluded that, as presented, the Proposal is not reasonable, it is not calculated to benefit the general body of creditors and there are serious issues regarding the good faith with which it has been prepared and presented by the debtors. The debtors and the Proposal Sponsor have the authority under art. 3.06 of the Proposal to amend the Proposal to address the concerns I have raised. It is up to them – with the approval of the Trustee – to do so if they are so inclined.

[85] I am directing the parties to return on Wednesday June 30 at 2:15 pm either to propose amendments to the Proposal that address the concerns I have raised in a substantive way or to address next steps.

[86] These written reasons expand upon the summary reasons I presented orally in a hearing on June 29, 2021. I have released these reasons with relatively little opportunity to proof them and correct typographical errors or minor nits or stylistic glitches. I shall do so over the next week when I have more time available to me and the capacity to call upon my able assistant Ms. Daisy Ng to assist in that effort. Accordingly, I shall be releasing an amended version of these reasons over the course of the next week with such minor and non-substantive corrections.

S.F. Dunphy J.

Date: June 29, 2021

The foregoing is the corrected text of my reasons. Orphaned words have been removed or obvious missing words restored along with corrections of minor errors only. The parties have received a blackline version to compare the changes. Since releasing these reasons, I have adjourned the hearing scheduled for June 30, 2021 at 2:15 until July 9, 2021 at 10:00am. In so doing, I issued the following additional directions:

As KSV Restructuring Inc. ("KSV") will become the bankruptcy trustee and court-appointed receiver on July 9, 2021 if no satisfactory amended proposal is approved at that time, this Court hereby authorizes and directs KSV to undertake the steps towards formulating a sales process that it would be undertaking if it had been appointed the receiver today.

KSV's costs of doing so from July 1, 2021 shall be deemed costs of the receiver upon the granting of a receivership order on July 9, 2021 failing which all such costs will be deemed to be costs of the Proposal Trustee in the proposal proceeding.

Issued: July 2, 2021

S.F. Dunphy J.

TAB 2

At para(s) 9-11, 32

YG Limited Partnership and YSL Residences (Re), 2021 ONSC 5206 (CanLII)

Date: 2021-07-16
File number: CV-21-00655373-00CL; BK-21-02734090-0031; CV-21-00661386-00CL;
CV-21-00661530-00CL
**Citation: YG Limited Partnership and YSL Residences (Re), 2021 ONSC
5206 (CanLII), <<https://canlii.ca/t/jh986>>, retrieved on
2024-04-25**

CITATION: YG Limited Partnership and YSL Residences (Re), 2021 ONSC 5206
COURT FILE NOS.: CV-21-00655373-00CL/BK-21-02734090-0031,
CV-21-00661386-00CL & CV-21-00661530-00CL
DATE: 20210716

SUPERIOR COURT OF JUSTICE – ONTARIO (COMMERCIAL LIST)

RE: IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, C. B-3, AS
AMENDED

AND:

IN THE MATTER OF THE NOTICES OF INTENTION TO MAKE A PROPOSAL OF YG LIMITED
PARTNERSHIP AND YSL RESIDENCES

APPLICATION UNDER THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, C. B-3, AS
AMENDED

AND RE: 2504670 CANADA INC., 8451761 CANADA INC. and CHI LONG INC., Applicants

AND

CRESFORD CAPITAL CORPORATION, YSL RESIDENCES INC, 9615334 CANADA INC., YG
LIMITED PARTNERSHIP and DANIEL CASEY, Respondents

AND RE: 2583019 ONTARIO INCORPORATED AS GENERAL PARTNER OF YONGESL INVESTMENT
LIMITED PARTNERSHIP, 2124093 ONTARIO INC., SIXONE INVESTMENT LTD., E&B
INVESTMENT CORPORATION and TAIHE INTERNATIONAL GROUP INC., Applicants

AND

9615334 CANADA INC. AS GENERAL PARTNER OF YG LIMITED PARTNERSHIP and YSL RESIDENCES INC., Respondents

BEFORE: S.F. Dunphy J.

COUNSEL: *Harry Fogul and Miranda Spence*, for YG Limited Partnership and YSL Residences Inc.

Shaun Laubman and Sapna Thakker, for 2504670 Canada Inc., 8451761 Canada Inc., and Chi Long Inc.

Alexander Soutter, for YongeSL Investment Limited Partnership, 2124093 Ontario Inc., SixOne Investment Ltd., E&B Investment Corporation, and TaiHe International Group Inc.

David Gruber, Jesse Mighton, and Benjamin Reedijk, for Concord Properties Developments Corp. and its affiliates

Jane Dietrich and Michael Wunder, for 2292912 Ontario Inc. and Timbercreek Mortgage Servicing Inc.

Robin B. Schwill, for KSV Restructuring Inc. in its capacity as the proposal trustee

Roger Gillot and Justin Kanji, for Kohn Pedersen Fox Associates PC

Reuben S. Botnick, for Royal Excavating & Grading Limited COB as Michael Bros. Excavation

Jamie Gibson, for Sarven Cicekian, Mike Catsiliras, Ryan Millar and Marco Mancuso

Brendan Bowles, for GFL Infrastructure Group Inc.

Mark Dunn, for Maria Athanasoulis

James MacLellan and Jonathan Rosenstein, for Westmount Guarantee Services Inc.

Albert Engle, for Priestly Demolition Inc.

HEARD at Toronto: July 9 and 16, 2021

REASONS FOR DECISION #2 (REVISED PROPOSAL)

[1] On June 29, 2021, I rejected the debtor's application for approval of its Proposal (identified as "Amended Proposal #2) and provided my detailed reasons for doing so on July 2, 2021. In delivering my reasons, I indicated that that it remained possible for the debtors to amend their Proposal if they so chose. The debtors for their part asked me to adjourn the hearing until July 9, 2021 in order to permit them an opportunity to do so. I granted the requested adjournment.

[2] An amended proposal was filed immediately prior to the hearing on July 9, 2021 entitled "Amended Proposal #3" and I have been asked to consider approving such Amended Proposal. I held a hearing on whether Amended Proposal #3 ought to be approved on July 9, 2021. Amended Proposal #3 was filed only a short while prior to that hearing. I delayed the start of the hearing for an hour to give parties time to review and analyse the document and proceeded to hear their submissions.

[3] As is usual, I called upon the Trustee to give its comments last. The Trustee requested a further week to review the document and to consider its position. I granted that request and the matter was adjourned to July 16, 2021 at 10:00 a.m. This second adjournment was granted – it must be noted – over the objections of the 1 mortgagee Timbercreek whose forbearance agreement with the debtors expired on June 30, 2021 and who has a long-standing hearing date for its receivership application on July 12, 2021. I adjourned the Timbercreek July 12, 2021 hearing to July 16, 2021 as well such that both proceedings were scheduled to appear before me on July 16, 2021.

[4] A term of the adjournment I granted was that the debtors and Timbercreek should both have circulated draft orders (Proposal approval order in the case of the debtors; Receivership Order in the case of Timbercreek) in advance of the hearing on July 16, 2021 with the expectation that I should sign one of the two orders on July 16, 2021.

[5] On July 15, 2021, a second version of Amended Proposal #3 was filed with the Official Receiver and the Trustee issued its Fourth Report commenting on version 2 of Amended Proposal #3. The Trustee's Fourth Report recommended approval of the Proposal as so amended.

[6] This Proposal has been through a few versions and the nomenclature can get confusing. The amendments made in version 2 of Amended Proposal #3 were minor and technical in nature – they did not adversely affect the rights of any Affected Creditor and at least one of them could just as easily have been added to the approval order outside of the Proposal without objection. My references to "Amended Proposal #3" below should be taken as referencing version 2 of Amended Proposal #3 unless the context requires otherwise.

[7] For the reasons that follow, I have decided to approve version 2 of Amended Proposal #3 and I have signed the approval order.

Background facts

[8] I shall not repeat my review of the facts nor my reasons for rejecting Amended Proposal #2 on June 29, 2021. My detailed reasons for that decision were released on July 2, 2021 and should be considered as if incorporated by reference herein.

[9] In broad strokes, the following summarizes the principal amendments made in Amended Proposal #3:

- a. Lien claimants who assigned their claims to the Proposal Sponsor (\$9.2 million) will not share in the pool of cash available to unsecured creditors under the Proposal – all lien claimants will be treated as Unaffected Creditors;
- b. Related party claims (\$38.3 million) will be treated as equity claims and not participate in the pool of cash available to unsecured creditors;
- c. Unsecured creditors' recoveries will no longer be limited to \$0.58 per dollar of proven claim but will share *pro rata* in the pool of cash available to unsecured creditors up to payment in full;
- d. The Proposal Sponsor will fund the full cash pool on Proposal Implementation without reduction should proven claims come in below the amount of the cash pool (\$30.9 million);
- e. The pool of cash available to unsecured creditors is reduced from \$37.7 million to \$30.9 million but subject to the above changes reducing the claims eligible to share in the pool;
- f. Secured creditors claims – including all construction lien claims – remain unaffected and are assumed by the Proposal Sponsor in purchasing the land and project assets;
- g. After Affected Creditor claims have been resolved and all required payments made to them, any residual amount will be returned to the debtor YG Limited Partnership to be dealt with as the partners direct or the court orders; and
- h. Proposal Implementation will occur three days after court approval.

[10] The Fourth Report of the Trustee summarized the impact of these changes. Some of the principal points made by the Trustee include the following:

- a. Construction lien claimants who agreed to assign their claims to the Proposal Sponsor prior to these amendments might potentially receive less under their assignment agreements than they would under Amended Proposal #3 which had not been made when they agreed to assign their claims. The Trustee contacted the

assigning creditors. Two were unable to be contacted but have voiced no objection one way or the other. The remainder of them expressed support for the approval of Amended Proposal #3 or made no objection to it. No assigning creditor was opposed.

- b. Version 2 of Amended Proposal #3 contains material improvements to Amended Proposal #2 and addresses concerns raised in my decision of June 29, 2021.
- c. Any payments to equity holders are entirely outside of the Proposal.
- d. The Trustee has analyzed the known unsecured claims that would share in the \$30.9 million pool available to Affected Creditors under Amended Proposal #3. The Trustee's estimate is that Affected Creditors will receive between 71% of their claims and payment in full under version 2 of Amended Proposal #3 as contrasted with between 40% and 58% of their claims under Amended Proposal #2. The lower assumption is based on all known claims being allowed in full as claimed with an identical estimate for claims not yet filed. In the event none of the disputed or contingent claims were allowed, the Affected Creditors would be paid in full and up to \$19 million may be available to holders of equity claims.

[11] Amended Proposal #3 came with an additional element that the Proposal Sponsor felt it proper to disclose to the Court and the parties. The Proposal Sponsor made a parallel and entirely voluntary offer to holders of limited partnership units in YG LP as well as other claims found by me to be equity claims (i.e. the related party claims) to sell their equity interests for 12.5% of the value of such interests subject to certain structuring conditions.

[12] I cannot say at this juncture whether any equity holders will take the Plan Sponsor up on this offer. The objecting limited partners have shown little interest in it to date at least. The offer has conditions that may or may not be acceptable to them depending upon their own tax situation and their views of value.

[13] Fifty years after the Carter Commission report, it remains the case that business transactions are invariably structured to minimize tax which continues to impact similar economic transactions differently depending upon the structures used. I am satisfied that the "equity offer" is not a disguised transfer of value from creditors to holders of equity claims – the structures required to be used potentially deliver tax attributes to a buyer of the claims that would not otherwise be available. This proposal has been properly disclosed but I do not view it as being particularly relevant to my assessment of Amended Proposal #3. That proposal delivers additional value to creditors under all scenarios compared to its predecessor. There is no diversion of value from creditors to equity holders to be found here. I concur with the Trustee's assessment that the equity offer is quite independent of the Proposal and does not contravene the *BIA* provisions against payment to equity ahead of debt even if it turns out that creditors receive less than payment in full (and that would be a fairly speculative assumption to make).

[14] The Trustee's Fourth Report concluded that the Debtors were proceeding with the request for approval of the Amended Proposal #3 in good faith.

Analysis and discussion

[15] This amended proposal is not perfect. The process that led to it was far from ideal. However, as now amended, this Proposal provides a superior outcome for all classes of creditors under every conceivable scenario and addresses all of the concerns raised in my reasons of July 2, 2021 constructively and substantively.

[16] As so amended, I have no hesitation in finding that Amended Proposal #3 is reasonable, it is calculated to benefit the general body of creditors and is being advanced at this juncture in good faith notwithstanding the defects that I found marred the negotiation and presentation of the initial version of the Proposal.

[17] There were some critical foundational findings that I made in my reasons of July 2, 2021 including:

- a. whatever breaches of the Limited Partnership Agreement may have occurred in the weeks and months prior to the filing of the NOI, the general partner *did* have authority to file the NOI;
- b. the Affected Creditor vote in support of Amended Proposal #2 was in fact unanimous; and
- c. whatever questions there may be regarding the solvency of the debtors from the perspective of the realizable value of their assets, there can be no question of the insolvency of the debtors from a liquidity point of view: secured and unsecured claims alike are overdue and unpaid and the debtors have no means to satisfy their claims in a timely way. Lien claims are more than a year in arrears for the most part while all forbearance periods have expired for the secured debt.

[18] While I found the probative value of the creditor vote to be attenuated somewhat by the factors I listed in those reasons, the vote did and does have probative value and it is material to note that unsecured creditors agreed to accept payment of less than full payment on their claims on June 15, 2021. All of the Affected Creditors will receive a superior outcome under Version 2 of Amended Proposal #3 under any reasonable assumptions. Their approval of the prior version of the Proposal remains as probative in the context of version 2 of Amended Proposal #3 if not more so.

[19] Version 2 of Amended Proposal #3 clearly satisfies the technical requirements of the *BIA* in that Amended Proposal #2 upon which the creditors did vote authorized the amendments that have been made in Amended Proposal #3 (including version 2 thereof).

[20] Version 2 of Amended Proposal #3 has constructively addressed each of the issues I raised in my June 29 ruling and my July 2 written reasons:

- a. The construction lien claims will not dilute the recovery of the unsecured creditors in any way.
- b. The related party claims are to be treated as equity claims and disentitled to share in the cash pool.
- c. While I expressed grave concerns regarding the lack of good faith and the breaches of fiduciary duty that preceded the filing of the NOI and the entry into the Proposal Sponsor Agreement, those concerns were primarily focused on the efforts made to prefer related party claims over those of other stakeholders in the search for an investor. Amended Proposal #3 cannot undo the past of course but it has addressed those findings constructively. The related party claims are treated as equity claims.
- d. There is a strong likelihood that proven creditor claims will be substantially lower than the \$30.9 million pool available to satisfy them and Amended Proposal #3 ensures that such surplus is returned to the limited partnership instead of being retained by the Proposal Sponsor.
- e. The claims of related parties and their priority relative to limited partners will be dealt with within the limited partnership structure itself, in broad daylight and subject to the full range of remedies open to the limited partners to protect their interests should the need arise. The conflicting interests that marred the development of Amended Proposal #2 have been substantially cured by the amendments effected by Amended Proposal #3. Related parties have been put in their proper place in the claims hierarchy.

[21] The strongest critique levelled at Amended Proposal #3 by the limited partners is that it does not answer the question of what the value of the project might have been had the project been offered on the open market in a competitive process. That is a fair criticism but not one that is sufficient to detract from the overwhelmingly positive attributes of this Proposal.

[22] The past cannot be undone and perfection is not the standard against which a proposal is to be measured. Section 59(2) of the *BIA* requires that approval of a proposal must be refused if its terms are not shown to be reasonable and calculated to benefit the general body of creditors. The common law has added to this the requirement that a proposal must be advanced in good faith.

[23] Amended Proposal #3 is both reasonable and calculated to benefit the general body of creditors. It provides for substantially improved outcomes to all creditors whose claims were impaired by Amended Proposal #2 under any reasonable assessment of the facts. As noted above, it is quite likely that a surplus will remain to be returned to the limited partnership after all affected unsecured claims have been paid in full to be dealt with as the limited partners direct (or by court order if necessary).

[24] The debtors are insolvent today. They are properly in bankruptcy proceedings. Their creditors have a right to payment and – to the extent reasonably possible – to payment in full as soon as possible. Amended Proposal #3 offers payment in full to most secured creditors within a matter of days following court approval. Unsecured creditor payments will be subject to reasonable reserves for unresolved claims but these too will begin flowing in short order. This contrasts to a delay of *many* months on the most optimistic of scenarios were a receiver directed to sell the project.

[25] There is a public interest in moving this very substantial project out of the quicksand in which it has become stuck for over a year. Approval of Amended Proposal #3 at this juncture ensures that the Project is in the hands of a solvent entity with the wherewithal and experience necessary to put it back on track as soon as possible.

[26] The real question before me today is whether limited partners have the right to require creditors to run the risk of a sale process producing an inferior outcome to Amended Proposal #3 in order to test the hypothesis that a greater value might emerge from a fresh marketing of the project in a liquidation process that might result in payment of some or all of the limited partners' equity claims. In my view, they do not.

[27] It is possible that higher values could emerge from a liquidation process but that possibility is not a one way street. The dissatisfaction I expressed in my reasons of July 2, 2021 regarding the quality of the appraisal evidence before me does not imply any level of probability that market value today is *higher* than the values suggested by the April 2021 CBRE appraisal. I was dissatisfied with the quality of *all* of the appraisal evidence because of the lack of evidence reconciling the differences between them and, in particular, assessing the reasonableness of the assumptions made in each.

[28] It is noteworthy that version 2 of Amended Proposal #3 offers the real prospect that a return on equity of more than 100% of the invested capital of the limited partners may come back to YG LP. The limited partners assent will be needed to any use of those funds unless a court order is obtained. The possible upside to limited partners arising from a new sales process has thus become that much more remote under this last revision to the Proposal compared to the first.

[29] There are costs involved in conducting a receivership that would come ahead of any potential surplus being made available to equity claimants such as the limited partners. Some of the risk of a sale process producing a lower outcome could potentially be insured against by procuring a stalking horse bid to put a floor under the sale process. There is no guarantee that a stalking horse bid would be available at or near the implied value of Amended Proposal #3. Stalking horse bids come with a price tag in the form of a break fee that is usually calculated as a percentage of the price. That too would stand to reduce the recoveries to unsecured creditors and create an additional hurdle to any prospect of additional recovery to limited partners.

[30] This is a real bankruptcy. There is nothing artificial about it. Creditors have been unpaid for over a year. I have before me a transaction that provides a pathway to payment of creditor claims in full and quickly while leaving a realistic prospect for equity claims to receive some significant recovery. Every

other option requires the creditors – who bear no responsibility for the mess that this project has found itself in – being subjected to the real risk of partial non-payment and substantial delay being added to the very lengthy delay to which they have already been subjected in order to test the hypothesis that a few percentage points of additional value might potentially be found. That is not a risk that it is fair to impose on creditors on these facts and having regard to the important favourable changes made to the Proposal.

Disposition

[31] Accordingly, an order shall issue approving version 2 of Amended Proposal #3. I have reviewed the draft form of approval order uploaded and approved and signed same. It was amended slightly to include in the preamble corrected references to the limited partners who appeared and the evidence they filed.

[32] This Proposal satisfies the technical requirements of the *BIA*. I have concluded that version 2 of Amended Proposal #3 represents a valid amendment to Amended Proposal #2 in accordance with its terms and thus has received the required double majority of creditor approval. The terms of this Proposal are reasonable and calculated to benefit the general body of creditors. The amendments presented have satisfied the concerns raised by me regarding the good faith of the debtors in pursuing *this* Proposal.

[33] I wish in particular to note that I have included, as requested, an order pursuant to s. 195 of the *BIA* permitting provisional execution of the approval order notwithstanding appeal. I have made this order in consideration of two primary factors:

- a. The secured creditors of YG LP have been deferred and stayed for a very, very long time at this point. Some of that deferral was purchased in the form of forbearance agreements with Timbercreek but the last negotiated extension – an extension that included every possible assurance that no further extensions would be sought – expired on June 30, 2021. I made it clear on July 9, 2021 that I would be approving the Proposal or a Receiver today. It would be unjust to Timbercreek to have its period of limbo indefinitely extended by the simple expedient of filing a Notice of Appeal and forcing Timbercreek to seek a lifting of an automatic stay to enforce its security. This project is, at its core, a hard asset consisting of real estate, a bundle of approvals and a hole in the ground. There is no goodwill to speak of. It has been held in limbo for much more than a year at this point and it must either be put in the hands of someone who will bring it forward to completion under the Proposal or of a Receiver who will find someone who can.

- b. Our courts have generally sought to achieve a degree of uniformity of practice as between the CCAA and the BIA. Approval of a CCAA Plan Is not subject to an automatic stay. An automatic stay in this case would operate as a functional veto of the Proposal itself because the result would be an almost certain slide into receivership unless the stay were promptly lifted.

[34] Timbercreek's receivership application was adjourned by me from July 12, 2016 until today. Based upon my approval of the Proposal today *and subject to the closing of version 2 of Proposal #3 in accordance with its terms by no later than July 31, 2021*, Timbercreek agrees that its application is moot. There is no reason to believe the Proposal will not be completed as planned, however, nothing can be taken for granted. I am adjourning Timbercreek's application to August 9, 2021 when I shall next be sitting. It is adjourned before me.

[35] Assuming (i) the Trustee confirms to me that the version 2 of Amended Proposal #3 has been completed and (ii) Timbercreek does not advise me in advance of August 9 of its intention to proceed, I shall endorse the Timbercreek application as withdrawn without costs on August 9, 2021. No attendances will be necessary from any party in that eventuality. If there is a reason for the application to move forward, I am relying on the Trustee and Timbercreek to so notify me as soon as practicable after July 31, 2021.

[36] A request was made by the limited partners to make submissions to me regarding costs of the bankruptcy proposal proceeding. For the avoidance of doubt, my signing of the order approving version 2 of Amended Proposal #3 has not disposed of the matter of costs of the proposal proceedings. I have made no order as to costs to this point nor have I heard submissions on the point.

[37] Any party seeking an order of costs in their favour shall have ten days from today to file written submissions and an outline of costs. Submissions should not exceed ten pages excluding the outline of costs. Cases need not be included beyond a hyperlinked table of cases. The Debtors and the Proposal Sponsor shall each have a further ten days to respond to any such requests for costs with similar size restrictions. All submissions are to be uploaded to CaseLines and copied to the Trustee. I am asking the Trustee to provide me with a consolidated set of submissions to which the Trustee may – but shall not be required to – add its own additional comments in the form of a brief supplementary report.

[38] Lastly, I need to give some directions regarding the two civil applications that immediately preceded these bankruptcy proceedings brought by the limited partners of YG LP. My reasons of June 29, 2021 made a number of findings in relation to matters raised in those two applications. However, it must also be clear that neither my ruling of June 29, 2021 nor this decision has fully disposed of either civil application.

[39] It is certainly true that I made findings in the context of the bankruptcy proposal proceedings that were and are relevant to the two applications. Even if those findings were made in the context of the bankruptcy proceedings, the three proceedings were to a degree inextricably intertwined. I was asked to

issue a formal order in relation to the findings I did make. I declined to do so not because I am resiling from any findings made – I do not – but because I did not and do not have the full scope of the claims of either application fleshed out before me. I directed certain matters to be explored and argued due to the interrelationship between the proceedings but I do not want my rulings in one context to be taken out of context in another.

[40] The safest course in my view is to let my rulings stand as made knowing that *res judicata* and issue estoppel can be applied as needed to avoid any abuse. I was asked to confirm – and do so now – that costs of those two civil applications have not been dealt with by me at all. They have not. The limited partner applicants in those two proceedings asked to make submissions regarding costs of the bankruptcy proposal proceeding and I have given them leave to do so as provided above. The costs of the two civil applications remain reserved to the judge disposing of them.

S.F. Dunphy J.

Date: July 16, 2021

Addendum:

As noted, I have reviewed the originally signed reasons and made a small number of clerical and stylistic changes to the text as originally released. As well, I was advised by the Trustee that the transaction was in fact completed on July 22, 2021. Accordingly, I have issued an endorsement today vacating the August 9, 2021 appointment reserved to hear the Timbercreek application and endorsed that matter as being abandoned without costs because moot. No party will be required to appear on August 9, 2021.

Date: July 27, 2021

S.F. Dunphy J.

TAB 3

At para(s) 12-14, 48-52, 81 and 83

YG Limited Partnership (Re), 2022 ONSC 6138 (CanLII)

Date: 2022-11-01

File number: BK-21-02734090-0031

Citation: **YG Limited Partnership (Re), 2022 ONSC 6138 (CanLII),**
<<https://canlii.ca/t/jsv6c>>, retrieved on 2024-04-24

CITATION: YG Limited Partnership (Re), 2022 ONSC 6138

COURT FILE NO.: BK-21-02734090-0031

DATE: 20221101
SUPERIOR COURT OF JUSTICE – ONTARIO
IN BANKRUPTCY AND INSOLVENCY
(COMMERCIAL LIST)

RE: IN THE MATTER OF *THE BANKRUPTCY AND INSOLVENCY*
ACT, R.S.C. 1985, c. B-3, AS AMENDED

IN THE MATTER OF THE NOTICES OF INTENTION TO

MAKE A PROPOSAL OF YG LIMITED PARTNERSHIP AND

YSL RESIDENCES INC.

BEFORE: Kimmel J.

COUNSEL: *Robin Schwill and Chenyang Li*, for the Proposal Trustee, KSV Restructuring Inc.

Jason Berall, for the Proposal Sponsor, Concord Properties Developments Corp.

Alexander Soutter, for Yonge SL LPs

Shaun Laubman, for Chi Long LPs

Mark Dunn and Sarah Stothart, for Maria Athanasoulis

HEARD: October 17, 2022

ENDORSEMENT
(funding motion)

Overview

[1] YG Limited Partnership and YSL Residences Inc. (together, “YSL” or the “Debtor”) filed Notices of Intention to Make a Proposal under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the “BIA”), which were procedurally consolidated pursuant to an Order dated May 14, 2021. The Debtor companies are special purpose entities established to hold the assets for a large real estate development in downtown Toronto known as the “YSL Project”.

[2] This court approved an Amended Third Proposal dated July 15, 2021 (the “Proposal”) on July 16, 2021. Under the Proposal, the moving party, KSV Restructuring Inc. (the “Proposal Trustee”), was authorized to deal with various claims against the Debtor, some of which were disputed.

[3] In the Proposal, Concord Properties Developments Corp. (the “Sponsor”) covenanted in sections 10.2 and 11.1 to indemnify the Proposal Trustee for “all Administrative Fees and Expenses (defined below) *reasonably incurred* [and not covered by the reserve established on the Proposal Implementation Date by the Sponsor in respect of the reasonably estimated additional Administrative Fees and Expenses anticipated to be incurred in connection with the administration of Distributions, resolution of any unresolved Claims ... and the Proposal Trustee’s discharge]”. [emphasis added]

[4] “Administrative Fees and Expenses” are defined in the Proposal as “the fees, expenses and disbursements incurred by or on behalf of the Proposal Trustee, the solicitors for the Proposal Trustee, the solicitors of the Company both before and after the Filing Date.”

[5] The Proposal Trustee brings this motion to compel the Sponsor to provide funding for the Proposal Trustee’s continuing work towards the determination and/or resolution of the outstanding proofs of claim against the Debtor.[1]¹ Jurisdictional questions have been raised within the motion.

[6] For reasons given orally at the hearing, I declined to grant the contested adjournment of this motion that the Sponsor asked for at the outset.

[7] For the reasons that follow, I have concluded that the Sponsor is not obligated to fund phase 2 of the Arbitration that was intended to determine the Athanasoulis Claim (as those terms are later defined herein). The Sponsor is obligated to indemnify the Proposal Trustee for its Administrative Fees and Expenses reasonably incurred to determine that claim itself, with the benefit of the Award from phase 1 of the Arbitration. The specific orders and directions arising from this ruling are detailed in this endorsement.

1. The motion originally sought the determination of the Sponsor’s obligation to fund certain past expenses incurred by the Proposal Trustee; however, these expenses have been funded through previous advances from the Sponsor and the Sponsor advised that it is not seeking to “claw-back” monies previously advanced nor challenge the use of funds by the Proposal Trustee to date. Thus, the practical implication of this motion is only to deal with future funding obligations of the Sponsor.

Background to the Motion

[8] As of October 2022, most of the claims filed against the Debtor had been settled or accepted by the Proposal Trustee. The largest claim, by far, filed against the Debtor is made by Maria Athanasoulis. This claim is comprised of \$1 million for wrongful dismissal damages and \$18 million in damages for alleged breaches of an oral profit-sharing agreement by which she alleges YSL must pay her 20% of the profits earned on the YSL Project (the “Athanasoulis Claim”).

[9] The Athanasoulis Claim is one of three disputed claims by various stakeholders that the Proposal Trustee says have increased the professional costs associated with the Proposal and prevented the Proposal Trustee from completing the administration of these proceedings.

[10] As of the end of July 2022, the Proposal Trustee’s Administrative Fees and Expenses totalled just under \$1.2 million, excluding Harmonized Sales Tax. Included in that total were the costs of phase 1 of an arbitration held from February 22-25, 2022 (the “Arbitration”) before William G. Horton (“the Arbitrator”). The Proposal Trustee and Ms. Athanasoulis both participated in the Arbitration. It resulted in a partial award dated March 28, 2022 (the “Arbitration Award”) that included findings that:

- a. The Debtor had entered into an oral profit sharing agreement with Ms. Athanasoulis;
- b. Ms. Athanasoulis was an employee of YSL; and
- c. Ms. Athanasoulis was constructively dismissed by YSL in December 2019.

[11] The Proposal Trustee says that it agreed to arbitrate the Athanasoulis Claim because the existence of the oral profit sharing agreement upon which it was based, as well as Ms. Athanasoulis’ status with the Debtors (and other entities within the same corporate group referred to as the Cresford Group), were disputed by the Debtor’s representative(s) and the determination of those questions would turn on credibility assessments. In these circumstances, the Proposal Trustee believed that the determination of whether Ms. Athanasoulis had a profit sharing agreement, what its terms were and whether she was an employee who was constructively dismissed, could be best determined through a hearing with *viva voce* evidence.

[12] The Sponsor was told on December 1, 2021 “that arrangements are being made with [Mr.] Horton to arbitrate the claim in late February, which is the earliest available date.”

[13] The terms of appointment of the arbitrator were signed by the Proposal Trustee and Ms. Athanasoulis on December 9, 2021 (the “Agreement to Arbitrate”). By its terms, the parties agreed to:

- a. appoint Mr. Horton to serve as sole arbitrator of their dispute relating to the Athanasoulis Claim; and

- b. bifurcate the Athanasoulis Claim such that the Arbitration shall initially resolve only the liability of YSL (in phase 1). In the event the Arbitrator finds that YSL is liable to Ms. Athanasoulis, the parties agreed to schedule an additional hearing before the Arbitrator to determine the quantum of YSL's liability (in phase 2).

[14] The Sponsor did not receive a copy of the Agreement to Arbitrate at that time and was not privy to its specific terms.

[15] The Proposal Trustee was advised on March 31, 2022 that “[w]e received the decision in the fact finding phase just the other day or so. Arbitrator Horton found an enforceable 20% profit sharing agreement to exist.”

[16] A few weeks later, the Proposal Trustee provided the Sponsor an updated budget. With only approximately \$210,000 remaining from the original reserve established under s. 10.1 of the Proposal, the Proposal Trustee requested additional net funds of approximately \$1.485 million in respect of Administrative Fees and Expenses anticipated to be incurred in connection with the resolution of the remaining three claims and to administer the distributions.

[17] Some limited partners of YSL (the Yonge SL LPs and Chi Long LPs, collectively the “LPs”) questioned the Proposal Trustee’s handling of certain disputed claims, including the Athanasoulis Claim. The LPs are entitled to any remaining cash in the \$30.9 million “Affected Creditors Cash Pool” established by the Sponsor, after proven claims are paid out. That cash pool is only to be used by the Proposal Trustee to satisfy proven claims. Therefore, the determination of the Athanasoulis Claim could impact the LPs’ recovery from the Affected Creditors Cash Pool.

[18] At a case conference on May 24, 2022, the LPs asked the court to schedule motions they proposed to bring. Their motions were described at that time to be directed to the Proposal Trustee’s authority to arbitrate the Athanasoulis Claim and to determine whether the Athanasoulis’ Claim is subordinate to the LPs’ entitlements. They also requested that the court order a stay of phase 2 of the Arbitration of the Athanasoulis Claim. At that time, the authority of the Proposal Trustee to enter into the Agreement to Arbitrate was being challenged by at least one of the LPs.

[19] Instead of scheduling that motion, the court urged the parties to work out an arrangement that would allow the LPs’ priority claims to be added to, and determined in, the existing Arbitration under an expanded comprehensive arbitration process (the “consolidated arbitration process”).[2]²

[20] At a further case conference on June 8, 2022, the parties updated the court about their ongoing discussions since the last case conference. The LPs indicated that they would be prepared to have their priority issues determined in a consolidated arbitration process. The Sponsor expressed concerns about the added cost of adding the LPs priority issues into the existing Arbitration process. The Sponsor asked for two conditions: i) that there be an attempt to settle through mediation before embarking upon stage

2. This reference to a “potential consolidated arbitration process” is not intended to resolve the dispute between Ms. Athanasoulis (and the Proposal Trustee), on the one hand, and the LPs on the other, about whether they did in fact reach an agreement to consolidate all issues into an arbitration. That issue was not squarely put before the court on this motion.

2 of the Arbitration and/or any consolidated arbitration process, and ii) that the LPs undertake to pay the Proposal Trustee's expenses associated with the next phase of the consolidated arbitration process. The LPs did not agree to either of these conditions.

[21] The court once again urged the parties to continue collaborating and refining the issues for a potential consolidated arbitration process and to try to reach an agreement about the additional cost of this expanded arbitration of all issues, in the face of the alternative of parallel proceedings and the added cost and delay that would ensue if the LPs' proposed motion was scheduled. The court summarized the outstanding issues to be addressed (or not to be addressed) in the context of a potential consolidated arbitration process and some of the terms that were under consideration, as had been identified by the parties at that time, in an endorsement dated June 8, 2022 as follows:

- a. The enforceability of the contract as found by Mr. Horton regarding Ms. Athanasoulis' claim and the quantum of any damages she may have suffered.
- b. Whether any claim for damages by Ms. Athanasoulis is in the nature of debt or equity.
- c. Any claim for damages that the LPs may assert against Ms. Athanasoulis.
- d. The Arbitration will not consider any claims between Ms. Athanasoulis and Cresford Capital/Dan Casey.
- e. The LPs will reserve their rights with respect to whether Mr. Horton's decision at phase 1 of the Arbitration regarding enforceability is rendered *res judicata*.
- f. At the conclusion of the Arbitration the Proposal Trustee will make a determination as to whether Ms. Athanasoulis' claim is provable, will value it and determine its priority.
- g. The parties' rights to appeal are preserved under the *BIA*.

The court directed counsel to return for a further case conference on July 29, 2022.

[22] On July 4, 2022 the Sponsor advised that it would be withdrawing funding from the Proposal Trustee. It objected to funding the estimated \$1.485 million in additional funding that the Proposal Trustee and indicated would be needed by it and its external counsel to complete the administration of these proceedings.[3]³

[23] By the July 29, 2022 case conference, the Sponsor had been provided with a copy of the Arbitration Award and the Agreement to Arbitrate. The parties continued to have differing views on whether the Proposal Sponsor was obligated to fund the Proposal Trustee's fees and expenses for phase 2 of the Arbitration. Accordingly, the Proposal Trustee's funding motion was scheduled.

3. This estimate assumed that the three remaining disputed claims would be adjudicated in the manner indicated by the Proposal Trustee, with no further procedural motions. Also included in this budget were estimated Administrative Fees and Expenses associated with the phase 2 of the Arbitration. The amount for this portion of the future fees was initially estimated to be approximately \$500,000, but that estimate is now approximately \$700,000. However, other disputed claims have been resolved such that the overall estimate for future funding that the Proposal Trustee anticipates remains at an estimated \$1.485 million.

[24] Although no formal stay was ordered, phase 2 of the Arbitration has not been rescheduled, pending the outcome of this motion, since the Proposal Trustee requires funds to participate in it. The Proposal Trustee and Ms. Athanasoulis anticipate that the phase 2 proceeding contemplated by the Agreement to Arbitrate will require additional fact and expert evidence. The original schedule had set aside two weeks in September, 2022 for phase 2 of the Arbitration, before any consideration of including the LPs' claims.

[25] In the intervening timeframe, the Proposal Trustee and Ms. Athanasoulis did attend a mediation to try to come to a resolution of the Athanasoulis Claim, but that mediation was not successful.

[26] On October 13, 2022, shortly before the return of this funding motion, the LPs provided a draft notice of motion indicating their intention to bring a motion for declarations that: (a) any claim by Ms. Athanasoulis to the proceeds of the YSL Project under any profit-sharing arrangement is subordinate to their entitlement to such proceeds; and (b) Ms. Athanasoulis' profit-sharing claim is unenforceable against the Debtors. The LPs' assertions are based primarily on alleged representations and promises made to them by Ms. Athanasoulis.

[27] The Proposal Trustee's Notice of Motion on this motion seeks an order declaring that:

- a. The Proposal Trustee's Administrative Fees and Expenses have been reasonably incurred.
- b. The Sponsor remains bound by the Proposal.
- c. The Sponsor is required to fund the Administrative Fees and Expenses of the Proposal Trustee pursuant to the Proposal.
- d. The commencement and continuation of Arbitration to determine the Athanasoulis Claim was a valid exercise of the Proposal Trustee's power under the Proposal or the *BIA*.

[28] The Sponsor does not dispute that it remains bound by the Proposal to fund Administrative Fees and Expenses reasonably incurred. It disagrees on whether the Proposal requires it to fund the Proposal Trustee's fees and expenses that will be incurred in respect of phase 2 of the Arbitration.

[29] The court does not technically need to deal with the Proposal Trustee's request for a declaration that its Administrative Fees and Expenses have been reasonably incurred up until now. The Sponsor is no longer seeking to claw-back prior expenses that the Proposal Trustee has already been paid from the initial funding reserve. This includes fees and expenses associated with phase 1 of the Arbitration.

[30] During the hearing, and considering the most up to date positions, the Proposal Trustee re-stated the issues to be decided on this motion:

- a. Whether the commencement and continuation of Arbitration to determine the Athanasoulis Claim was a valid exercise of the authority granted to the Proposal Trustee under the Proposal or the *BIA* (the “Jurisdiction Question” below), and therefore are any Administrative Fees and Expenses associated with it reasonably incurred?
- b. If not, and in the alternative, is the question of whether the Sponsor is obligated to fund the Administrative Fees and Expenses of the Proposal Trustee and its counsel associated with phase 2 of the Arbitration *res judicata* and has this court already ruled that phase 2 of the Arbitration should proceed in some fashion, either with or without the added issues raised by the LPs?
- c. Should there be any other order made at this time regarding the approval of the fees of the Proposal Trustee and its counsel?
- d. Should the Sponsor pay the Proposal Trustee’s costs of this motion, which are rolled up in its defence of the reasonableness and appropriateness of the Arbitration process?

Analysis

The Positions of the Parties

[31] The focus of the analysis is on the question of whether any Administrative Fees and Expenses associated with completing phase 2 of the Arbitration would be “reasonably incurred,” such that the Sponsor is obligated to indemnify the Proposal Trustee for them under s. 11.01 of the Proposal.

[32] The Sponsor argues that the Proposal Trustee should have either allowed or disallowed the Athanasoulis Claim without resorting to arbitration. The Sponsor says the Proposal Trustee should determine and value that claim on its own, with such input from Ms. Athanasoulis and others as it deems appropriate. This process, the Sponsor postulates, could be completed more efficiently and at a significantly lesser cost than through the Arbitration.

[33] The Proposal Trustee argues that, even with the benefit of hindsight, a process outside of the Arbitration resulting in an allowance or disallowance of the Athanasoulis Claim would not necessarily have been more cost effective or timely. It postulates that both parties would have inevitably challenged the Proposal Trustee’s decision regarding the determination of the Athanasoulis Claim under s. 37 of the *BIA*. Either Ms. Athanasoulis would appeal a decision against her to the court, or the LPs would further challenge a ruling that favoured Ms. Athanasoulis. The Proposal Trustee believes that these appeals or challenges to the court under s. 37 of the *BIA* would have the potential to involve the same evidentiary input, time and expense as the Arbitration.

[34] The Proposal Trustee likens the Arbitration to the appointment of a claims officer to adjudicate the Athanasoulis Claim and urges the court to permit that process to now run its course through phase 2 of the Arbitration.

[35] The Proposal Trustee also maintains that it was reasonable to have entered into the Agreement to Arbitrate and that it cannot now renege and disallow the Athanasoulis Claim simply because the Sponsor does not like the outcome of phase 1. The Sponsor counters that if the Agreement to Arbitrate, the terms of which it only had full disclosure of in July 2022, improperly delegates to the Arbitrator the Proposal Trustee's responsibility for determining and valuing the Athanasoulis Claim and was entered into without authorization or jurisdiction, then it is invalid *ab initio* and unenforceable.

[36] Ms. Athanasoulis supports the Proposal Trustee's position and adds that she is an innocent third party. Having contracted with the Proposal Trustee for an arbitration in two phases and having herself invested significant time and expense on phase 1, it would be unfair to her to now return to square one for the determination and valuation of her claim.

[37] Ms. Athanasoulis further argues that there is no principled distinction between the jurisdiction to arbitrate phase 1 vs. phase 2 of the Arbitration. She contends that the Sponsor's withdrawal of its objection to paying the fees and expenses for phase 1 is a concession that arbitrating in phase 1 was authorized and within the jurisdiction of the Proposal Trustee, and thus phase 2 must be as well.

[38] The LPs still intend to argue that they are not bound by any findings in the Arbitration or its outcome, and that the Athanasoulis Claim is subordinate to theirs. Neither of those arguments are before the court now. However, should the court find that the Proposal Trustee lacked the authority or jurisdiction to arbitrate the Athanasoulis Claim, that would make their intended motion less complicated and possibly moot, depending on the Proposal Trustee's timing and ultimate determination of the Athanasoulis Claim.

The Issues

A) The Jurisdiction Question

i) Contractual and Statutory Framework

[39] Section 3.02 of the Proposal provides that the Proposal Trustee will assess claims in accordance with s. 135 of the *BIA*.

[40] Section 135 of the *BIA* provides that:

- (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.
- (1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.

ii) Relevant Jurisprudence Relied Upon by the Parties

[41] The Sponsor objects to providing additional funding for phase 2 of the Arbitration on the grounds that the Arbitration falls outside the Proposal Trustee's mandate under the Proposal, which is to determine and resolve disputed claims in accordance with s.135 of the *BIA*. The Sponsor maintains that because the Proposal Trustee improperly delegated that decision-making function to the Arbitrator and assumed the role of adversary, rather than the decision-maker, any Administrative Fees and Expenses associated with phase 2 of the Arbitration will not be reasonably incurred.

[42] The Sponsor relies upon the recent decision of this court *In the Matter of the Proposal to Creditors of Conforti Holdings Limited*, 2022 ONSC 3264, leave to appeal refused, 2022 ONCA 651. In *Conforti*, the court declined to relieve a trustee of its responsibility under s. 135 of the *BIA* to determine a particular claim through a single claims process under the supervision of the Bankruptcy Court and declined to approve the trustee's suggestion that it be determined, instead, by a foreign court.

[43] This court held in *Conforti* that s. 135(1.1) of the *BIA* contains mandatory language that "unambiguously" requires the Proposal Trustee itself to determine and value claims. *Conforti* confirms, at para. 42, that:

The regime under the *BIA* provides for a summary procedure for (i) determination by the trustee of whether a contingent or unliquidated claim is a provable claim, and, if so, (ii) for the trustee to value it. [...] Insolvency proceedings under the *BIA* are subject to court supervision, and the court is able to give directions for the timely and efficient determination of claims.

[44] This is not the first time a trustee's "mandatory statutory duty to review claims and value unliquidated or contingent claims" has been recognized: see *Asian Concepts Franchising Corporation (Re)*, 2018 BCSC 1022, 62 C.B.R. (6th) 123, at para. 99.

[45] Unlike in *Conforti*, the Proposal Trustee says it is not seeking to dispense with any obligation to determine the Athanasoulis Claim. It says it still intends to go through the motions of that determination but wishes to do so with the benefit of the Arbitrator's decision in phases 1 and 2.

[46] The Proposal Trustee also seeks to distinguish *Conforti* on the grounds that it has a very broad discretion under s. 135 of the *BIA* to obtain or require further evidence in support of a claim and has the power under s. 30 to bring, institute or defend any action or legal proceeding relating to the property of the bankrupt and to compromise any claim made by or against the estate. The Proposal Trustee argues that this permits a trustee to arbitrate a claim; or, at the very least, that this permits the Proposal Trustee to use an arbitration process to assist in the development of the evidence and facts that will be needed to determine and value a claim.

[47] The Proposal Trustee defends the Arbitration process as fair, reasonable and transparent. It emphasizes the importance of its role in ensuring all stakeholder interests are protected (as was envisioned in *Asian Concepts*, at paras. 55-56, 98, for example). The Proposal Trustee's contends that its decision to gather facts in respect of the Athanasoulis Claim by way of Arbitration was a reasonable

decision and that it was an appropriate process to achieve a fair determination of the merits of the Athanasoulis Claim because it tested the potentially relevant evidence. It maintains that there is no single correct way to value a claim and that a trustee's decision should be afforded deference: see *Galaxy Sports Inc. (Re)*, 2004 BCCA 284, 29 B.C.L.R. (4th) 362, at paras. 39-43.

iii) The Agreement to Arbitrate – is it Beyond the Scope of s. 135 of the *BIA*?

[48] In theory, the Proposal Trustee does have a broad discretion under s. 135 of the *BIA* that might justify its participation in adversarial proceedings that could inform the eventual determination of claims. The Proposal Trustee seeks to characterize what the Arbitrator was asked to do as a fact finding exercise: to determine whether Ms. Athanasoulis was an employee who was constructively dismissed and whether she had an oral profit sharing agreement. The issue here is whether the Agreement to Arbitrate in this case—which was not before the court and had not been disclosed to the Sponsor or the LPs until sometime in July, 2022—went beyond a fact finding exercise.

[49] Although no determination need be made on this point, the Proposal Trustee's participation in phase 1 of the Arbitration may have been sound in the sense that the necessary parties and information were before the Arbitrator to enable him to make determinations about the existence of the oral profit sharing agreement and a finding of constructive dismissal. The Proposal Trustee can consider and take into account these inputs from the Arbitration in its determination and valuation of the Athanasoulis Claim.

[50] Since the Sponsor is no longer challenging the right of the Proposal Trustee to be indemnified for the Administrative Fees and Expenses incurred in respect of phase 1 of the Arbitration, the issue now before the court is whether the Proposal Trustee is acting within the scope of s. 135 of the *BIA* by engaging in phase 2 of the Arbitration to determine whether to allow the Athanasoulis Claim, and if so in what amount.

[51] The Proposal Trustee concedes that the Arbitrator's determination of the damages question in phase 2 of the Arbitration would be both informative and probative, and that the Proposal Trustee's determination of the Athanasoulis Claim would be heavily influenced by the Arbitrator's decision. The suggestion that the Proposal Trustee could, after the Arbitration, still determine and value the Athanasoulis Claim in a manner inconsistent with the decision of the Arbitrator on liability and damages is difficult to reconcile with the words of the Agreement to Arbitrate and the intended binding nature of arbitrations under s. 37 of the *Arbitration Act 1991*, S.O. 1991, c. 17.

[52] I find that phase 2 of the Agreement to Arbitrate goes beyond a fact finding exercise. By its very terms, the Agreement to Arbitrate contemplates an eventual ruling from the Arbitrator on "damages" (the quantum of the Debtors' liability) at the end of phase 2. On their face, the terms of the Agreement to Arbitrate contemplate a final adjudication by the Arbitrator. That amounts to an improper delegation to the Arbitrator by the Proposal Trustee of its ultimate responsibility to determine and value the Athanasoulis Claim.

[53] It was suggested that the court would be effectively ordering, or approving, the Proposal Trustee to breach the Agreement to Arbitrate if the Sponsor's position with respect to the funding of phase 2 of the Arbitration is accepted. I do not see it that way. If the Proposal Trustee did not have the authority to agree to phase 2 of the Arbitration as was provided for in the Agreement to Arbitrate because it amounted to an improper delegation of its responsibility to the Arbitrator, then that aspect of the Agreement to Arbitrate is unenforceable as against the Proposal Trustee. Further, as a practical matter, if the Sponsor is not required to fund the Administrative Fees and Expenses associated with phase 2 of the Arbitration, it cannot proceed.

[54] I also do not accept the assertion that just because the Sponsor is no longer challenging its obligation to fund the Proposal Trustee's Administrative Fees and Expenses incurred in connection with phase 1 of the Arbitration, that the court is bound to accept that entering into the Agreement to Arbitrate was a valid exercise of the Proposal Trustee's discretion and a valid delegation of its responsibility to the Arbitrator in all respects, or that the Sponsor is estopped from asserting that any aspect of the Agreement to Arbitrate exceeded the Proposal Trustee's authority under s. 135 of the *BIA*.

iv) Would the Cost of this Arbitration be a Reasonably Incurred Expense?

[55] One of the other grounds upon which the Sponsor argued that the anticipated Administrative Fees and Expenses for phase 2 of the Arbitration would not be reasonably incurred was because they would be the product of a complex, lengthy and expensive process that is not in keeping with the summary and efficient adjudication of claims envisioned by the *BIA*, especially one that might not have resulted in a final resolution of the Athanasoulis Claim without the willing participation of the LPs,^[4] leaving the LPs' priorities and other enforceability issues to be determined through some other process.

[56] Section 135 of the *BIA* is intended to be a summary procedure for the determination of claims, animated by the objectives of speed, economy and informality: see *Conforti*, at para. 43 and *Asian Concepts*, at para. 53.

[57] The decision on the Jurisdiction Question renders it unnecessary to decide whether the anticipated budgeted cost of phase 2 of the Arbitration represents anticipated reasonably incurred Administrative Fees and Expenses that the Sponsor should be required to fund. The court will not order the Sponsor to fund this aspect of the Arbitration that involves the ultimate determination of this claim by someone other than the Proposal Trustee as that would not be a determination of the Athanasoulis Claim in accordance with s. 135 of the *BIA*.

v) Section 135 *BIA* Determination of the Athanasoulis Claim

4. As previously indicated, there is a dispute about whether the LPs agreed to arbitrate their priority and enforceability challenges to the Athanasoulis Claim. The court was not asked to determine whether the LPs had in fact agreed to arbitrate their issues in the expanded phase 2 of the Arbitration. I do not need to decide this question to decide the funding motion.

[58] The Proposal Trustee has identified various aspects of what had been expected to be resolved through the anticipated phase 2 Arbitration that will still require factual inputs and findings for the Proposal Trustee to make its determination of the Athanasoulis Claim. For example, to determine the meaning of “profits” under the oral profit sharing agreement, and when and how they should be calculated, expert valuation evidence may be required. This was part of the justification for the Arbitration process envisioned, and has not been resolved by the court’s finding that the process agreed to went too far by improperly delegating the ultimate issue to be decided by the Proposal Trustee to the Arbitrator.

[59] Further, whether the Athanasoulis Claim is a provable claim under s. 135 of the *BIA* depends on whether the claim is in debt or equity, which in turn may require further evidence and inputs from other stakeholders, like the LPs. Not only would the LPs potentially have relevant information, but they also have a direct interest in these determinations.

[60] The Proposal Trustee has the power under s. 135 of the *BIA* to seek additional information and documents from the claimant: see *Urbancorp Cumberland 2 GP Inc.*, 2022 ONSC 2430, at paras. 23, 26. It remains open to the Proposal Trustee under s. 135 of the *BIA* to receive and consider expert input from Ms. Athanasoulis and other stakeholders.

[61] The broad discretion afforded to the Proposal Trustee also allows it to seek out its own expert input, as well as information and input from the LPs and other stakeholders in respect of the issues it must decide.

[62] In these circumstances, the Proposal Trustee will need to carry out its responsibilities under s. 135 of the *BIA*, get the factual and other inputs it requires from witnesses, other stakeholders, experts and the like and determine whether the Athanasoulis Claim has been proven and, if so, at what amount it should be valued.

[63] The Proposal Trustee complains that the Sponsor has not spelled out an alternative process to the Arbitration for doing this.

[64] In the absence of any proposed alternative, the Proposal Trustee is entirely unencumbered and may determine its own process for how it wishes to do this, which will be afforded significant deference. According to the Court of Appeal in *Galaxy*, at paras. 39 and 44,

- a. the Proposal Trustee is entitled to evaluate the Athanasoulis Claim in accordance with s. 135(1.1) with significant discretion, taking into account factors that may appear in the *BIA*;
- b. there is no one “correct” answer to the valuation of the Athanasoulis Claim;
- c. the Proposal Trustee’s valuation of the Athanasoulis Claim will be scrutinized on a “reasonableness” standard; and

- d. the Proposal Trustee can use its knowledge and expertise to consider whether, as a factual matter, the valuation as to the full amount of the Athanasoulis Claim is appropriate.

[65] The Proposal Trustee is concerned that this may lead to *de novo* appeals or challenges (by either Ms. Athanasoulis or the LPs) and could end up being as much or more expensive than the anticipated cost of phase 2 of the Arbitration. There is no crystal ball that can foretell this.

[66] The Sponsor says that it will not micromanage this aspect of the Proposal Trustee's determination of the Athanasoulis Claim. While the Sponsor does not expect that this alternative process will end up costing as much as the current estimate for phase 2 of the Arbitration, it is prepared to accept the possibility that it does. The Sponsor has said it will pay for the Proposal Trustee to develop and follow a process to determine and value the Athanasoulis Claim in accordance with s. 135 of the *BIA*.

[67] The Proposal Trustee must determine how to reasonably determine and value the Athanasoulis Claim in a timely and principled manner. It will be afforded significant deference. All parties agree that it can use the Arbitration Award from phase 1 of the Arbitration and build on it so that time and effort is not wasted. The goal is not the gold standard of coming up with a process that cannot be challenged.

[68] The Proposal Trustee may choose to invite expert evidence and inputs from Ms. Athanasoulis and then determine if it needs its own expert to review and comment upon what is provided. It may choose to share that plan with the other stakeholders participating in this motion and seek their input. If it chooses to share its plan with the Sponsor and/or other stakeholders, and if the parties require some further direction and assistance from the court, they may arrange a case conference before me.

[69] In any event, the parties will eventually need to come back on a scheduling appointment to determine the sequencing and timing of the LPs' priorities and enforceability motion, but only after that motion (with supporting evidence) has been served and the parties have met and conferred amongst themselves to consider the appropriate timing and sequencing of all that needs to occur.

[70] Whatever process the Proposal Trustee may adopt, the Sponsor remains obligated under the Proposal to indemnify the Proposal Trustee for the Administrative Fees and Expenses reasonably incurred going forward to the final determination of the Athanasoulis Claim.

B) The Res Judicata and Estoppel Argument(s)

i) *Res Judicata*

[71] There can be no finding of *res judicata* with respect to the issues raised on this funding motion regarding the Sponsor's obligation to fund phase 2 of the Arbitration.

[72] The Proposal Trustee and Ms. Athanasoulis argue that Gilmore J. held, at two separate case conferences in May and June 2022, that arbitration was an appropriate way to proceed, and that issue estoppel prevents the court from revisiting this in the context of this funding motion. I disagree.

[73] There are three requirements for invoking issue estoppel: (i) the same question has or could have been decided in a prior proceeding; (ii) the decision giving rise to estoppel is final; and (iii) the parties to the decision giving rise to estoppel are the same as the parties to the subsequent proceeding in which estoppel is claimed: see *The Catalyst Capital Group Inc. v. VimpelCom Ltd.*, 2019 ONCA 354, 145 O.R. (3d) 759, at para. 25. It is the first requirement upon which the *res judicata* argument fails in this case.

[74] The Proposal Trustee argues that the endorsement of Gilmore J. arising out of the June 8, 2022 case conference requires an arbitration of the Athanasoulis Claim because it was stated in the endorsement that the "arbitration must prevail" and the Sponsor never sought to appeal that declaration.

[75] I do not read the June 8, 2022 endorsement as ordering an arbitration. Rather, it was the court's strong preference that the parties agree to expand the Arbitration to address the issues raised by the LPs and avoid a parallel, costly and time consuming motion process to determine the priority and enforceability issues. I am not aware of any authority upon which the court can order unwilling parties to arbitrate a dispute; that is a matter of private agreement. The court was simply strongly encouraging the parties to make such an agreement, building upon the arbitration process already in place.

[76] Nor do I agree with the implicit suggestion that the same question about the authority of the Proposal Trustee to enter into the Agreement to Arbitrate and to delegate its responsibility for determining and valuing the Athanasoulis Claim to the Arbitrator has been or could have been previously decided by Gilmore J. at the earlier case conferences. Leaving aside the nature of those case conferences and the typical procedural scope of directions from the court, it is clear that is not what Gilmore J. understood to be happening. To the contrary, her June 8, 2022 endorsement records that:

At the conclusion of the arbitration the Proposal Trustee will make a determination as to whether Ms. Anathasoulis' [*sic*] claim is provable and will value it and determine its priority.

[77] At that time, the court did not have the Agreement to Arbitrate with the full description of the issues being submitted to arbitration and cannot be taken to have made any meaningful assessment as to whether the statement that there was still something left for the Proposal Trustee to determine at the end of the Arbitration was a fair characterization of what had been agreed to. The court did not previously order the parties to arbitrate, nor did it make any finding that phase 2 of the Arbitration could be conducted in a manner consistent with s. 135 of the *BIA*. There is no *res judicata*.

ii) Other Estoppel Considerations

[78] That said, it was prudent of the Sponsor to drop its opposition to the Proposal Trustee's request for approval of the expenses associated with phase 1 of the Arbitration, already incurred and paid. Regardless of the court's determination of the threshold Jurisdiction Question in relation specifically and only to phase 2 of the Arbitration, the Sponsor would have faced other obstacles in attempting to claw back from the Proposal Trustee Administrative Fees and Expenses incurred and paid for out of the initial reserve, including for phase 1 of the Arbitration.

[79] These obstacles would include the Sponsor's inaction and failure to ask any questions or raise any complaint about, or object to phase 1 of the Arbitration proceeding while it was ongoing. However, the Sponsor's concession obviates the need for any ruling on this.

iii) The Timing of Objections and Related Considerations

[80] Ms. Athanasoulis is understandably concerned about having engaged in phase 1 of a two phase arbitration process in good faith and now facing objections to the jurisdiction or authority of the Proposal Trustee to have entered into the Agreement to Arbitrate.

[81] Unfortunately, the Sponsor and the LPs did not have a copy of the Agreement to Arbitrate until July, 2022. Their concerns were raised in a timely manner upon learning more about the scope of the Arbitration and its anticipated cost. The fact that this discovery also coincided with their learning that the phase 1 outcome favoured Ms. Athanasoulis does not automatically lead to the inference that their objections are disingenuous.

[82] In any event, no one is suggesting that the work done in phase 1 of the Arbitration is lost. It will be one of the inputs that the Proposal Trustee will use to determine and value the Athanasoulis Claim. All parties agree on this.

[83] While I do not go so far as to accept the suggestion by the Sponsor and LPs that Ms. Athanasoulis knowingly took on the risk of this challenge and outcome, the Sponsor and LPs were left out of the process and cannot be precluded from raising the legal objections that have ultimately dictated the outcome of this motion on the Jurisdiction Question, as it relates to phase 2 of the Arbitration.

C) Fee Approvals

[84] Gilmore J.'s endorsement scheduled this funding motion to determine the Proposal Trustee's entitlement to be indemnified for the costs of the Arbitration. The indemnity reimbursements taken up until now from the reserve fund are no longer at issue. The relief sought by the Proposal Trustee for the approval of its past activities and fees might have been warranted if the challenge to entitlement to indemnification for expenses incurred in phase 1 of the Arbitration was still at issue.

[85] However, this is no longer at issue. There is no immediate reason or need to attempt to deal with the broader requests for general approval of the activities and fees of the Proposal Trustee and its counsel.

[86] The Sponsor is right that, in general, such requests should be supported by fee affidavits: see *Jethwani v. Damji*, 2017 ONSC 1702, 46 C.B.R. (6th) 96, at paras. 8-11.

[87] For the same reason, it is also inappropriate to grant the requested charge over all past and future distributions to the Sponsor. This issue was not fully argued and I was not taken to the evidence or authority that I would need to consider to make such an order.

[88] Instead, the Proposal Trustee may now wish to prepare a new budget and request additional reserve funding for the indemnity obligations of the Sponsor. If the Sponsor does not agree to supplement the reserve, the parties can arrange to come back for a case conference for further consideration of the questions of up front funding and/or security for future funding to be provided by the Sponsor.

D) Costs

[89] Despite having found that the contemplated phase 2 of the Arbitration goes beyond the scope of what the Proposal Trustee was authorized to agree to, given the original position of the Sponsor that it was also challenging its obligation to fund expenses for phase 1 and given the added complications introduced by the LPs, I consider it to have been reasonable for the Proposal Trustee to have brought this motion for directions.

[90] The Proposal Trustee's and its counsel's costs of this motion were reasonably incurred as part of the administration of distributions and the resolution of unresolved claims such that those costs should be indemnified by the Sponsor under the s. 11.1 of the Proposal on the basis that they were reasonably incurred Administrative Fees and Expenses.

[91] Ms. Athanasoulis has asked to be awarded some reasonable costs thrown away in the event the Arbitration is not proceeding to phase 2. She spent \$300,000 on phase 1 (in line with the Proposal Trustee's disclosed legal costs for phase 1) and had started working with her expert on phase 2. I understand that there was an agreement that each side would bear their own costs of the Arbitration.

[92] I agree that if Ms. Athanasoulis had actually incurred costs thrown away of the Arbitration, that are now wasted, she might be entitled to an award for her trouble: see *Caldwell v. Caldwell*, 2015 ONSC 7715, 70 R.F.L. (7th) 397, at paras. 10-12.

[93] However, given that the phase 1 Arbitration findings will be the factual predicate upon which the determination of her claim will proceed and that it is reasonable to expect that Ms. Athanasoulis will require expert input, regardless of the procedure, to have her claim determined by the Proposal Trustee, I am not convinced that she has suffered any costs thrown away.

[94] The parties are just now pivoting to a different process for the final determination of the Athanasoulis Claim, but the onus is still on her to prove it. It is difficult to see how she has wasted the cost of whatever work she did in furtherance of her quest to persuade the Arbitrator to decide in her favour the same issue that the Proposal Trustee will now take into consideration when determining her claim. All the work should be usable to support the proof of her claim to the Proposal Trustee.

[95] As such, no costs thrown away are awarded to Ms. Athanasoulis.

Final Disposition

[96] The court's decision on each of the issues on this funding motion, as re-stated by the Proposal Trustee, is as follows:

- a. The continuation of phase 2 of the Arbitration provided for in the Agreement to Arbitrate the Athanasoulis Claim is not a valid exercise of the authority granted to the Proposal Trustee under the Proposal or s. 135 of the *BIA*. Therefore, the court makes no order requiring the Sponsor to fund (and/or indemnify the Proposal Trustee for) the budgeted Administrative Fees and Expenses associated with phase 2 of the Arbitration (of approximately \$700,000).
- b. The questions of whether phase 2 of the Arbitration was a procedure that the Proposal Trustee had the jurisdiction to engage in, and the Sponsor's obligation to fund the Administrative Fees and Expenses of the Proposal Trustee associated therewith, are not barred by *res judicata* or any other estoppel or laches.
- c. The Sponsor is required to indemnify the Proposal Trustee for all of the reasonably incurred Administrative Fees and Expenses in relation to the determination and valuation of the Athanasoulis Claim, including for phase 1 of the Arbitration and for whatever procedure the Proposal Trustee, in its discretion, determines appropriate to receive the further evidence and positions of Ms. Athanasoulis and other interested stakeholders and any expert inputs deemed necessary.

- d. The Proposal Trustee should first determine how it intends to proceed in light of the court's decision on this motion, and may prepare a budget for the anticipated Administrative Fees and Expenses associated with this exercise, or seek indemnification after the fact, as it deems appropriate.
- e. If asked to do so and the Sponsor is not prepared to top up the reserve for the funding of the Proposal Trustee's anticipated Administrative Fees and Expenses to complete the determination and valuation of the Athanasoulis Claim, the parties may request a case conference before me so that the court can provide further directions in this regard and any related issues. The parties are directed to confer about these issues before scheduling a case conference so that the appropriate amount of court time is reserved.
- f. If the LPs are proceeding with their proposed motion, they shall serve their motion record(s) with supporting evidence and, after that, the parties shall confer about the timetabling and sequencing of those motions and then seek a scheduling appointment (if all agree) or a longer case conference (if all do not agree) for directions, timetabling and a motion hearing date if determined appropriate.
- g. There have been no costs demonstrated to have been thrown away as a result of the court's ruling on this motion, and none are awarded.
- h. The costs of the Proposal Trustee and its counsel for this motion were reasonably incurred and may be paid out of the remaining reserve fund and/or a claim for reimbursement by the Sponsor for those costs may be made under the Proposal.

[97] This endorsement and the orders and directions contained in it shall have the immediate effect of a court order without the necessity of the formal issuance and entry of an order.

KIMMEL J.

Date: November 1, 2022

TAB 4

At para(s) 5

YG Limited Partnership (Re), 2023 ONSC 4638 (CanLII)

Date: 2023-02-10

File number: BK-21-2734090-0031

Citation: YG Limited Partnership (Re), 2023 ONSC 4638 (CanLII),
<<https://canlii.ca/t/jzqpg>>, retrieved on 2024-04-24

CITATION: YG Limited Partnership (Re) 2023 ONSC 4638

COURT FILE NO.: BK-21-2734090-0031

DATE: 20230210

SUPERIOR COURT OF JUSTICE – ONTARIO

RE: IN THE MATTER OF THE NOTICES OF INTENTION TO MAKE A PROPOSAL OF YG LIMITED PARTNERSHIP AND YSL RESIDENCES INC. OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO

BEFORE: Kimmel J.

COUNSEL: *Matthew Milne-Smith*, counsel for KSV Restructuring Inc. (Proposal Trustee)

Alexander Soutter, counsel for Yonge SL Investment Limited Partnership

Mark Dunn / Sarah Stothart, counsel for Maria Athanasoulis

Jason Berall, counsel for Concord Properties Development Corp.

Shaun Laubman / Crystal Li, counsel for 2504670 Canada Inc., 8451761 Canada Inc. and Chi Long

HEARD: January 16, 2023

ENDORSEMENT

Background to the Proposal Trustee’s Motion for Directions

[1] Maria Athanasoulis filed a proof of claim against YG Limited Partnership and YSL Residences Inc. (together, the “Debtor”). The proof of claim was filed in the context of a court approved proposal (the “Proposal”) under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the “BIA”) in respect of unsecured claims she asserts as follows (together, the “Athanasoulis Claim”):

- a. \$1 million in respect of damages for wrongful dismissal (the “Wrongful Dismissal Claim”); and

- b. \$18 million in respect of damages for breach of an oral agreement that Ms. Athanasoulis would be paid 20 percent of the profits earned on the YSL Project (the “Profit Share Claim”).

[2] The Debtor was developing the YSL Project, which was part of a broader development group controlled by Daniel Casey that used the brand name “Cresford”.

[3] As part of the Proposal that was eventually approved by the court on July 16, 2021, Concord Properties Developments Corp. (the “Sponsor”) acquired the YSL Project and set aside \$30.9 million to satisfy proven creditor claims, with the balance of that fund to be distributed to equity stakeholders (including the limited partners of the YG Limited Partnership, the “LPs”).

[4] My November 1, 2022 endorsement dealt with the Sponsor’s obligation to fund administrative fees and expenses incurred by KSV Restructuring Inc. (the “Proposal Trustee”) in connection with the resolution of the Athanasoulis Claim: see *YG Limited Partnership (Re)*, 2022 ONSC 6138 (the “Funding Decision”).

[5] The Funding Decision determined that the Sponsor was not obligated to fund phase 2 of an arbitration in which Ms. Athanasoulis and the Proposal Trustee had agreed to participate (the “Arbitration”). That determination was made on the basis that phase 2 of the proposed arbitration improperly delegated to the arbitrator the responsibility of determining the Athanasoulis Claim. In phase 2 of the arbitration, the arbitrator was asked to determine any damages payable in respect of the Wrongful Dismissal Claim and/or the Profit Share Claim, based on his findings in phase 1 of the arbitration (the “Phase 1 Arbitration Findings”) that: Ms. Athanasoulis was wrongfully terminated (constructively dismissed) in December 2019 and that she had entered into a valid and enforceable oral profit sharing agreement that entitled her to 20 percent of the profits earned on any of Cresford’s (including the Debtor’s) current and future projects (the “Profit Sharing Agreement”).

[6] The Funding Decision determined that the Sponsor is obligated to indemnify the Proposal Trustee for Administrative Fees and Expenses (as defined in the Funding Decision) reasonably incurred to itself determine the Athanasoulis Claim.

[7] The following specific orders and directions were provided in the Funding Decision with respect to the Proposal Trustee’s determination of the Athanasoulis claim:

- a. The Proposal Trustee shall reasonably determine and value the Athanasoulis Claim in a timely and principled manner. It will be afforded significant deference. All parties agree that it can use the Arbitration Award from phase 1 of the Arbitration and build on it so that time and effort is not wasted.
- b. The Proposal Trustee shall, in its discretion, determine an appropriate procedure to receive the further evidence and submissions of Ms. Athanasoulis and other interested stakeholders. The Proposal Trustee may choose to share its proposed procedure with the other participating stakeholders and seek their input.

- c. If expert inputs are deemed necessary to determine the Athanasoulis Claim, the Proposal Trustee may choose to invite expert evidence and input from Ms. Athanasoulis and then determine if it needs its own expert to review and comment upon what is provided.
- d. The process by which the Proposal Trustee will determine the Athanasoulis Claim may need to account for the fact that the LPs are expected to advance claims that may require determinations from the Proposal Trustee and/or the court regarding the subordination and/or priority of their claims in relation to the Athanasoulis Claim, the enforceability of any proven Athanasoulis Claim as against them and the damages that they claim to be entitled to for alleged breaches of fiduciary and other duties and contractual obligations that they seek to set-off against the Athanasoulis Claim, if the Athanasoulis Claim is allowed.

[8] In the Funding Decision, the court indicated that if the Proposal Trustee chose to share its proposed procedure for the determination of the Athanasoulis Claim with the Sponsor and/or other stakeholders, and if the parties require some further direction and assistance from the court, they may arrange a case conference before me.

[9] The Proposal Trustee engaged in a consultative process with Ms. Athanasoulis, the Sponsor and the LPs about the procedure for determining the Athanasoulis Claim. There were fundamental points of disagreement, largely between Ms. Athanasoulis on one side and the Sponsor and the LPs on the other.

[10] Based on the input received, the Proposal Trustee suggested the following compromise procedure for resolving the Athanasoulis Claim:

- a. The Proposal Trustee will issue a notice pursuant to ss. 135(2) and (3) of the BIA, substantially in the form of the draft attached as an appendix to its report (the “Notice of Determination”). Under the draft Notice of Determination, the Proposal Trustee would allow the Wrongful Dismissal Claim in part (in the amount of \$880,000) as an unsecured claim but would disallow the Profit Share Claim in its entirety. The Proposal Trustee bases its Notice of Determination upon:
 - i. the proof of claim, as filed;
 - ii. all material on the record in these proposal proceedings to date, together with all material on the record in the proceedings by the LPs against YSL Residences Inc. et al in court file numbers CV-21-00661386-00CL and CV-21-00661530-00CL and some additional submissions provided by the LPs to the Proposal Trustee (that were initially not shared with Ms. Athanasoulis but eventually were shared with her counsel prior to the January 16, 2023 hearing);
 - iii. the partial arbitration award of Mr. William G. Horton (the “Arbitrator”) dated March 28, 2022 (the “Partial Award”);

- iv. all material filed and produced, and all testimony given, in phase 1 of the Arbitration;
and
 - v. all responses received by the Proposal Trustee from counsel to the LPs and counsel to Ms. Athanasoulis in respect of any information requests made by the Proposal Trustee.
- b. Consistent with the Funding Decision, the Partial Award and factual findings and determinations therein form part of the “factual predicate upon which the determination of [Ms. Athanasoulis’] claim will proceed”.
 - c. Ms. Athanasoulis may file any appeal pursuant to s. 135 of the BIA.
 - d. In the appeal, Ms. Athanasoulis shall not be required to adduce detailed evidence valuing and quantifying her profit share claim, but may address any issues raised in the Notice of Determination.
 - e. The LPs shall be entitled only to raise issues in the appeal that pertain directly to: (a) whether the LPs must be repaid in full prior to any payments being made on the Athanasoulis Claim; and (b) the enforceability of any element of the Athanasoulis Claim given the terms of the Limited Partnership Agreement (a point not decided in the Arbitration that may be separately advanced by the LPs if the enforceability is being argued on an appeal).
 - f. Ms. Athanasoulis will be entitled to make a full response to any materials filed by the LPs in this regard.
 - g. The LPs shall not be entitled to raise issues relating to any counterclaim or set-off that they may assert against Ms. Athanasoulis. Such issues will be addressed, if necessary, at a future distribution motion (see below), after the LPs breach of contract, tort and other claims against Ms. Athanasoulis have been decided in the separate legal proceedings in which they are being advanced (the “LP’s Claims”).
 - h. To the extent that the decision on appeal finds that a debt is owing and payable to Ms. Athanasoulis under her Profit Sharing Agreement, then a summary trial to quantify her damages will be scheduled.
 - i. Thereafter, if the Profit Share Claim is proven and determined to have any value then the LPs priority, subordination, and set-off arguments (in turn, dependent upon the determination of the LP’s Claims against Ms. Athanasoulis being pursued in separate proceedings) can be raised for consideration in the context of any proposed distribution in respect of the Profit Share Claim.

[11] None of the other stakeholders wholly accepted or endorsed the Proposal Trustee’s compromise procedure. Thus, the Proposal Trustee requested a case conference (held on December 21, 2022) at which the Proposal Trustee’s within motion for directions regarding the procedure for determining the

Athanasoulis Claim and related issues was scheduled. Despite the Proposal Trustee's discretion to determine the procedure and impose it on the stakeholders, it was appropriate for the Proposal Trustee bring this motion for directions given the divergent positions and competing interests at stake.

The Competing Positions

[12] Each stakeholder filed extensive materials on this motion. The focus of the motion, the submissions and this endorsement are on the procedure for determining the Profit Share Claim and any appeal therefrom. The procedure for the determination of the Wrongful Dismissal Claim and any appeal therefrom, and the positions of the parties regarding that procedure, will be addressed at the end of this endorsement.

a) The Proposal Trustee's Position

[13] The Proposal Trustee's position, reflected in its suggested, and rejected, compromise, is as follows:

- a. The Proposal Trustee says that it does not require any further evidence or submissions to make its determination to disallow the Profit Share Claim. It anticipates that it will disallow the Profit Share Claim for the reasons set out in its draft Notice of Determination, as follows:
 - i. The Profit Share Claim is, in substance, a claim in equity, rather than in debt, and is therefore not a provable claim under s. 121(1) of the BIA.
 - ii. The Profit Sharing Agreement was to be based on profits calculated using *pro forma* budgets, to be paid by the project owner when earned, usually upon the completion of a project (according to the Phase 1 Arbitration Findings). Under the Proposal, the YSL Project was effectively transferred to the Sponsor and the Debtor could no longer earn profits. As of the date of the Proposal, the Debtor had not completed the YSL Project. It was nothing more than a hole in the ground, such that there was no profit earned or to be shared by the Debtor at that time.
 - iii. Insofar as the Athanasoulis Claim relies on projected future profitability of the YSL Project as a contingent claim as at the date of the Proposal, that contingent and unliquidated claim is too speculative, and the alleged damages are too remote, to be considered a provable claim or subject to any meaningful and reasonable computation. Therefore, the claim is valued at zero dollars.
 - iv. Any claim by Ms. Athanasoulis for unrealized hypothetical gains (future profitability) of the YSL Project prior to the Proposal, dating back to the date of her wrongful termination, is inconsistent with the Phase 1 Arbitration Findings that profits were only payable under the Profit Sharing Agreement when earned at the completion of the YSL Project.

- v. Even if she could predicate her claim on earned but unrealized profits at a point in time, Ms. Athanasoulis has admitted under oath that any entitlement she may have to a profit share would arise only after the LPs are repaid their original investment, and the Profit Share Claim is therefore subordinated to the LP's Claims since the LPs will not be receiving a full return of their equity investment in the YSL Project.
- b. On this basis the Proposal Trustee suggests that it should issue its Notice of Determination based on the identified matters of principle and law, Ms. Athanasoulis should then appeal that determination (within the 30 days prescribed under s. 135(4) of the BIA) and the appeal should be decided based on the reasons provided for the disallowance in the Notice of Determination. This defers the significant time and expense that will be incurred to value the aspects of the Athanasoulis Claim that are dependent on the future profitability of the YSL Project (whether as at the date of her wrongful termination in December 2019 or as at the date of the Proposal) that will entail further evidence and expert analysis, at least until it is determined on appeal whether the Profit Share Claim is a provable claim.
- c. The valuation of the Athanasoulis Claim, if found on appeal to be provable, will be determined in a summary trial thereafter, only if necessary.
- d. The priorities, set-offs and other arguments of the LPs in relation to the Athanasoulis Claim will be determined in a later distribution hearing.

b) Ms. Athanasoulis' Position

[14] Ms. Athanasoulis does not accept the Proposal Trustee's determination that her claim is a claim in equity, although she does not dispute that her appeal of that ground of disallowance could be argued based on the existing record (as defined by the Proposal Trustee).

[15] However, Ms. Athanasoulis does not accept the Proposal Trustee's premise that profits were only payable upon completion of the YSL Project. This leads her to a different view of what is required for the determination of her Profit Share Claim on any appeal, because:

- a. She claims that the damages from her Profit Share Claim (in other words, its value) should be calculated as at the date she was wrongfully terminated from her employment (the repudiation date), or as of the Proposal Date, based on the real and significant chance that existed at that time that the YSL Project would ultimately generate profits ("Future Oriented Damages").
- b. Alternatively, she maintains that there is a distinction between earned vs. realized profits, and that her Profit Share Claim can be proven and valued based on "earned profits" even if none were realized because of the Proposal. She claims to have already received documents from the Debtor in the Arbitration that establish that, as of the date of the Proposal, the expenses of the YSL Project did not exceed its revenues, which she points to as an indication that it was "profitable" at least in that sense.

Further, she claims to have documents evidencing the withdrawal or distribution of funds (profits) to others prior to the date of the Proposal. These are not future oriented profit calculations, and could be proven without the time and expense of significant further evidence, including from experts.

[16] Ms. Athanasoulis seeks to appeal all of the grounds upon which the Proposal Trustee intends to disallow her Profit Share Claim. If successful, she will ask the court to value her entitlements. She says that, while she has some of the necessary documents that she could submit now, she requires further disclosure from the Debtor and/or Cresford and others to establish the value of her Profit Share Claim (which she had anticipating obtaining in phase 2 of the Arbitration process). Ms. Athanasoulis asks that the court either order that disclosure and permit her to complete the evidentiary record before she is required to appeal the disallowance of her Profit Share Claim, or to declare now that the appeal will be *de novo* and she will be at liberty to put in further evidence on the appeal.

[17] Further, Ms. Athanasoulis challenges the premise of the Proposal Trustee's suggested procedure since its purported efficiency (in terms of time and cost savings) will only be achieved if she loses on appeal. If she wins, there will be at least three separate steps beyond the appeal itself:

- a. The valuation of her claim at a summary trial.
- b. The determination of the LPs damages in a separate proceeding, and then the determination of any entitlement that they have to set-off.
- c. A distribution hearing (at which priorities will be determined).

[18] Ms. Athanasoulis argues that the Proposal Trustee's suggested incremental process is inefficient and not in keeping with the principles of speed, economy and finality that s. 135 of the BIA demands of a trustee in the determination and valuation of claims.

[19] At the hearing of this motion, Ms. Athanasoulis conceded that there might be a way to defer the briefing and argument of her Future Oriented Damages claims until after the determination of the appeal of whether the Profit Share Claim is a provable claim with a value of more than "zero".

[20] Ms. Athanasoulis challenges the LPs standing to participate in the appeal of the disallowance of the Athanasoulis Claim on any matters that are being addressed by the Proposal Trustee. However, she submits that since there is overlap between the priority and subordination issues as between the Profit Share Claim and the LPs allegation against her for breach of contract and misrepresentation, she considers it to be most expeditious for the LP's Claims to be adjudicated all at once in this proceeding to avoid a multiplicity of proceedings in respect of overlapping claims.

c) The LPs' and Sponsor's Positions

[21] The LPs' and the Sponsor's positions are largely aligned. Coming into the motion, they both argued that it was premature and unnecessary for any directions to be provided by the court, in particular (for the LPs) with respect to limiting the scope of the participation in the appeal. However, once at the hearing, all were content to make submissions and receive the court's advice and directions so that the matter can move forward.

[22] The LPs and Sponsor oppose the suggestion that the court can now order that Ms. Athanasoulis' appeal of the disallowance of her claim be heard as a *de novo* appeal. They contend that under s. 135 of the BIA, an appeal is to be a true appeal, and not *de novo*, unless the court is satisfied that there was some unfairness in the process of the determination of the claim under appeal.

[23] Neither the Sponsor nor the LPs expect to be providing any further evidence or submissions if the Proposal Trustee's suggested process is adopted. They have no objection to the court allowing Ms. Athanasoulis to file further evidence and submissions addressing the specific grounds of disallowance, the points raised in the LPs further brief and submissions on the issues of enforceability of the Profit Share Agreement under the Limited Partnership Agreement and/or on the issues of subordination and priority. They invite Ms. Athanasoulis to file further evidence relevant to the Proposal Trustee's grounds for its determination to disallow her Profit Share Claim so that the record is complete before the Notice of Determination is formally issued and she can then appeal (a true appeal) based on that record.

[24] The Sponsor and the LPs agree with the Proposal Trustee that the valuation questions (including any further factual or expert evidence to decide those questions) ought to be deferred with further directions to be provided when the appeal is decided, if necessary, as to how the Athanasoulis Claim will be valued and finally determined if the preliminary grounds of disallowance are not found to preclude the proof of her Profit Share Claim. The parties concede that further evidence will be required if the Profit Share Claim is to be valued.

[25] The Proposal Trustee suggests the LPs play a limited role in the appeal process since the stated grounds for disallowance would only engage issues associated with their claims insofar as they relate to their entitlement to be repaid in full prior to any payments being made on the Athanasoulis Claim and the enforceability of any element of the Athanasoulis Claim given the terms of the Limited Partnership Agreement.

[26] Other aspects of the LPs' Claims and their claimed set-off would only arise in the event that the Athanasoulis Claim is allowed and valued above zero (upon or after any appeal). The LPs maintain that the LP's Claims cannot be determined in these bankruptcy proceedings. However, they acknowledge that there may be some overlap with the subordination/priority arguments that they seek to advance in relation to the determination of the Athanasoulis Claim and the LP's Claims being prosecuted outside of these proceedings. To that extent, they recognize that there may be some issues that, if determined in this process, will become *res judicata* and subject to issue estoppel in the LP's Claims civil proceeding. They are prepared to accept that outcome.

[27] The LPs are not content with the restricted role suggested for them by the Proposal Trustee in the appeal process. They contend that they should have full party standing on all issues if there is to be an appeal. They have also requested the opportunity to respond to any further evidence or submissions provided by Ms. Athanasoulis to the Proposal Trustee in support of her claim.

Analysis and Directions – Profit Share Claim

[28] The following issues require advice and direction from the court regarding the procedure for determining the Profit Share Claim:

- a. Can and should the court provide directions now about whether the appeal of the Proposal Trustee's disallowance of the Profit Share Claim will be a true appeal or an appeal *de novo*?
- b. What will the appeal record be comprised of if it is not an appeal *de novo*?
 - i. Should Ms. Athanasoulis be permitted to obtain additional evidence by way of production from the Debtor and/or Cresford or others and an examination for discovery of a representative of them?
 - ii. Should Ms. Athanasoulis be permitted to submit additional evidence and make further submissions before a final Notice of Determination is issued so that it is available to be considered by the Proposal Trustee and in the context of any appeal from the Notice of Determination?
- c. What issues will the LPs have standing to participate in on the appeal?
- d. What directions should the court provided regarding the procedure to be followed for the determination of the Profit Share Claim?

a) *True Appeal or Appeal de novo*

[29] The default for appeals of a trustee's decision under s. 135 of the BIA is that appeals are to proceed as true appeals, based on the materials relied upon by the trustee in its decision, and not *de novo*: see e.g. *Galaxy Sports Inc. (Re)*, 2004 BCCA 284, 29 B.C.L.R. (4th) 362, at para. 40; *Asian Concepts Franchising Corporation (Re)*, 2017 BCSC 1452, 51 C.B.R. (6th) 313, at para. 24. This is in keeping with the efficient and cost-effective administration of bankrupt estates and the objective of the BIA to enable parties to have their rights and claims determined in an expeditious fashion: see *Credifinance Securities Limited v. DSLC Capital Corp.*, 2011 ONCA 160, 74 C.B.R. (5th) 161, at para. 26.

[30] The court has discretion to conduct an appeal *de novo* "if the Trustee committed an error or the interests of justice require it": *Bambrick (Re)*, 2015 ONSC 7488, 32 C.B.R. (6th) 228, at para. 18. An appeal *de novo* may be ordered where to proceed otherwise would result in an injustice to the creditor: see *Credifinance*, at paras. 1, 18, 24.

[31] However, there is no basis for finding that there will be an injustice to Ms. Athanasoulis without an appeal *de novo*, or that the interests of justice require an appeal *de novo*. She was invited to provide further evidence and make further submissions if she wishes to do so before the Proposal Trustee makes the final determination of whether the Profit Share Claim is provable. No one opposes this. All parties agree that Ms. Athanasoulis should be provided with all material that the Proposal Trustee has received in connection with the Athanasoulis Claim, including material received from the LPs in December 2022 that was not initially provided to her but now has been.

[32] I do not agree with Ms. Athanasoulis' submission that there is an inherent injustice in the claims process simply because the Proposal Trustee originally agreed to arbitrate the entirety of her claim. The court ruled that procedure was an improper delegation of the Proposal Trustee's duty to determine whether the Athanasoulis Claim is provable and, if so, to value it. There is no injustice in the procedure for the determination of her claim being reset now, even if that means that the Profit Share Claim may not be fully valued (in respect of her Future Oriented Damages claims) until the determination of whether it is a provable claim and/or that it does not have a value greater than zero has been appealed and, only then, if she is successful.

[33] Nor do I agree that the Proposal Trustee's participation in phase 1 of the Arbitration and advocating for an outcome that is now reflected in its draft Notice of Determination creates an inherent injustice by allowing the Proposal Trustee to determine that her Profit Share Claim is not provable and should be disallowed. The Proposal Trustee intends to do so on similar grounds to those that it was urging the Arbitrator to consider to reach that same determination in the Arbitration. The fact that the Proposal Trustee had urged the Arbitrator to reach the same determination on the same grounds that the Proposal Trustee has now determined that the Profit Share Claim is not a provable claim, or should be valued at zero, does not derogate from the integrity of that determination. The Proposal Trustee is a court appointed officer. There is nothing in the record before the court to suggest that the Proposal Trustee did not impartially and fairly reach its determination regarding the Profit Share Claim.

[34] Ms. Athanasoulis' concern about the injustice of a true appeal is predicated on her preclusion from filing any further evidence or submissions in support of the Athanasoulis Claim before the Notice of Determination is formally issued. In circumstances where a creditor has not had a full opportunity to put forward its claim or to respond to the disallowance of a trustee, or the interests of justice otherwise require it, an appeal *de novo* may be appropriate: see *Credifinance*, at para. 24; *Charlestown Residential School, Re*, 2010 ONSC 4099, 70 C.B.R. (5th) 13; *Poreba, Re*, 2014 ONSC 277, at para. 27. See also *Bambrick*, at paras. 16-18.

[35] In any event, this claimed prejudice can be avoided by the directions that the court provides in this endorsement regarding additional evidence and submissions to be filed by Ms. Athanasoulis before the Notice of Determination is finalized. Ms. Athanasoulis raises a secondary concern about the delay that this procedure will entail while she gathers the necessary evidence. Notably, much of the anticipated delay would be for the retention and instruction of experts in connection with her Future Oriented Damages claims, that she has acknowledged could be deferred until after the appeal as long as

her rights are preserved. However, some delay will be inevitable, particularly because, to avoid the prospect of any injustice, the Proposal Trustee will also be required to review and consider any such new evidence filed before making the final decision and issuing its Notice of Determination.

[36] I prefer to provide advice and directions now with a view to avoiding these injustices. In a complicated situation such as this, in which it is acknowledged that there are stakeholders with specific interests and evidence, it makes sense that a process be put in place to create a complete record for the Proposal Trustee's determination and for any appeal.

[37] I am not prepared to provide any directions now about whether any appeal taken from the final Notice of Determination issued by the Proposal Trustee will proceed *de novo*, rather than presumptively as a true appeal. If some injustice or prejudice ensues, those concerns will have to be raised with the appeal court.

b) The Appeal Record: Further Discovery and Evidence

[38] Section 135(1.1) of the BIA requires the Proposal Trustee to determine whether any contingent claim or unliquidated claim is provable and, if provable, the Proposal Trustee shall value it. The wording of this section at least allows for the possibility that the determination of whether a claim is provable might happen before the claim is valued.

[39] Ms. Athanasoulis was understandably concerned with the suggested procedure for determining the Athanasoulis Claim, in which the Proposal Trustee would issue its Notice of Determination of the Profit Share Claim based on the record to date and Ms. Athanasoulis would appeal that disallowance based on the existing record. When the court concluded that phase 2 of the Arbitration amounted to an improper delegation of the Proposal Trustee's responsibility for determining the Athanasoulis Claim, it was not intended that Ms. Athanasoulis be precluded from relying on any further evidence in support of the proof of her Profit Share Claim. Up until that time, she had quite justifiably assumed that there would be an opportunity for her to support her claim through the agreed upon arbitration process, which was cut short because of my Funding Decision, through no fault of her own.

[40] A trial-like procedure is not something that a claimant in a bankruptcy proceeding is entitled to, nor is it the norm. The proposed expansion of the Arbitration into that type of trial-like process is in part to blame for the court's decision to put an end to that process. The s. 135 claims process under the BIA is "intended to be an efficient and summary process" for the determination of claims: *Asian Concepts Franchising Corporation (Re)*, 2018 BCSC 1022, 62 C.B.R. (6th) 123, at para. 53.

[41] That said, the court recognizes that the Profit Share Claim is the most significant claim in this bankruptcy proceeding and that it is a complex fact-dependent claim. If there is information and documents to support the Athanasoulis Claim that she anticipated having the ability to obtain from the Proposal Trustee or the Debtor and/or Cresford in the context of the Arbitration, it is reasonable to

make some accommodation to enable her to access that information and documentation and include it with the material that the Proposal Trustee will be asked to consider and that will be in the record for appeal purposes.

[42] While all parties recognize that there may be some efficiency in carving out the Future Oriented Damages from the Profit Share Claim pending the determination of whether it is a provable claim under s. 135(1.1) of the BIA, there remain aspects of the procedure suggested by the Proposal Trustee that are too limiting and unfair to Ms. Athanasoulis. They include:

- a. Having been advised of the grounds upon which the Proposal Trustee intends to determine that the Profit Share Claim is not a provable claim, Ms. Athanasoulis should be permitted to put the evidence that she relies upon to counter the identified grounds for this determination.
- b. Similarly, having now just received the materials and submissions provided by the LPs to the Proposal Trustee in respect of the positions they seek to assert on the question of whether the Profit Share Claim is a provable claim and on the question of the subordination of that claim to the LPs' interests which they say should be given priority, fairness requires that Ms. Athanasoulis be given the opportunity to put into the record any evidence and submissions that she relies upon to counter the LPs' positions.

[43] A procedure must be established that will ensure that the evidence that Ms. Athanasoulis seeks to rely upon is available in an established record before the Proposal Trustee makes its determination of whether the Profit Share Claim is provable.

[44] Under a reservation of rights, the valuation of the Future Oriented Damages included in the Profit Share Claim (beyond the ascribed "zero" valuation by the Proposal Trustee for reasons that do not involve an actual valuation) can be deferred, along with all evidence and submissions about the calculation of these Future Oriented Damages, until after the appeal of the Proposal Trustee's determination to disallow it.

[45] As mentioned earlier, during oral argument, counsel for Ms. Athanasoulis agreed that it might be more efficient and economical to defer the valuation of her Future Oriented Damages claims (based on the repudiation date or the date of the Proposal), given that those valuations will be dependent upon expert input, until the appeal of the determination of whether the Profit Share Claim is provable on the principled/legal grounds (equity vs. profit, earned vs. realized profits and subordinated to the LPs' Claims) has been decided (with a reservation of her right to pursue those Future Oriented Damages if the appeal succeeds).

[46] In addition to evidence that Ms. Athanasoulis may already have and that could be compiled for submission to the Proposal Trustee, she has identified further evidence that she may need to obtain from the Debtor (and/or Cresford). For example, evidence to counter the Proposal Trustee's determination that the Profit Share Claim is to be valued at zero predicated on the assumption that there were no profits in the YSL Project at, or at any time prior to, the date of the Proposal (because it

was not built). Ms. Athanasoulis is entitled to test that determination. To do so she may need additional production from the Debtor and/or Cresford of historic financial documents, beyond those that she has already received. Insofar as the Proposal Trustee is in control of any of the Debtor's records that Ms. Athanasoulis may ask for, it too may be required to produce documents to Ms. Athanasoulis.

[47] I agree with Ms. Athanasoulis that if the goal is to create a record now that can be used for a true appeal, the issues identified in the Proposal Trustee's draft Notice of Determination warrant an opportunity for a further exchange of materials and some (circumscribed and limited) cross-examinations so that there is a complete record for the appeal.

[48] While the claims process is intended to a summary process and not a full adjudicative process with a trial, this is a complex claim with a multitude of competing interests. Fairness requires that Ms. Athanasoulis be given access to documentary records (and a witness from the Debtor or Cresford who can explain/prove them, if necessary) that she needs to prove her claim and counter the grounds upon which it is expected to be ruled by the Proposal Trustee not to be provable.

[49] The court has the jurisdiction to order this under its general discretionary powers in s. 183(1)(a) of the BIA. See also *Toronto-Dominion Bank v. Brad Duby Professional Corporation*, 2022 ONSC 6066, at para. 33. In this instance, the use of those powers in the unique circumstances of this case is appropriate to ensure procedural fairness in the determination of the Athanasoulis Claim and any appeals that may arise from the Proposal Trustee's determination.

c) Standing of the LPs on the Appeal of the Profit Share Claim Disallowance

[50] The LP's Claims are not part of this proceeding, except to the extent that they are relevant to the identified grounds for the Proposal Trustee's intended disallowance of the Profit Share Claim. I cannot accede to the request from Ms. Athanasoulis to order the LP's Claims to be adjudicated on their merits in this proceeding, absent the consent of the LPs, which is not forthcoming.

[51] The Proposal Trustee suggests that the LPs be entitled only to raise issues in the appeal that pertain directly to: (a) whether the LPs must be repaid in full prior to any payments being made on the Athanasoulis Claim (the enforceability of the Profit Share Claim as against the LPs, which in turn is tied into preliminary questions of subordination and priority); and (b) the enforceability of any element of the Athanasoulis Claim given the terms of the Limited Partnership Agreement."

[52] The LPs argue that because they would be the ones most immediately and directly impacted by any aspect of the Athanasoulis Claim that is allowed, and by the value ascribed to any allowed claim, they should have full participation rights on all issues. At some level, every creditor has an interest in minimizing or eliminating the claims of other creditors on equal footing. That is not a reason to grant the LPs advance standing on an appeal, or even to give them full standing in the determination of the Athanasoulis Claim.

[53] The Proposal Trustee's suggestion is reasonable and strikes the appropriate balance. Subject, always, to the discretion of the judge hearing the appeal, I see no reason to grant the LPs *carte blanche* to double down on all the arguments already being made by the Proposal Trustee. The LPs have a legitimate interest in bringing forward any unique evidence, claims and arguments that they can offer, but not to duplicate or pile onto arguments already being made by the Proposal Trustee.

[54] I consider this situation to be distinguishable from another situation that arose in this case, in relation to a different proof of claim: see *YG Limited Partnership and YSL Residences Inc.*, 2022 ONSC 6548 (now under appeal). In that circumstance, the LPs were held not to have any standing to participate in the adjudication of a creditor's claim at the *de novo* appeal of a claim filed by CBRE involving a contract that the LPs had no involvement in or evidence to offer in respect thereof. The justification for not granting the LPs standing in that situation was fact specific (as it often is). Notably, as well, no one in the circumstances of this case is suggesting that the LPs should have no standing to address any issues on appeal.

[55] Here, the LPs have been afforded standing to provide evidence and make submissions to the Proposal Trustee in connection with the Notice of Determination regarding the "provability" of the Profit Share Claim. They have a unique perspective to offer with respect to their argument that the Profit Share Agreement should be found to be unenforceable because it is contrary to the Limited Partnership Agreement (a ground not relied upon by the Proposal Trustee but raised and therefore forms part of the record for appeal purposes that Ms. Athanasoulis must respond to).

[56] The LPs may also have a unique perspective on the preliminary question of whether the Profit Share Agreement can be enforced in the face of Ms. Athanasoulis' admissions that she agreed with the LPs that they would be paid out before her. These unique perspectives have been placed before the Proposal Trustee; Ms. Athanasoulis will be permitted to respond to and challenge them, and they will be "in play" on any appeal.

[57] Subject to the discretion and views of the judge hearing the appeal, I would anticipate that the LPs will have at least some status at the appeal to address at least these points, but perhaps not beyond them.

[58] Finally, the certainty and finality that the determination of these issues will bring is important because of the LP's Claims outside of this proceeding. The LPs need to be given standing to participate in order for an issue estoppel to arise so as to prevent the re-litigation of the same points in the context of the LP's Claims.

[59] For all these reasons, it is anticipated that the LPs will be afforded an opportunity to participate on the appeal to the extent of any unique or added perspective or submissions that they have that are not advanced by the Proposal Trustee, or that the Proposal Trustee defers to the LPs on. In contrast, the LPs should not expect to be permitted to make submissions on points already being addressed by the Proposal Trustee, such as, the argument that the Profit Share Claim is a claim in equity, not a debt owing by the Debtor.

[60] The LPs asked to be afforded the opportunity to make further submissions in response to Ms. Athanasoulis' further evidence and submissions. I do not consider that to be necessary or appropriate. However, if the Proposal Trustee asks them for further information or documents after receiving the further evidence and submissions from Ms. Athanasoulis, whatever the LPs provide must be given to Ms. Athanasoulis as well.

d) Directions Regarding the Procedure for the Determination of the Profit Share Claim

[61] Having considered all the written and oral submissions received, and in the exercise of my discretion, the following directions are provided in respect of the suggested procedure by the Proposal Trustee for the determination and appeal of the Profit Share Claim:

- a. Within one week of the release of this endorsement, Ms. Athanasoulis will be provided with a complete record of all evidence and submissions received from other stakeholders in connection with the Proposal Trustee's draft Notice of Determination with respect to her Profit Share Claim. This may have already occurred by the delivery of materials previously provided by the LPs to the Proposal Trustee just prior to the hearing of this motion; however, in the interests of completeness a further week is being afforded to ensure that she has now been provided with all materials.
- b. Within two weeks of the release of this endorsement, Ms. Athanasoulis may make reasonable and targeted document requests from the Proposal Trustee, the Debtor and/or Cresford, or any other participating party for documents that she does not have and claims she needs to support the proof of the Athanasoulis Claim and to establish that it should be valued at more than "zero" (for example, in support of any grounds upon which she challenges the Proposal Trustee's determination that there were no profits in the YSL Project as at the date of the Proposal or at any time prior to that date).
- c. Ms. Athanasoulis' requests shall be responded to, and any documents that are in the possession, control or power of the Proposal Trustee or the Debtor and/or Cresford shall be provided, within three weeks of any such request.
- d. Within two months of the release of this endorsement, Ms. Athanasoulis shall deliver her submissions and a supplementary record containing any further evidence that she relies upon in support of the Athanasoulis Claim or that she relies upon to challenge any determination that may be made to disallow her Profit Share Claim on the grounds that:
 - i. it is equity, not debt;
 - ii. the YSL Project did not generate any profits at, or at any time prior to, the date of the Proposal;
 - iii. it is to be subordinated to the LPs return of equity (that will inevitably be subject to a shortfall) because of representations to that effect made to the LPs by Ms. Athanasoulis; and/or

- iv. it is not enforceable as against the LPs because it was entered into in breach of the Limited Partnership Agreement, breach of fiduciary duties owed to the LPs by the general partner and/or misrepresentations made to the LPs by Ms. Athanasoulis.
- e. The Proposal Trustee may request further submissions, evidence or documents in respect of its consideration and assessment of the supplementary material provided by Ms. Athanasoulis, the Debtor, the LPs or elsewhere as it deems appropriate. Any such evidence or documents shall be requested by the Proposal Trustee and provided to Ms. Athanasoulis within four weeks of the delivery of her supplementary record.
- f. Within two weeks after the provision of any further evidence or documents received by the Proposal Trustee (or the deadline for so doing),
 - v. the Proposal Trustee may question (by way of an examination under oath) Ms. Athanasoulis about any evidence or submissions she provides in support of the proof of the Athanasoulis Claim;
 - vi. Ms. Athanasoulis may examine a representative of the Debtor and/or Cresford under oath on the question of whether there were any profits in the YSL Project as at the date of the Proposal or at any time prior to that date.
- g. The Proposal Trustee shall deliver to all interested parties its final Notice of Determination in accordance with s. 135(3) of the BIA (which may, in the Proposal Trustee's discretion, be revised from the draft Notice of Determination previously delivered, taking into account the additional evidence and submissions it receives) within two weeks of the completion of any questioning/cross-examinations (or the date for their completion having lapsed).
- h. Ms. Athanasoulis may thereafter appeal the Proposal Trustee's Notice of Determination and its anticipated disallowance of any aspect of the Athanasoulis Claim in the normal course in accordance with s. 135(3) of the BIA.
- i. Subject to the discretion of the appeal judge, the LPs standing on the appeal shall be limited to submissions in respect of the impact of the prohibition contained in the Limited Partnership Agreement on non-arm's length agreements (such as the Profit Sharing Agreement), on the question of enforceability of the Profit Share Claim and in respect of the priority/subordination of the Profit Share Claim to the LPs recovery of their initial investment based on alleged breaches of contractual and fiduciary duties and alleged misrepresentations.
- j. If the parties require further directions or clarifications from the court as they progress through these steps, a case conference may be requested before me through the Commercial List scheduling office.

[62] I realize that this will result in a number of months delay in the ultimate determination of the Athanasoulis Claim before any appeal; however, it is still a far less cumbersome process than what was contemplated by the Arbitration, and it is a process that places the determination of the provability of the Athanasoulis Claim, and its valuation, in the hands of the Proposal Trustee.

[63] To be clear, it is not expected that there will be any material or submissions at this time regarding the Future Oriented Damages (whether calculated at the repudiation date or the Proposal date). If Ms. Athanasoulis is successful on appeal of any disallowance of the Profit Share Claim, the parties shall make an appointment for a case conference before me (if my schedule permits within the time frame requested) to seek directions about the process for the determination of the more complex valuation question that will likely require expert input.

Analysis and Directions – Wrongful Dismissal Claim

[64] The Proposal Trustee allowed the Wrongful Dismissal Claim in part and valued it at \$880,000. \$120,000 was discounted because the Proposal Trustee determined that this amount had already been paid to Ms. Athanasoulis in the context of another proceeding. It has not been suggested that there is a need for further evidence or submissions in respect of the Proposal Trustee's determination of this claim reflected in the draft Notice of Determination. If Ms. Athanasoulis has further evidence or submissions on the narrow question of whether she has already received \$120,000 on account of this claim, those may be provided to the Proposal Trustee when she delivers her supplementary record in connection with the Profit Share Claim (as indicated in the previous section, to be provided within two months of this endorsement).

[65] The issues raised for the court's consideration in respect of this aspect of the Athanasoulis Claim are:

- a. Whether the LPs have standing in respect of the determination of the Wrongful Dismissal Claim.
- b. Should the allowed portion of this claim be paid out in a manner consistent with other employee claims, or deferred until the appeal and other steps in the determination of the entire Athanasoulis Claim have been resolved?

[66] The Proposal Trustee is of the view that the LPs have no standing with respect to the Proposal Trustee's determination of the Wrongful Dismissal Claim for the reasons set out in the decision of Osborne J. in respect of the CBRE claim (discussed earlier in this endorsement at paragraph 54, *YG Limited Partnership and YSL Residences Inc.*). The Proposal Trustee is aware that certain of the LPs have appealed this decision.

[67] There has been no indication that the LPs have any unique perspective or evidence to offer in respect of this issue (unlike the Profit Share Claim, where they do, and have accordingly been afforded rights of participation commensurate with their unique perspective and evidence). I do not see any basis on which they should be involving themselves in the determination or valuation of the Wrongful Dismissal Claim.

[68] It will be a matter for the Proposal Trustee to decide, but it was indicated at the hearing that the “allowed” portion of the Wrongful Dismissal Claim will be treated in same way as “like” employee claims which, if not appealed, have been paid out at 70 cents on the dollar.

Costs and Final Disposition

[69] The Proposal Trustee does not seek costs from any party in respect of this motion.

[70] Ms. Athanasoulis and the LPs asked that the court reserve to the parties the ability to request their costs of this motion if there is a future adjudication of costs in connection with the determination and valuation of the Athanasoulis Claim. That makes sense and I so order.

[71] The Court’s orders and directions are set out in paragraph 61 in the previous sections of this endorsement and will not be repeated. This endorsement and the orders and directions contained in it shall have the immediate effect of a court order without the necessity of a formal order being taken out. Any party may take out a formal order by following the procedure under r. 59.

Kimmel J.

Date: February 10, 2023

TAB 5

At para(s) 68, 74, 78, 86-89, 96, 98-106

Extreme Venture Partners Fund I LP v. Varma, 2021 ONCA 853 (CanLII)

Date: 2021-12-01

File number: C67057; C67376; C67364; C67062

Citation: **Extreme Venture Partners Fund I LP v. Varma, 2021 ONCA 853 (CanLII)**, <<https://canlii.ca/t/jl3lh>>, retrieved on 2024-04-25

COURT OF APPEAL FOR ONTARIO

CITATION: Extreme Venture Partners Fund I LP v. Varma, 2021 ONCA 853

DATE: 20211201

DOCKET: C67057, C67062, C67364 & C67376

Hourigan, Huscroft and Coroza J.J.A.

BETWEEN

DOCKET: C67057

Extreme Venture Partners Fund I LP, EVP GP Inc.,
Ravinder Kumar Sharma, Imran Bashir, and Kenneth Teslia

Plaintiffs/Defendants by Counterclaim
(Respondents)
and

Amar Varma, Sundeep Madra, Varma Holdco Inc.,
Madra Holdco Inc., Chamath Palihapitiya, El Investco I Inc.,
Extreme Venture Partners Annex Fund I LP, and EVP GP Annex Fund I Inc.

Defendants/Plaintiffs by Counterclaim
(Appellants/Respondents)

AND BETWEEN

DOCKET: C67062

Extreme Venture Partners Fund I LP, EVP GP Inc.,
Ravinder Kumar Sharma, Imran Bashir, and Kenneth Teslia

Plaintiffs/Defendants by Counterclaim
(Respondents/Appellants by Cross-Appeal)
and

Amar Varma, Sundeep Madra, Varma Holdco Inc.,
Madra Holdco Inc., Chamath Palihapitiya, El Investco I Inc.,
Extreme Venture Partners Annex Fund I LP,
EVP GP Annex Fund I Inc., Cassels Brock & Blackwell LLP, and
Seven Hills Group LLC

Defendants/Plaintiffs by Counterclaim
(Appellants/Respondents by Cross-Appeal)

AND BETWEEN

DOCKET: C67364

Extreme Venture Partners Fund I LP, EVP GP Inc.,
Ravinder Kumar Sharma, Imran Bashir, and Kenneth Teslia

Plaintiffs/Defendants by Counterclaim
(Respondents)
and

Amar Varma, Sundeep Madra, Varma Holdco Inc.,
Madra Holdco Inc., Chamath Palihapitiya, El Investco I Inc.,
Extreme Venture Partners Annex Fund I LP,
EVP GP Annex Fund I Inc., Cassels Brock & Blackwell LLP, and
Seven Hills Group LLC

Defendants/Plaintiffs by Counterclaim
(Appellants)

AND BETWEEN

DOCKET: C67376

Extreme Venture Partners Fund I LP, EVP GP Inc.,
Ravinder Kumar Sharma, Imran Bashir And Kenneth Teslia

Plaintiffs (Respondents)

and

Amar Varma, Sundeep Madra, Varma Holdco Inc.,
Madra Holdco Inc., Chamath Palihapitiya, El Investco I Inc.,
Extreme Venture Partners Annex Fund I LP,
EVP GP Annex Fund I Inc., Cassels Brock & Blackwell LLP, and
Seven Hills Group LLC

Defendants (Appellants)

Jonathan Lisus, Crawford Smith, Nadia Campion, Vlad Calina and John Carlo Mastrangelo, for the appellants Amar Varma, Sundeep Madra, Varma Holdco Inc. and Madra Holdco Inc.

Andrew Brodtkin, David E. Lederman and Daniel Cappe, for the appellants Chamath Palihapitiya and El Investco 1 Inc.

Won J. Kim, Megan B. McPhee, Aris Gyamfi and Rachael Sider, for the respondents

Heard: October 4-5, 2021 by video conference

On appeal from the orders of Justice Barbara A. Conway of the Superior Court of Justice, dated May 14, 2019, July 24, 2019, and February 4, 2020, and the judgment of Justice Barbara A. Conway of the Superior Court of Justice, dated May 14, 2019.

Hourigan J.A.:

Part I - Introduction

[1] After a five-week trial, the trial judge released thorough and compelling reasons that weaved a narrative of corporate malfeasance, avarice, and deceit in the technology sector. The appeals before this court raise important issues about remedies and, more fundamentally, acceptable standards of conduct in corporate Canada.

[2] I begin with an introduction of the key players. Amar Varma and Sundeep Madra, along with their respective holding companies, Varma Holdco Inc. (“Varma Holdco”) and Madra Holdco Inc. (“Madra Holdco”), are the “Varma/Madra Appellants.” Chamath Palihapitiya and his holding company,

El Investco 1 Inc. (“Investco”), are the “Palihapitiya Appellants”. They are collectively referred to as the “Appellants”. Extreme Venture Partners Fund I LP, EVP GP Inc., Ravinder Kumar Sharma, Imran Bashir and Kenneth Teslia are the “Respondents”.

[3] At trial, the Respondents asserted two central claims: (1) the “Annex Fund Claim”, alleging that the Varma/Madra Appellants were liable for breach of fiduciary duty and breach of contract regarding the establishment of a competing business, and (2) the “Xtreme Labs Claim”, alleging that the Varma/Madra Appellants were liable for breach of fiduciary duty, breach of contract, and conspiracy and that the Palihapitiya Appellants were liable in tort for knowing assistance in breach of fiduciary duty, inducing breach of contract, and conspiracy, all concerning the sale of Xtreme Labs Inc. (“Xtreme Labs”).

[4] The trial judge found in favour of the Respondents and ordered that: (1) on the Annex Fund Claim, Varma and Madra are liable for \$250,000 in punitive damages, and (2) on the Xtreme Labs Claim, the Palihapitiya Appellants and the Varma/Madra Appellants are jointly and severally liable for \$3.36 million (U.S.) in damages and \$12.33 million (U.S.) in disgorgement of profits. She also made additional orders regarding the applicable exchange rate and prejudgment interest.

[5] The two groups of appellants take different approaches to this appeal. The Varma/Madra Appellants do not challenge the factual findings made by the trial judge. Instead, in their written materials, these appellants raise several alleged legal errors, which were narrowed in their oral submissions to two issues: (i) the calculation of damages on the sale of Xtreme Labs, and (ii) the validity of an amendment to the statement of claim to seek disgorgement regarding the sale of Hatch Labs Inc. (“Hatch Labs”) and the disgorgement order ultimately made by the trial judge.

[6] In these reasons, I will explain why I am not persuaded by either of these arguments or the other grounds of appeal that were not addressed in oral argument. In summary, the trial judge made a sensible damages calculation, grounded in the evidence, which does not require appellate intervention. She also reasonably exercised her discretion in permitting the amendment of the claim and making the disgorgement order. There is also no basis to interfere with the trial judge’s conclusions on the issues raised by the Appellants in their written material but not addressed in their oral submissions.

[7] The Palihapitiya Appellants adopt the legal arguments advanced by the Varma/Madra Appellants. They further submit that the trial judge erred in imposing joint and several liability for her disgorgement order. Relying on English authority, they say that a knowing assistant should not face the same liability as a faithless fiduciary. While that position is contrary to some Canadian jurisprudence, I am prepared to accept that there might be circumstances where a knowing assistant should have their liability limited. However, this is not such a case. Here, the Palihapitiya Appellants were active participants in the core wrongful conduct as well as its primary beneficiaries. There is no equitable reason why their liability should be limited.

[8] The Palihapitiya Appellants also offer a double-barrelled attack on the trial judge's factual findings as part of their submission that she erred in finding that Palihapitiya had knowingly assisted in the breaches of fiduciary duty. First, they argue that she made a series of palpable and overriding errors of fact. Second, they submit that their conduct was well within the boundaries of ethical and legal corporate behaviour and that the trial judge's findings of misconduct are based on her own "idiosyncratic moral values." These appellants argue that permitting the trial judge's findings to stand would result in confusion in the Canadian corporate world as business people would be held to unknowable standards of conduct that conflict with their legitimate business interests.

[9] The principal problem with the first part of the Palihapitiya Appellants' position is that it is dependent upon the Appellants' credibility. The trial judge rightly found the Appellants to be incredible witnesses whose sworn testimony was routinely contradicted by the written record. Moreover, Palihapitiya had an unusual habit in his public and private communications of bragging about significant aspects of his alleged misbehaviour but then inexplicably denying any misconduct on the witness stand.

[10] The second part of the submission is a straw man argument. The trial judge's conclusions were not grounded in her idiosyncratic moral values, nor did she require Palihapitiya to compromise his legitimate business interests. Instead, she applied well-established tort and corporate law principles to his conduct and made findings of illegality supported by the record. Counsel's submission that the Appellants' unethical and illegal behaviour should be excused as standard examples of corporate conduct is meritless. The trial judge, an experienced commercial judge, saw through this argument and reached the correct conclusion. In my view, if the Appellants' conduct was not the subject of adverse findings by her, the court would have communicated a message that there are few, if any, limits to corporate malfeasance. Such a message would have caused significant uncertainty in the Canadian business world.

[11] The final legal issue is the cross-appeal. Ms. McPhee, on behalf of the Respondents, submits that the trial judge was correct in making an order for disgorgement. Further, she argues that the trial judge was right in finding that the order should act as a deterrent to similar behaviour in keeping with the prophylactic purpose of disgorgement. However, Ms. McPhee submits that the order made will have no deterrent effect because the Appellants are obliged to disgorge to the Respondents only what they would otherwise be entitled to receive had they not breached their fiduciary duty. I am persuaded by that argument and agree that the disgorgement order should be increased to achieve its deterrent purpose.

[12] The question raised by the panel in oral argument was whether a prophylactic disgorgement order necessarily requires the disgorgement of all ill-gotten gains. The Respondents argue that it should. However, counsel for the Appellants chose to make no submissions on the point. My view is that courts should have flexibility in making a prophylactic disgorgement order, and thus there should not be an automatic rule for the disgorgement of all profits in all circumstances. However, on the facts of this case, where the Appellants have engaged in a litany of brazenly illegal acts and where their counsel elected not to offer any submissions on the point, I would order disgorgement of the total amount of the profits.

Part II – Background Facts

[13] The following high-level factual overview will provide the necessary context to consider the issues in these appeals.

(a) Fund I

[14] Extreme Venture Partners Fund I LP (“Fund I”) is a venture capital fund that provides seed capital to start-up technology companies. It was established in November 2007 by the following parties in this litigation: Sharma, Bashir, Teslia, Varma and Madra.

[15] Fund I was registered as a limited partnership, and its general partner, EVP GP Inc. (“EVP GP”), was incorporated. The shares of EVP GP were owned personally by Sharma, Bashir and Teslia, as well by Varma Holdco and Madra Holdco.

[16] EVP GP managed the business of Fund I. The board of directors of EVP GP consisted of Sharma, Bashir, Teslia, Varma and Madra. In addition, Varma and Madra served as managing directors of EVP GP, were responsible for all aspects of the day-to-day operations of Fund I, and recommended companies for investment to the Investment Committee.

[17] Fund I grew rapidly, but by late 2010, tensions had started to develop in the relationship between Sharma, Bashir and Teslia on the one hand and Varma and Madra on the other. Varma and Madra testified at trial that they were doing all the work to grow the businesses and were not being adequately recognized or compensated for their efforts.

(b) Annex Fund

[18] In November 2010, Madra was on a plane to California and ran into the managing director of Northleaf Capital Partners (“Northleaf”). They began talking about establishing a fund together, with Northleaf as the primary limited partner. Varma, who had been looking into pitching Northleaf for Fund I with Sharma, joined these conversations at a later meeting. Madra and Varma did not tell Sharma, Bashir or Teslia about the meetings.

[19] In December 2011, Madra and Varma established a second fund named the Annex Fund. Madra and Varma did not tell Sharma, Bashir or Teslia about the establishment of the Annex Fund. Instead, Madra and Varma surreptitiously obtained \$5 million in financing from Northleaf. After the Annex Fund was established, Madra and Varma provided Northleaf with confidential information about Fund I's portfolio and investment strategy. As a result, the Annex Fund invested in six of Fund I's most successful portfolio companies and operated for two years until it closed in 2013. The foregoing facts were the basis of the Annex Fund Claim.

(c) Xtreme Labs

[20] One of Fund I's investments was Xtreme Labs, a mobile software development lab business co-founded by Madra and Varma. The original equity of Xtreme Labs, less 5% held by Go Pivotal Inc. ("Pivotal"), was split equally among Sharma, Bashir, Teslia, Varma Holdco and Madra Holdco. Fund I later acquired an interest in the company. Madra and Varma were also the managing directors and co-CEOs of Xtreme Labs and were responsible for its day-to-day operations.

[21] By 2011, the parties had started to explore options to sell Xtreme Labs. Despite the prior years' rapid growth, Madra and Varma presented projections that estimated the company's growth would slow, which surprised and disappointed the Xtreme Labs board. They advised the board, which included Sharma, Bashir and Teslia, that the projected revenues for the current fiscal year would be \$12 million (U.S.). The initial efforts to sell Xtreme Labs were unsuccessful, and the board members had different opinions about the company's value.

[22] On February 1, 2012, Palihapitiya contacted Madra to talk about buying Xtreme Labs. Palihapitiya is a prominent Silicon Valley entrepreneur, a founding senior executive at Facebook, and a good friend of Varma and Madra. On March 20, Palihapitiya, Varma and Madra had dinner together in Toronto and then went to Varma's apartment afterward. Together, they prepared an offer by Palihapitiya to purchase the company that would allow Varma and Madra to stay on with the company after the sale. The offer was forwarded to the rest of the board the next day, but Varma and Madra did not tell the board that they had been with Palihapitiya the previous evening, working on the offer.

[23] After the offer and a counteroffer, as well as an independent valuation by Seven Hills Group LLC ("Seven Hills") that Varma and Madra oversaw, the Respondents agreed to sell their shares in Xtreme Labs to Palihapitiya's holding company, Investco. The purchase price was based on an enterprise value for Xtreme Labs of \$18 million (U.S.). The selling shareholders received \$12 million (U.S.) for their shares of Xtreme Labs. Varma and Madra and the Xtreme Labs employees received \$6 million (U.S.) in the ongoing equity of the company.

[24] In October 2013, Palihapitiya negotiated the sale of shares of Xtreme Labs to Pivotal for \$60 million (U.S.). Prior to the sale, Palihapitiya, Varma and Madra carved certain assets out of Xtreme Labs and transferred them to a holding company of which they were the sole shareholders, 2390184 Ontario Inc. ("239 Ontario"). One of those assets was a 13% equity interest in Hatch Labs, which had developed the mobile dating app Tinder. In March 2014, 239 Ontario sold its stake in Hatch Labs to a large American corporation, InterActive Corp. ("IAC"), for \$30 million (U.S.).

Part III – Proceedings Below

[25] The Respondents sued the Appellants, asserting various causes of action, including breach of fiduciary duty, breach of contract, inducing breach of fiduciary duty and inducing breach of contract.

(a) Standing

[26] At trial, the Appellants noted that Varma and Madra were managing directors of EVP GP and not Fund I. Therefore, they submitted, Fund I had no standing to claim a breach of fiduciary duty. Further, they argued that EVP GP had no standing to assert such a claim because it had not suffered harm. In addition, the Appellants' position was that in the Xtreme Labs sale, Varma and Madra were acting exclusively in their role as Xtreme Labs directors, not EVP GP directors. Thus, they argued that they owed no duty to any of the Respondents.

[27] The trial judge rejected these submissions. She observed that "[i]n this case, Fund I is alleging that it suffered harm *as a result of* the breach of fiduciary duty owed by Amar and Sunny to its general partner, EVP GP, which was responsible for managing the business of Fund I." The trial judge also noted that EVP GP holds all the property of the limited partnership. Therefore, to the extent that EVP GP received any damages, those damages would be the property of Fund I. Under either rationale, the damages would be receivable by Fund I, the party that alleged the loss. Additionally, she found that Varma and Madra were directors of both EVP GP and Xtreme Labs, and "as directors of EVP GP, owed fiduciary duties to that company in connection with the sale of Xtreme Labs."

(b) Annex Fund Claim

[28] Sharma, Bashir and Teslia testified that they trusted Varma and Madra as managing directors of Fund I. Their evidence was that the plan from the outset was to operate a series of funds under the Extreme Venture Partners brand, with Varma and Madra taking a lead role. If Varma and Madra started a new fund independently, the expectation was they would do so transparently and properly by buying out the Respondents' interests in EVP GP under the EVP GP Shareholders' Agreement. Varma and Madra, on the other hand, testified they were entitled to pursue the second fund on their own, without the Respondents' involvement.

[29] The trial judge accepted the Respondents' account and found that Varma and Madra had breached their duties of honesty, loyalty, and confidentiality owed by virtue of being directors of EVP GP. However, the trial judge dismissed the Respondents' passing off claim.

[30] While the Respondents alleged reputational damages as part of the Annex Fund Claim, the trial judge ruled such damages were not made out. In addition, Fund I sought compensatory damages for lost opportunities, but the trial judge rejected that claim. However, the trial judge found that punitive damages were appropriate on the basis that Varma and Madra's conduct was "most deserving" of sanction and required denunciation. Accordingly, she awarded \$250,000 punitive damages against each of Varma and Madra, payable to Fund I.

(c) Xtreme Labs Claim

(i) General Findings

[31] Palihapitiya, Varma, and Madra denied that they conspired on the Xtreme Labs acquisition. However, the trial judge rejected their evidence as incredible, in part because it was contradicted by the written record. Instead, she found that they worked together and coordinated their efforts to present Palihapitiya's offer to buy the company at the board meeting in March 2012. Further, Varma and Madra hid this coordination and pressured the board to accept the offer. They acted out of self-interest as Palihapitiya's offer to buy the company was their opportunity to increase their compensation and equity in the business.

[32] The trial judge also found that Varma and Madra worked with Palihapitiya to facilitate his acquisition of Xtreme Labs at a discounted purchase price by: (a) understating the company's revenue projections, (b) advancing a low earnings multiple, and (c) concealing the company's equity interest in Hatch Labs.

(ii) Causes of Action

[33] The trial judge carefully considered each of the constituent elements of the causes of action asserted.

[34] Regarding the claim of breach of fiduciary duty, Fund I alleged at trial that Varma and Madra breached their fiduciary duties as directors of Fund I's general partner, EVP GP, in connection with the Xtreme Labs sale transaction. The trial judge agreed. She found that they were in a conflict of interest and were not transparent with the EVP GP board. The board was entitled from the outset to know the role Varma and Madra were playing with respect to Palihapitiya's offer. In addition, Varma and Madra breached their duty of loyalty in various ways, such as by providing confidential information to Palihapitiya before the sale had closed.

[35] On the claim of breach of contract/breach of warranty, the trial judge found that Varma and Madra breached their warranties in the Xtreme Labs sale contract. In addition, their conduct constituted a breach of contract by Varma Holdco and Madra Holdco of their confidentiality obligations.

[36] Palihapitiya testified that he did not know what information was exchanged and what communications Varma and Madra had with other board members. Accordingly, he denied that he provided knowing assistance to any breach of fiduciary duty. His evidence was found to be contradicted by his email to Madra on March 16, instructing Madra what to tell the board about the multiplier on a recent sale regarding Pivotal. It was also contradicted by the ongoing communications between the co-conspirators as to what was transpiring among board members. The trial judge found that Palihapitiya worked together with Varma and Madra on an offer that included a Pivotal multiplier figure that they knew was understated. Palihapitiya sent this offer to Varma and Madra to present to the board and, by extension, knowingly participated in their advancing an understated multiplier figure to the board. Palihapitiya therefore assisted Varma and Madra in breaching their duty of honesty.

[37] The trial judge also concluded that Palihapitiya knowingly assisted Varma and Madra in breaching their duty of honesty concerning Hatch Labs/Tinder. Varma and Madra did not disclose the existence of the equity interest in Hatch Labs or the launch of Tinder to Fund I before closing. Palihapitiya was found to have known about Hatch Labs/Tinder and, along with Varma and Madra, to have closed the transaction based on this concealed information. In so doing, Palihapitiya knowingly assisted Varma and Madra in the breach of their fiduciary duty.

[38] The elements of the tort of inducing breach of contract were met as Palihapitiya induced Varma Holdco and Madra Holdco to breach their contractual obligations under the Xtreme Labs Shareholders' Agreement. Palihapitiya intended to and did procure the breach of the Xtreme Labs Shareholders' Agreement when he asked Varma and Madra to provide him with confidential information from Xtreme Labs before signing the letter of intent in May 2012.

[39] Concerning the conspiracy claim, the trial judge relied on, among other things, Palihapitiya's talk at a Town Hall held with the employees of Xtreme Labs shortly after the sale and his speech at the Collision Conference in 2014 to find that Palihapitiya, Varma and Madra were acting in concert. The requisite unlawful conduct included the breaches of fiduciary duty, contract and warranty, as well as Palihapitiya's knowing assistance in the breach of fiduciary duties and his inducement of the breach of the Xtreme Labs Shareholders' Agreement. This misconduct was directed towards the Respondents and caused damages.

(iii) Remedies

[40] The trial judge found that Fund I, Sharma and Bashir sold their shares of Xtreme Labs based on the wrongful conduct of Palihapitiya, Varma and Madra. Had Fund I, Sharma and Bashir been given accurate information about the financial position and prospects of Xtreme Labs, they would have had the opportunity to negotiate a sale to Palihapitiya or another buyer based on this accurate information or to continue to hold their shares.

[41] Using actual revenues of \$17.2 million (U.S.) for FY 2012, the trial judge multiplied that figure by 1.5, resulting in a revised purchase price of \$25.8 million (U.S.). Since Fund I, Sharma and Bashir owned 64.56% of the shares of Xtreme Labs, the trial judge concluded that they would receive 64.56% of \$17.20 million (U.S.), the latter figure referring to the cash amount they would have received on the new purchase price. In other words, they would have received \$3.36 million (U.S.) more than what they did receive on the sale of the company. Further, because Palihapitiya, Varma, Madra, Investco, Varma Holdco and Madra Holdco were all participants in the acquisition of Xtreme Labs that was based on the breaches of fiduciary and contractual duties and all played a role in the conspiracy, she concluded that they should be jointly and severally responsible for the \$3.36 (U.S.) million in losses.

[42] Regarding Hatch Labs, while the Respondents initially claimed damages for the undervalued share price and lost opportunity, during their closing submissions they sought to amend their claim to elect disgorgement. After considering the Appellants' submissions on prejudice, the trial judge granted leave to amend the claim. She found no non-compensable prejudice in granting the amendment, as it was simply another remedy being asserted and would not take the Appellants by surprise.

[43] At the time of the sale to Palihapitiya (through Investco), Fund I owned 41.82% of the shares of Xtreme Labs and therefore had a 41.82% indirect interest in the Hatch Labs equity. One year later, Palihapitiya, Varma and Madra transferred the Hatch Labs equity to their holding company, 239 Ontario. The shareholders of 239 Ontario were Investco (50%), Varma and Madra (25% each). Six months later, 239 Ontario sold the Hatch Labs equity to IAC for \$30 million (U.S.).

[44] According to the trial judge, by concealing the existence of the Hatch Labs equity, Varma and Madra, working with Palihapitiya/Investco, deprived Fund I of the opportunity to take it into account on the sale of its shares of Xtreme Labs, to renegotiate the terms of sale, or to decide not to sell its shares of Xtreme Labs at that time. Further, as a direct result of this concealment, Varma, Madra and Palihapitiya /Investco were able to profit from Fund I's interest in the Hatch Labs equity. Accordingly, the trial judge found that they should not be entitled to retain the profits attributable to their wrongdoing. A disgorgement order was required to serve a deterrent purpose. However, she found that the order should only apply to the profits that corresponded to Fund I's 41.82% interest in the Hatch Labs equity.

(iv) Exchange Rate and Prejudgment Interest

[45] The trial judge issued supplementary reasons for judgment regarding the exchange rate and prejudgment interest applicable to the awards she made in her primary reasons for judgment.

[46] Orders payable in a foreign currency are subject to s. 121(1) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 ("*CJA*"). The default rule is that the applicable exchange rate to be used is the rate on the day before payment is received by the judgment creditor. However, s. 121(3) of the *CJA* gives the court the discretion to apply a different exchange rate date if it considers using the rate on the day before payment to be inequitable.

[47] The Appellants submitted that the trial judge should exercise her discretion to use the exchange rate that existed on the date of the transactions in question because the current exchange rate reflected a significantly weakened Canadian dollar. Further, the Appellants argued that because the Respondents' expert used the date of the transactions in his report for currency conversion, the Respondents were estopped from asserting a right to the current exchange rate.

[48] The trial judge found that the Appellants had not met their onus of establishing why she should depart from the usual rule regarding the exchange rate. She observed that the s. 121(3) discretion is often exercised with a view to preventing inequity and making plaintiffs whole. Here, however, choosing

the transaction dates with a more favourable exchange rate in favour of the Appellants would allow them to benefit from their wrongful conduct at the expense of the Respondents. Further, she found that the Respondents did not rely on their expert report in closing submissions.

[49] Regarding prejudgment interest on the Xtreme Labs Claim, the parties used the same formula and the same rate of 1.3%. The only issue was the starting date. The Respondents claimed prejudgment interest on the full amount from August 15, 2012. This was the date the Xtreme Labs sale closed and, they submitted, the date the cause of action arose. The Appellants agreed that August 15, 2012 was the date for the Xtreme Labs sale damages but submitted that the loss arising from the Hatch Labs sale only occurred on April 3, 2014, the date when they first received profits from the sale that closed on March 11, 2014.

[50] The trial judge ruled in favour of the Respondents, finding that the Appellants were improperly equating the remedy of disgorgement with the date that the cause of action arose. Disgorgement of profits was the remedy for Varma and Madra's breach of fiduciary duty and Palihapitiya/Investco's knowing assistance concerning the concealment of Xtreme Labs' equity interest in Hatch Labs. The cause of action arose with the concealment of this asset when the Appellants purchased the shares of Xtreme Labs on August 15, 2012. Therefore, the trial judge concluded that this was the date the cause of action arose and the date from which prejudgment interest should be calculated.

Part IV – Analysis

(a) Damages on Sale of Xtreme Labs (Excluding Hatch Labs)

[51] The Appellants make three submissions regarding the award of damages on the sale of Xtreme Labs. I am not persuaded by any of these arguments.

[52] First, they submit that the damages award lacked an evidentiary foundation. In setting a revised purchase price of \$25.8 million (U.S.) and then calculating damages on that basis, they say that the trial judge took an “extraordinary step in crafting her own damages theory.” According to the Appellants, the “trial judge erred in failing to accept the experts’ evidence, absent any cogent reason, given that both parties’ experts agreed there were no damages.”

[53] The jurisprudence recognizes that trial judges are not held to a standard of perfection in making damages awards. Appellate courts will not interfere with reasonable damages awards where they have an evidentiary basis, as damages cannot always be calculated with mathematical precision. Sometimes the trial judge must do the best they can in the circumstances: *Penvidic v. International Nickel*, 1975 CanLII 6 (SCC), [1976] 1 S.C.R. 267, at 280. An appellate court should interfere with a trial judge's damages assessment only if it is “tainted by an error in principle, or is unreasonably high or low”: *Whitefish Lake Band of Indians v. Canada (Attorney General)*, 2007 ONCA 744, 87 O.R. (3d) 321, at para. 28. See also *1758704 Ontario Inc. v. Priest*, 2021 ONCA 588, at para. 70; *Southwind v. Canada*, 2021 SCC 28, 459 D.L.R. (4th) 1, at paras. 153-60.

[54] I am satisfied that there is no basis for interference with the trial judge's damages calculation. She was not obliged to accept the evidence of the expert witnesses on damages. The trial judge reasonably calculated the damages, basing her calculations on the actual revenues for FY 2012 and the fact that the Respondents were amenable to selling at a 1.5 multiplier. This award aimed to put the Respondents in the position they would have been in had they been given correct information regarding the revenues of Xtreme Labs.

[55] Second, the Appellants submit that the trial judge erred in ignoring the lack of evidence of a buyer at a higher price. Their position is that there was no evidence that a \$25.8 million purchase price could have been achieved but for their alleged misconduct. They note as well that there was no suggestion that Palihapitiya, others in his group of buyers or anyone else, would have paid that price.

[56] This submission ignores the critical fact that the misconduct of the Appellants prevented the company from being properly marketed, as the correct underlying revenue and other information was concealed by the Appellants and thus could not be presented to potential buyers. Moreover, the trial judge found that the Respondents were deprived of the opportunity to sell the company or retain their shares and sell at a higher value later. It should be remembered that Xtreme Labs was sold at a much higher value just over one year later.

[57] Finally, the Appellants argue that the Respondents were awarded loss of chance damages that were not claimed or argued at trial. I disagree. While the Respondents changed the methodology of their damages calculation during the course of the trial, they consistently sought damages on the sale of Xtreme Labs. They argued that as a result of the Appellants' misconduct, they did not obtain a fair price on the sale of the company. The trial judge's damages calculation is responsive to that claim.

(b) Amendment to the Statement of Claim

[58] The Appellants submit that the trial judge erred in allowing the Respondents to amend their statement of claim after trial to include a claim for disgorgement. They argue that the presumptive prejudice of late-stage amendments means the party seeking the amendment bears the burden of establishing the absence of irreparable prejudice. According to the Appellants, the trial judge reversed this burden, requiring the Appellants to show prejudice. Further, they note that the Respondents never ended up amending their claim formally, so the trial judge made a finding of liability and awarded substantial damages on a theory that was not pleaded. Counsel for the Varma/Madra Appellants submitted in oral argument that the correct course is to order a new trial on the issue of disgorgement so that his clients may adduce further evidence to respond to this claim. I would not give effect to this argument.

[59] Initially, the Respondents claimed damages for the losses they suffered in selling their shares of Xtreme Labs to Palihapitiya at an undervalued price. They also claimed damages for lost opportunity regarding Hatch Labs due to the concealment of Xtreme Labs' 13% equity interest in that company.

However, due to errors in their expert's report, they were forced to abandon the latter claim. The Respondents raised disgorgement of the profits from the Hatch Labs sale during closing submissions, and the trial judge commented that they appeared to be trying to amend their claim to seek new relief.

[60] The Appellants opposed the amendment, arguing that it would cause non-compensable prejudice because they would have conducted the trial differently if they had known about a claim for disgorgement of profits. After considering the Respondents' submissions, the trial judge gave reasons granting leave to amend the claim to seek disgorgement of profits for Hatch Labs. She concluded that there was no non-compensable prejudice, that disgorgement was simply another remedy being sought, and that the Appellants would not be taken by surprise in any of the substantive allegations or amounts claimed. Further, the trial judge also found that most of the evidence concerning profits was in the Appellants' possession or control.

[61] The Appellants were then given an opportunity to request an adjournment and/or present further evidence and make additional submissions. On their return to court ten days later, the Appellants advised that they maintained their position that they had suffered non-compensable prejudice and that leave to amend should not have been granted. They advised the court that they would not be seeking an adjournment and would not be tendering additional evidence or making further submissions on the Hatch Labs issue.

[62] The trial judge was correct in finding that there was no prejudice to the Appellants. They have not articulated for this court what substantial new evidence they might call at the new trial they are requesting. My view is that they have not done so because there is no new evidence. They knew at trial that there was an allegation that Varma and Madra had hidden Xtreme Labs' equity interest in Hatch Labs. The defence proffered was twofold: (i) they did not know about the interest in Tinder, and (ii) the gains made on the investment were based entirely on a fortuitous series of events that occurred after the closing of the sale. Evidence was tendered in support of these positions. It is reasonable to infer that the same evidence would be presented in a new trial on disgorgement. In any event, the Appellants were given an opportunity to either lead further evidence or seek an adjournment. They declined both options. That was a strategic choice, and the Appellants must live with the consequences of their choice.

[63] The fact that the pleading was not amended is of no moment. Rule 26.06 provides that "[w]here a pleading is amended at the trial, and the amendment is made on the face of the record, an order need not be taken out and the pleading as amended need not be filed or served unless the court orders otherwise": *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194. In the present case, the pleading was effectively amended at trial through the motion judge's order. I am satisfied that the Appellants understood the amended claim against them. Thus, no formal amendment of the statement of claim was necessary.

[64] Finally, the trial judge did not reverse the onus. Here, it was clear to the trial judge that an amendment would cause no irreparable prejudice to the Appellants. The Appellants were given an opportunity to dissuade the trial judge of that view and failed to do so.

(c) Disgorgement Award

[65] The Appellants submit that the trial judge made four errors in making her order for disgorgement independent of her alleged error in permitting the statement of claim to be amended.

[66] First, they submit that the trial judge erred in not requiring a causal relationship between the wrongdoing and the profits to be disgorged. Here, the profits held to have been received from the sale of the Hatch Labs equity were not causally connected to the wrongful conduct. The Hatch Labs equity was only worth at most \$500,000 (U.S.) when the Xtreme Labs sale closed – its increase in value thereafter was due to Tinder's success at the 2014 Sochi Olympics and “a lot of luck.” It is argued that the trial judge allowed the Respondents to take the benefit of a significant increase in value that resulted from external independent events unrelated to the appellants’ conduct.

[67] I am not persuaded that the trial judge erred in this regard. I concur with her statement in paragraph 173 of her reasons where she rejected this same argument:

The defendants argue that no one could have predicted in August 2012 that Tinder would become a great success. There are two problems with this submission. First, it is not consistent with the position advanced by the defendants in their testimony. The defendants did not testify that they were aware of Tinder but failed to disclose it to the board because they thought it had no value at the time. Rather, they testified that they never heard of Tinder until well after the sale transaction. I have rejected their evidence and found that they did know about Tinder at the time of the sale and failed to tell the plaintiffs about it. Second, as fiduciaries, Amar and Sunny had a duty to disclose to the board all of the information with respect to the company’s assets, regardless of whether or not they thought it had the potential for future success at the time. They did not do so.

[68] The trial judge's second point is worth emphasizing. What the fiduciaries did in this case was hide the investment in Hatch Labs/Tinder. As a consequence of their actions, Fund I lost the opportunity to participate in the upside of the investment. It is no defence to such actions to say that no one knew that Hatch Labs would be profitable. A fiduciary has a duty of utmost good faith and an obligation to disclose so that the beneficiary has an opportunity to make an informed decision about the best course of action: see *Hodgkinson v. Simms*, 1994 CanLII 70 (SCC), [1994] 3 S.C.R. 377, at paras. 93-94. By breaching their duty in this case, the appellants denied the respondents the opportunity to make that decision.

[69] Second, the Appellants submit that the trial judge erred in ordering disgorgement from 239 Ontario, Varma and Madra when there was no evidence that they had personally profited from Hatch Labs' sale to IAC. Thus, they say that the trial judge pierced the corporate veil of 239 Ontario, a non-party.

[70] I reject this argument. The trial judge found that the Appellants or their holding companies “wholly owned” 239 Ontario and that a sizable portion of the profits “were distributed” to the Appellants. This was an available inference on the facts as one of the purposes of the conspiracy was to

conceal an asset of Xtreme Labs – namely Hatch Labs – from the selling shareholders for the benefit of the co-conspirators. There was no order that 239 Ontario itself make any disgorgement and therefore no veil piercing or disregard of any corporate form.

[71] Third, the Appellants contend that the trial judge's disgorgement award focused exclusively on the sale price and did not account for deductions/expenses in completing the sale. In effect, the Appellants argue, she made her order in an evidentiary vacuum. But if there was indeed an evidentiary vacuum, it was created by the Appellants. The trial judge recognized that they held the evidence regarding the precise details of the sale. Nevertheless, they elected not to call that evidence and cannot now complain about its absence from the record.

[72] Fourth, the Appellants argue that the trial judge's damages calculation includes an element of double counting. Their position is as follows. The trial judge's calculation is based on an enterprise value of \$25.8 million (U.S.), representing a 1.5 multiple applied to the actual FY 2012 revenues of \$17.2 million (U.S.). The enterprise value, the Appellants claim, included the price of Hatch Labs Equity. Thus, the trial judge erred by ordering both damages that included this value as well as disgorgement of proceeds from the sale of Hatch Labs. Damages and disgorgement are alternative remedies; a plaintiff cannot obtain a judgment for both.

[73] This argument is flawed in its central contention that the value of Hatch Labs was reflected in the damages awarded. That award was made to compensate for the depressed sale price received by the Respondents for Xtreme Labs and was based on the trial judge's assessment of the extent to which the actual FY 2012 figures for the revenues of Xtreme Labs exceeded the depressed figures put forth by Varma and Madra. The trial judge based the damages calculation on a multiple of actual earnings. However, the Hatch Labs equity interest did not contribute to the Xtreme Labs revenue stream during that fiscal year and was therefore not included in the damages calculation. Thus, there was no double counting.

(d) Knowing Assistance in Breach of Fiduciary Duty

[74] The constituent elements of the tort of knowing assistance in the breach of a fiduciary duty are that: (i) there must be a fiduciary duty; (ii) the fiduciary must have breached that duty fraudulently and dishonestly; (iii) the stranger to the fiduciary relationship must have had actual knowledge of both the fiduciary relationship and the fiduciary's fraudulent and dishonest conduct; and (iv) the stranger must have participated in or assisted the fiduciary's fraudulent and dishonest conduct: *Air Canada v. M & L Travel Ltd.*, 1993 CanLII 33 (SCC), [1993] 3 S.C.R. 787, at pp. 811-13.

[75] The Palihapitiya Appellants submit that the trial judge erred in her application of the knowing assistance test because there was no intentional wrongful act in this case. They argue that the trial judge erred in reaching her factual conclusions. They allege, for example, that the trial judge incorrectly concluded that Palihapitiya knew of the Hatch Labs equity and Tinder at the time of closing. In addition, these appellants submit that Palihapitiya's conduct was legal and entirely consistent with Canadian

business conduct standards. To properly analyze this submission, it is necessary to consider its two underlying themes: (i) the trial judge made palpable and overriding errors of fact, and (ii) the trial judge erred in imposing her idiosyncratic moral code upon what was otherwise standard business conduct.

(i) Factual Findings

[76] It should be remembered that the Varma/Madra Appellants accept the factual findings of the trial judge. The Palihapitiya Appellants do not. It is helpful to review some of the significant findings of fact made by the trial judge in her comprehensive reasons for judgment, including the following:

- Varma, Madra and Palihapitiya were incredible witnesses. They were not forthright in their testimony. Their testimony constituted an attempt to get around the contemporaneous emails and documents that contradict their version of events.
- Teslia, Bashir and Sharma were straightforward in their testimony, which was consistent with the documentary evidence.
- Varma, Madra and Palihapitiya worked together and coordinated their efforts to present Palihapitiya's offer to buy Xtreme Labs at the board meeting on March 21. They undertook this coordinated campaign in the weeks leading up to the meeting as proven by their emails, which showed that they were working together on the offer to purchase, had brought "key folks" on board and were planning the "hammer drop" for the board meeting.
- When Varma and Madra presented the offer to the board, they pretended that they were not involved in its creation and acted as though they had just received an unsolicited offer from Palihapitiya. They immediately sent a slide deck recommending the offer and pressured the Respondents intensely to accept the offer over the next few days. They tried to resist a valuation of the company and voted against giving the board an M&A mandate.
- Varma and Madra were motivated by their self-interest because they wanted to increase their compensation and equity interests in Xtreme Labs.
- Varma and Madra downplayed Xtreme Labs' financial prospects to facilitate Palihapitiya's acquisition of the company at a discounted price. The trial judge rejected Varma and Madra's testimony that they thought their \$12 million projection was reasonable as of April 2012. Their testimony was contradicted by the much higher figures they were providing around the same time to others such as Samsung and Palihapitiya.
- Varma and Madra provided Seven Hills with understated revenue projections.
- Contrary to what they were telling the Respondents, Varma and Madra were actually optimistic about the business and its potential for continued growth and knew that upcoming projects would generate significant additional revenues for FY 2012.

- Varma, Madra and Palihapitiya all knew the Pivotal multiple was higher than the 0.75x number contained in Palihapitiya's March 20 offer. Varma and Madra nonetheless conveyed the offer to the board, even though the offer was based upon a number they knew to be understated.
- When told by Sharma that a 3x multiple would be appropriate, Varma and Madra tried to persuade him that the appropriate multiple was a lower number.
- Varma and Madra never disclosed to the board the fact that Xtreme Labs had a 13% equity interest in Hatch Labs, which was significant, given management's view that the way for a fee for service business to evolve was by developing proprietary technology, which is what Hatch Labs was doing.
- Palihapitiya's testimony wherein he denied knowing anything about Hatch Labs at the time of the sale transaction and said that he only learned of the investment shortly after closing was false.
- Varma knew about the development of the Tinder app and its launch in the Apple Store at the time of closing. Further, given how closely Varma, Madra and Palihapitiya were working together on the Xtreme Labs transaction, they clearly all knew about Tinder.

[77] The Palihapitiya Appellants challenge these findings, but they fail to specify, either in their factum or oral submissions, how the trial judge went wrong in her factual analysis or how she made any palpable and overriding errors of fact. They point out, for example, that the initial offer to purchase Xtreme Labs was rejected by the board and thus argue that the offer had no impact. However, this submission ignores the trial judge's finding that the offer was only one instance of the illegal activity employed as part of the ongoing conspiracy to purchase Xtreme Labs at a discounted purchase price.

[78] Another example of an objection to the findings is the specious argument that the board could have discovered the actual revenue numbers if they had undertaken more due diligence. That is not the way corporate law works. A board of directors has a right to believe what its officers and directors are telling it. Where that information is deliberately falsified, as in this case, it is no defence to say that the board should have known better: *Business Corporations Act*, R.S.O. 1990, c. B. 16, s 135(4).

[79] The Palihapitiya Appellants also submit that the trial judge ought to have accepted Palihapitiya's evidence over the testimony of the Respondents. The difficulty with this argument is that Palihapitiya's testimony was contradicted time and again by the written record. Indeed, Palihapitiya's private and public statements are inconsistent with his sworn evidence. I offer the following examples:

- On September 27, 2012 – just seven weeks after closing – Palihapitiya wrote an email to a friend regarding the acquisition of Xtreme Labs, boasting: “25% net cash margins, 100% YoY revenue growth – should do \$35 – 40M next year. We bought it for \$16M. Yum, yum!!!!”
- Palihapitiya spoke at a Town Hall for the Xtreme Labs employees shortly after closing. In his remarks, he talked about how the previous owners of the company were "douchebags," "fuckfaces" and "idiots that were counterproductive." He described how at the 11th hour, the company's ownership

structure got "convoluted," and in his opinion, Varma and Madra "got taken advantage of." He said that "over the course of this last year, sort of instigating and pushing and prodding, we finally found the path to basically buy Xtreme and recapitalize it."

- Palihapitiya's denials about knowing about Hatch Labs and Tinder before closing, as well as his testimony that he found out about Hatch Labs shortly after closing and considered it worthless, were contradicted by a speech he gave at a Collision Conference in 2014. In his speech, Palihapitiya described his strategy in acquiring Xtreme Labs, selling it to Pivotal, carving out the Hatch Labs equity and selling it to IAC four months later. Palihapitiya said he knew that his friend had been developing apps and receiving equity in lieu of payment.

[80] In his testimony, Palihapitiya tried in vain to distance himself from his previous statements. The trial judge saw through that effort. It is difficult to imagine any judge believing his denials and prevarications in spite of the record, and I am satisfied that the trial judge made no factual errors in finding that he was not only an active participant in the core wrongful activity, but also its primary beneficiary. I am fortified in that conclusion by the fact that the Varma/Madra Appellants are not challenging the trial judge's factual findings on these appeals. On the contrary, they sensibly concluded that those findings were unassailable.

(ii) Standard of Business Conduct

[81] I come now to the second theme. As noted earlier, the Palihapitiya Appellants assert that Palihapitiya's conduct was in keeping with how business is conducted in Canada, and the trial judge inappropriately applied her idiosyncratic moral values and thereby found wrongdoing where there was none. The policy issue said to underlie this submission is that allowing trial judges to impose their own moral codes will lead to uncertainty in the corporate world. The crux of the argument is that business people are supposed to maximize profit and look after their own interests; it will lead to uncertainty if they are held to a different standard whereby they are obliged to look out for the best interests of their competition.

[82] This is a straw man argument. Counsel for these appellants queries whether business people should be forced to assume broad and unknowable duties of fairness to their counterparts in transactions. The obvious answer to that question is no. But, of course, that was not the question before the court below or this court. What was in issue was whether the Appellants had breached their duties and/or engaged in tortious conduct by organizing the sale of Xtreme Labs. This was not a case of the trial judge imposing some new morality-based constraints on the way business operates; it was the court applying the settled law of corporations, fiduciary duty, contract, and tort to the conduct of the Appellants. The trial judge correctly rejected the Appellants' submission, finding in her reasons that:

This is not a case of tough business tactics and clever negotiating strategy. Nor is it a case of sellers' remorse. This is a case of a purchaser conspiring with fiduciaries of a company to acquire a business and doing so based on breaches of fiduciary and contractual duties.

[83] Another argument under this theme is that Palihapitiya's real interest was in protecting young tech entrepreneurs and that this motivation somehow rendered his illegal conduct justifiable in the circumstances. The following excerpt from his cross-examination regarding his initial offer to purchase Xtreme Labs is particularly revealing on this point:

Q. Sir, you are a founder of Social Capital, and you talk about having Social Capital values and Chamath values-the highest ethics. Did you find it weird that the potential sellers are helping you with an offer that tightens the screws on them?

A. If you're asking for my opinion, this, Your Honour, it's quite common place. It tends to be the case in Silicon Valley that young founders are so in need of money that many of them do really bad deals at the beginning and then they do find themselves in a situation where their boards really take advantage of them and I do think that this type of stuff is quite common place there amongst these kind of deals because you're not talking about 35, 40, 50-year-old with years of experience, you're talking about folks that are starting their new venture a few years in. They're quite naïve and they often do get taken advantage of and they do react this way.

[84] Remarkably, Palihapitiya does not challenge the premise of the question that Varma and Madra were assisting him in breach of their duties. Instead, he justifies his participation in this conduct on the basis that they had been taken advantage of by the board. It is hard to believe that a business person of Palihapitiya's experience and sophistication believed that his conduct was legal and justified by reason of his co-conspirators' dissatisfaction with their compensation. It is tempting to conclude that Palihapitiya used Varma and Madra for his own purposes and, in the process, reaped a multi-million dollar windfall. However, I need not determine this matter, because even if I believed Palihapitiya's dubious justification, it offers no defence in law.

(e) Joint and Several Liability

[85] The Palihapitiya Appellants submit that the trial judge erred in law by holding them jointly and severally liable with the Varma/Madra Appellants. They argue, relying on an English trial court decision, *Ultraframe (UK) Ltd. v. Fielding*, [2005] EWHC 1638 (Ch.), that a knowing assistant's liability ought not to be synonymous with a fiduciary's because the knowing assistant, who has not given an undertaking of loyalty, is not in the same position as the fiduciary. The court ruled in that case, at para. 1600:

I can see that it makes sense for a dishonest assistant to be jointly and severally liable for any loss which the beneficiary suffers as a result of a breach of trust. I can see also that it makes sense for a dishonest assistant to be liable to disgorge any profit which he himself has made as a result of assisting in the breach. However, I cannot take the next step to the conclusion that a dishonest assistant is also liable to pay to the beneficiary an amount equal to a profit which he did not make and which has produced no corresponding loss to the beneficiary. As James LJ pointed out in *Vyse v. Foster* (1872) LR 8 Ch App 309:

"This Court is not a Court of penal jurisdiction. It compels restitution of property unconscientiously withheld; it gives full compensation for any loss or damage through failure of some equitable duty; but it has no power of punishing any one. In fact, it is not by way of punishment that the Court ever charges a trustee with more than he actually received, or ought to have received, and the appropriate interest thereon. It is simply on the ground that the Court finds that he actually made more, constituting moneys in his hands "had and received to the use" of the *cestui que trust*."

[86] There is Canadian jurisprudence where our courts have found a knowing assistant to be jointly and severally liable: see, for example, the decision of this court in *Enbridge Gas Distribution Inc. v. Marinaccio*, 2012 ONCA 650. Contrary to the assertion of the Palihapitiya Appellants, the Canadian cases do not all involve situations where the knowing assistant was found to be a constructive trustee: see, for example, *Imperial Parking Canada Corporation v. Anderson*, 2015 BCSC 2221. Counsel for the Palihapitiya Appellants was unable to point to any Canadian authority that supports his position.

[87] There is also academic commentary that supports a finding of joint and several liability for the knowing assistant (also referred to by some as the dishonest assistant). Steven Elliott and Professor Charles Mitchell, in their article "Remedies for Dishonest Assistance", (2004) 67 Mod L Rev 16, write at p. 40 that:

[A] well established line of Canadian authority flowing from *Canada Safeway Ltd v Thompson* tells us that a dishonest assistant is jointly and severally liable for whatever unauthorised profit the wrongdoing fiduciary has made....This is consistent with and finds support in the secondary nature of liability for dishonest assistance. [Footnotes omitted.]

[88] *Ultraframe* is the leading case in England on the issue of a knowing assistant's joint and several liability: see Geoffrey Morse, ed, *Palmer's Company Law* (London, UK: Sweet & Maxwell, 2021), at vol. 2, ch. 8.3614. Based on a legal article filed with this court, however, it appears that the English approach towards knowing assistance is not followed in Australia: see Madison Robins, "Accessory Liability in Canadian Law" (2020) Annual Rev Civ Litigation 1, at p. 9. In any event, there is little reason to hew closely to the *Ultraframe* approach; the reasoning in that case is in my view inconsistent with the policy goals underlying equitable remedies. A court exercising its equitable jurisdiction seeks to fashion remedies that are fair in the circumstances of the case before it. While I agree that a knowing assistant should not be penalized, experience tells us that a judgment against a faithless fiduciary is often uncollectable. Indeed, that is one of the reasons why plaintiffs normally seek an order for joint and several liability. As between the wronged beneficiary and the knowing assistant, in most circumstances, the loss more equitably falls on the shoulders of the knowing assistant who has deliberately taken steps to procure a breach of fiduciary duty.

[89] I do not purport to establish a rule that liability should always be joint and several between the faithless fiduciary and the knowing assistant. There may be circumstances where a different order should be made. Courts should be given sufficient flexibility to fashion a fair remedy in the

circumstances of the particular case. In this case, where Palihapitiya was intimately involved in the breach of the fiduciary duty as part of a conspiracy where he received most of the profits, there is no equitable reason why the liability should not be joint and several.

(f) Other Grounds of Appeal

[90] The parties were allocated two full days of court time to argue the appeals and cross-appeal. However, counsel for the Appellants chose to restrict their oral submissions to the issues discussed above. Therefore, the remaining grounds of appeal from their factums, which were not pressed in oral argument, may be dealt with summarily as follows.

(i) Punitive Damages

[91] The trial judge did not err in awarding punitive damages on the Annex Fund Claim. Varma and Madra engaged in outrageous and illegal conduct that was worthy of sanction by the court. The damages awarded were appropriate to accomplish the objectives of denunciation and deterrence of others from acting similarly. Indeed, they could well have been higher in the circumstances.

(ii) Exchange Rate and Prejudgment Interest

[92] The trial judge did not err in exercising her discretion not to deviate from the default rules for prejudgment interest and the exchange rate. In both instances, she correctly applied the law and ruled that the Appellants had not met their onus to establish that a variation of the standard rule was appropriate.

(iii) Group Enterprise Theory

[93] The trial judge did not use the group enterprise theory to affix liability for any breach of fiduciary duty. The Appellants' argument that any breach of duty was owed exclusively to Xtreme Labs does not withstand scrutiny. I agree with the trial judge that Varma and Madra owed fiduciary duties to EVP GP to maximize the value realized by the sellers as part of the sale of Xtreme Labs and that they breached those duties.

(iv) Directors' Liability

[94] The Appellants argue in their factums that they cannot be held liable for any breach because the party to whom they owed the duty, EVP GP, is different than the party that suffered the loss, Fund I. In rejecting this argument, I reach the same conclusion as the trial judge but for different reasons.

[95] I note that the position taken by the Appellants that no duty was owed directly to the Limited Partnership is inconsistent with the text of the Limited Partnership Agreement. Article 6.5 of that document states that the General Partner and its "officers, directors, shareholders or agents" can be

liable to the Limited Partnership or a Limited Partner for acts or omissions “performed or omitted fraudulently or in bad faith” or that “constituted willful misfeasance or negligence in the performance of their obligations or as a result of the reckless disregard of such obligations.”

[96] Moreover, it would be an anomalous result if the law offered no remedy for the breach of a director's fiduciary duty in circumstances where the limited partnership suffered the resulting loss. If that were the case, directors could act with impunity to damage the interests of the limited partnership, including by engaging in self-dealing, and there would be no remedy for such a breach of fiduciary duty. The law of fiduciary duties, which is based in equity, should not brook such a lacuna in its remedies.

[97] To analyze this issue it is helpful to turn to first principles. Before doing so, I note that the trial judge relied on *McGrail v. Phillips*, 2018 ONSC 3571, 83 B.L.R. (5th) 271 (Div. Ct.), at para. 33, for the proposition that the directors owe a duty only to the corporate general partner, not to the limited partnership itself. The Divisional Court in that case in turn cited to *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.* (1995), 1995 CanLII 1301 (ON CA), 26 O.R. (3d) 481 (C.A.). *McGrail* is not binding on this court. Moreover, the problem with relying on *ScotiaMcLeod*, and by extension *McGrail*, is that *ScotiaMcLeod* did not feature a fiduciary duty claim. The court's comments regarding the personal liability of directors were in the context of claims in tort and are of limited assistance in analyzing a claim for breach of fiduciary duty.

[98] In the present case, we are dealing with a limited partnership, which is a hybrid organization that combines elements of partnership law and the law of corporations. A limited partnership consists of a general partner, who manages the affairs of the limited partnership and has liability for all its debts and obligations and at least one limited partner, whose liability is restricted to the amount they contributed or agreed to contribute to the limited partnership. The general partner owes a fiduciary duty to the limited partners. Limited partnerships are not a distinct legal entity. Despite this, the law permits a limited partnership to act as a distinct legal entity for certain limited purposes. A limited partnership can, for example, bring and defend actions: Neil Guthrie, “Some Lacunae in the Law of Limited Partnerships” (2009) 88 Can Bar Rev 147 at 148-49.

[99] The question is whether Varma and Madra's fiduciary duty should expand to include a duty to the limited partnership. In my view, it should. Varma and Madra conducted themselves in a manner that clearly breached their duties to EVP GP. This is not a situation where they were balancing the corporation's interests against those of the limited partnership. Instead, they acted solely in their self-interest and contrary to the interests of both the general partner and the limited partnership. For that reason, they are being sued by both Fund I and EVP GP.

[100] Where, as here, the directors ignore the interests of the general partners and the limited partnership and act solely in their self-interest, the concept of a director's fiduciary duty should be flexible enough to include duties to both the general partner and the limited partnership. Further, it

should come as no surprise to the corporate directors that the limited partnership, which stands in a fiduciary relationship to the general partner and whose interests are supposed to be safeguarded, should have a right to claim against them personally.

[101] In a limited partnership the *raison d'être* of the general partner is to manage the business operations of the limited partnership and shield the limited partners from the unlimited liability they would face in a partnership. The use of the corporate form by the general partner is in turn designed to limit its liability exposure. It would be inequitable if the corporate form could be used to insulate directors who are in breach of their duties to the general partner and who have caused damages to the limited partnership. Given the unique structure of limited partnerships, the common law should impose a fiduciary duty on corporate directors of the general partner towards the limited partnership.

[102] It is well established that the “categories of fiduciary relationship are never closed”: *Frame v. Smith*, 1987 CanLII 74 (SCC), [1987] 2 S.C.R. 99, at para. 36; see also *Guerin v. R.*, 1984 CanLII 25 (SCC), [1984] 2 S.C.R. 335 at 384. Certain status relationships—solicitor-client or doctor-patient, for example—give rise to a *per se* fiduciary relationship. In other circumstances, courts can find an *ad hoc* fiduciary duty. Such a duty arises where: (1) the fiduciary has the discretionary power to affect the vulnerable party’s legal or practical interests and (2) the fiduciary has made an express or implied undertaking that it will exercise the discretionary power in the vulnerable party’s best interests: *Galambos v. Perez*, 2009 SCC 48, [2009] 3 S.C.R. 247, at paras. 66, 83.

[103] Varma and Madra owed the limited partnership an *ad hoc* fiduciary duty. Both the limited partners and the limited partnership constituted a class of vulnerable and defined beneficiaries, whose legal and substantial practical interests stood to be and in fact were adversely affected by Varma and Madra’s exercise of discretion. Varma and Madra’s undertaking arose from the nature of the business relationship itself—a general partner operates on behalf of the limited partnership—as well as from the Limited Partnership Agreement, which recognized the duty of the general partners towards the limited partners and the limited partnership.

[104] Further, I note that certain jurisdictions in the United States have similarly determined that the liability owed by a general partner to the limited partnership should be expanded: see Colin P. Marks, “Piercing the Corporate Veil” (2015) 19 Lewis & Clark L Rev 73 at 83; J. William Callison & Maureen A. Sullivan, *Partnership Law & Practice* (St. Paul, MN: Thomson Reuters, 2021) at § 22:18; *In re Harwood*, 637 F (3d) 615 at 622 (5th Cir 2011); One seminal American case is *In re USACafes, L.P. Litig.*, 600 A (2d) 43 (Del Ch 1991). Delaware courts have consistently upheld and in certain cases expanded the reach of that decision: Marks, at 83, 85. In *USACafes*, Chancellor Allen drew an analogy to corporate trustees:

While the parties cite no case treating the specific question whether directors of a corporate general partner are fiduciaries for the limited partnership, a large number of trust cases do stand for a principle that would extend a fiduciary duty to such persons in certain circumstances. The problem comes up in trust law because modernly corporations may serve as trustees of express trusts. Thus, the question has arisen whether directors of a corporate trustee may personally owe duties of loyalty to cestui que trusts of the corporation. A leading authority states the accepted answer:

The directors and officers of [a corporate trustee] are certainly under a duty to the beneficiaries not to convert to their own use property of the trust administered by the corporation. . . . Furthermore, the directors and officers are under a duty to the beneficiaries of trusts administered by the corporation not to cause the corporation to misappropriate the property. . . . The breach of trust need not, however, be a misappropriation. . . . Any officer [director cases are cited in support here] who knowingly causes the corporation to commit a breach of trust causing loss . . . is personally liable to the beneficiary of the trust. . . .

Moreover, a director or officer of a trust institution who improperly acquires an interest in the property of a trust administered by the institution is subject to personal liability. He is accountable for any profit. . . . Even where the trustee [itself] is not liable, however, because it had no knowledge that the director was making the purchase . . ., the director . . . is liable to the beneficiaries. . . . The directors and officers are in a fiduciary relation not merely to the [corporation] . . . but to the beneficiaries of the trust administered by the [corporation].

[105] Chancellor Allen also made the following comments that are particularly pertinent to the circumstances of the case at bar:

The theory underlying fiduciary duties is consistent with recognition that a director of a corporate general partner bears such a duty towards the limited partnership. That duty, of course, extends only to dealings with the partnership's property or affecting its business, but, so limited, its existence seems apparent in any number of circumstances. Consider, for example, a classic self-dealing transaction: assume that a majority of the board of the corporate general partner formed a new entity and then caused the general partner to sell partnership assets to the new entity at an unfairly small price, injuring the partnership and its limited partners. Can it be imagined that such persons have not breached a duty to the partnership itself? And does it not make perfect sense to say that the gist of the offense is a breach of the equitable duty of loyalty that is placed upon a fiduciary?[1]⁵

[106] I agree with and adopt Chancellor Allen's analysis. In my view, for the reasons discussed above, the law of fiduciary duty must hold Madra and Varma to account. Accordingly, I would find that they are both liable to Fund I for their fiduciary breaches as directors of EVP GP.

5. See also Ben Barnes, Do Fiduciaries of Fiduciaries Owe Duties? (2019), online: American Bar Association <<https://www.americanbar.org/groups/litigation/committees/business-torts-unfair-competition/practice/2019/imposition-fiduciary-duties-departing-llc-members1/>>

(g) Cross-Appeal

[107] The trial judge based the amount of the disgorgement award on the proportion of shares of Xtreme Labs that Fund I held at the time of the transaction. Her reasoning is summarized at paragraphs 297 to 298 of her reasons:

[297] By concealing the existence of the Hatch Labs Equity, Amar and Sunny (working with Chamath/El Investco) deprived Fund I of the opportunity to take it into account on the sale of its shares of Xtreme Labs, to renegotiate any terms of sale or to decide not to sell its shares of Xtreme Labs at that time. Further, as a direct result of this concealment, Amar, Sunny, and Chamath/El Investco were able to profit from Fund I's interest in the Hatch Labs Equity. In my view, they should not be entitled to retain the profits attributable to their wrongdoing. A disgorgement order is required to serve a deterrent purpose in this case.

[298] In determining the extent of this equitable relief, however, I agree that the disgorgement order should only apply to the profits that correspond to Fund I's 41.82% interest in the Hatch Labs Equity. Those are the only profits that flow from the breach of fiduciary duty. Concealment of the Hatch Labs Equity deprived Fund I from realizing 41.82% of the profits from the sale of the Hatch Labs Equity. Any disgorgement order beyond that would result in Fund I receiving profits to which it was not otherwise entitled. [33]

[108] The cases cited in footnote 33, *Olson v. Gullo*, (1994), 1994 CanLII 1268 (ON CA), 17 O.R. (3d) 790 (C.A.) and *Rochweg v. Truster* (2002), 2002 CanLII 41715 (ON CA), 58 O.R. (3d) 687 (C.A.), are relied upon by the Appellants on the cross-appeal.

[109] The Respondents submit that the trial judge committed an error in principle because prophylactic disgorgement is aimed not at what the beneficiaries lost but rather at what the wrongdoers gained. They say that the apportioned disgorgement award issued by the trial judge represents an outcome where the wrongdoers are no worse off than if they had never breached fiduciary duties in the first place – meaning no deterrence has been achieved. Thus, they argue that disgorgement should be ordered for all profits made from the Hatch Labs Equity sale, which is \$29.5 million (U.S.).

[110] The Appellants submit that the trial judge followed the law correctly and that there is no causal connection between the additional profits sought and any wrongdoing found to have been committed against Fund I. There is, in their submission, no right to profits unrelated to the breach. They note that Fund I has no claim to the remaining 58.18% of the profits, and no other shareholders of Xtreme Labs sought or established a fiduciary breach against the Appellants that could ground disgorgement of this portion of the profits.

[111] The leading case on disgorgement of profits is *Strother v. 3464920 Canada Inc.*, 2007 SCC 24, [2007] 2 S.C.R. 177, where the Supreme Court stated:

74. This Court has repeatedly stated that "[e]quitable remedies are always subject to the discretion of the court". (internal citations omitted) In *Neil*, the Court stated emphatically: "It is one thing to demonstrate a breach of loyalty. It is quite another to arrive at an appropriate remedy" (para. 36).

75. Monarch seeks "disgorgement" of profit earned by Strother and Davis. Such a remedy may be directed to either or both of two equitable purposes. Firstly, is a *prophylactic* purpose, aptly described as appropriating for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest.

(*Chan v. Zacharia* (1984), 154 C.L.R. 178, *per* Deane J., at p. 198)

76. The second potential purpose is *restitutionary*, i.e. to restore to the beneficiary profit which properly belongs to the beneficiary, but which has been wrongly appropriated by the fiduciary in breach of its duty. ...

77. The concept of the *prophylactic* purpose is well summarized in the Davis factum as follows:

[W]here a conflict or significant possibility of conflict existed between the fiduciary's duty and his or her personal interest in the pursuit or receipt of such profits . . . equity requires disgorgement of any profits received even where the beneficiary has suffered no loss because of the need to deter fiduciary faithlessness and preserve the integrity of the fiduciary relationship. [Emphasis omitted; para. 152.]

Where, as here, disgorgement is imposed to serve a *prophylactic* purpose, the relevant causation is the breach of a fiduciary duty and the defendant's gain (not the plaintiff's loss). Denying Strother profit generated by the financial interest that constituted his conflict teaches faithless fiduciaries that conflicts of interest do not pay. The prophylactic purpose thereby advances the policy of equity, even at the expense of a windfall to the wronged beneficiary.

[112] In my view, it is evident that the disgorgement order was imposed to serve a prophylactic purpose. Indeed, the trial judge stated explicitly that a "disgorgement order is required to serve a deterrent purpose in this case." Further, there is a clear nexus between the breach of the fiduciary duties and the gains as the profits were secured as a direct result of the breach. Thus, the necessary causal connection has been established.

[113] In the circumstances, the trial judge was obliged to fashion a remedy that would have a deterrent impact. I agree with counsel for the Respondents that simply ordering the Appellants to pay the Respondents what they would otherwise have been entitled to receive serves as no disincentive. A party considering breaching a fiduciary duty could reasonably look at the trial judge's decision and conclude that in a worst-case scenario, they would only be forced to pay over to the aggrieved beneficiary what the beneficiary was always owed, thereby profiting from the breach of their fiduciary duties.

[114] The Appellants' reliance on *Olson* and *Rochweg* is also misplaced. In those cases, which were decided under the *Partnership Act*, R.S.O. 1990, c. P.5, the courts did not impose disgorgement orders for a prophylactic purpose; they were made for restitutionary purposes. Thus, these authorities are of no assistance to the court in this case where the trial judge chose to make the order for a prophylactic purpose. Similarly, the Appellants' argument about the Respondents receiving a windfall fails because,

in the case of a prophylactic disgorgement order, the focus of the inquiry is not the beneficiary's loss but the gain of the faithless fiduciary. This is so even if there is a potential windfall to the beneficiary:

Strother, at para. 77.

[115] The question that remains is whether, in fashioning a prophylactic disgorgement order, the court is required to order disgorgement of all ill-gotten gains or whether it can make an order that achieves its deterrent purposes but does not require full disgorgement. When this issue was put to counsel for the Respondents, she took the position that the jurisprudence appears to call for full disgorgement. On the other hand, counsel for the Appellants took no position on this issue. In other words, they offered no assistance to the court regarding a sum short of full disgorgement that would meet the deterrent purpose.

[116] There may well be circumstances where it would be inequitable to order a faithless fiduciary to disgorge all profits. Equity seeks what is fair and what is fair should be determined with flexibility, not by means of hard and fast rules. For that reason, I would not endorse an inflexible rule that full disgorgement of all profits must be ordered in all cases, but nor would I speculate on the sorts of reasons that may justify something less than full disgorgement. I note that Australian courts have grappled with the circumstances in which full disgorgement ought to be made and whether there should be a rebuttable presumption that full disgorgement is appropriate: see e.g. *Warman International Ltd v. Dwyer*, [1995] HCA 18, at paras. 33-35. I decline to decide these questions today, as counsel for the Appellants failed to address either point.

[117] There is nothing to suggest that a partial disgorgement order should be made in the case at bar. Certainly, counsel for the Appellants did not argue for such an order nor did he offer any suggested amount for such an award in response to questions from the court. In these circumstances, an order of disgorgement of all profits – \$29.5 million (U.S.) – is in my view appropriate.

Part V – Disposition

[118] I would dismiss the appeals of the Palihapitiya Appellants and the Varma/Madra Appellants. I would allow the cross-appeal.

[119] Regarding costs of the appeals and cross-appeal, the parties may make written submissions. The Respondents' submissions are due within two weeks of the release of these reasons. They shall be no more than five pages in length plus a costs outline. The Palihapitiya Appellants and the Varma/Madra Appellants' submissions are also limited to five pages each, and they are both required to file a costs outline. Those submissions are due one week after receiving the Respondents' cost submissions. The Respondents may file reply submissions of no more than three pages within a week of receiving the Appellants' costs submissions.

Released: December 1, 2021 "CWH"

"C.W. Hourigan J.A."

"I agree. Grant Huscroft J.A."

"I agree. S. Coroza J.A."

TAB 6

2022 CarswellOnt 10973
Supreme Court of Canada

Amar Varma, et al. v. Extreme Venture Partners Fund I LP, et al.

2022 CarswellOnt 10973, 2022 CarswellOnt 10974

Amar Varma, Sundeep Madra, Varma Holdco Inc., Madra Holdco Inc., Chamath Palihapitiya and El Investco 1 Inc. (Applicants) and Extreme Venture Partners Fund I LP, EVP GP Inc., Ravinder Kumar Sharma, Imran Bashir, Kenneth Teslia, Extreme Venture Partners Annex Fund I LP and EVP GP Annex Fund I Inc. (Respondent)

None given.

Judgment: August 4, 2022

Docket: 40079

Proceedings: Leave to appeal refused, 2021 CarswellOnt 18074, 340 A.C.W.S. (3d) 363, 2021 ONCA 853, 77 C.P.C. (8th) 37, 24 B.L.R. (6th) 38 (Ont. C.A.)Reversed in part, 2019 CarswellOnt 7501, 308 A.C.W.S. (3d) 514, 2019 ONSC 2907, 94 B.L.R. (5th) 38 (Ont. S.C.J. [Commercial List])Affirmed, 2019 CarswellOnt 11923, 308 A.C.W.S. (3d) 628, 148 O.R. (3d) 360, 2019 ONSC 4459, 94 B.L.R. (5th) 119, 46 C.P.C. (8th) 148 (Ont. S.C.J. [Commercial List])Additional reasons, 2019 CarswellOnt 7501, 308 A.C.W.S. (3d) 514, 2019 ONSC 2907, 94 B.L.R. (5th) 38 (Ont. S.C.J. [Commercial List])

Counsel: Counsel — not provided

Subject: Civil Practice and Procedure; Contracts; Corporate and Commercial; Intellectual Property; Torts

Business associations

Civil practice and procedure

Intellectual property

Remedies

Torts

Per curiam:

¹ The application for leave to appeal from the judgment of the Court of Appeal for Ontario, Numbers C67057, C67062, C67364 and C67376, 2021 ONCA 853, dated December 1, 2021 is dismissed with costs.

TAB 7

At para(s) 36, 37, 37 (majority), 71 (dissent)

Molchan v. Omega oil and Gas Ltd., 1988 CanLII 103 (SCC), [1988] 1 SCR 348

Date: 1988-02-25

File number: 19687

Other citations: 47 DLR (4th) 481 — 83 NR 25 — [1988] 3 WWR 1 — 57 Alta LR (2d) 193 — 87 AR 81 — [1988] CarswellAlta 17 — [1988] SCJ No 12 (QL)

Citation: Molchan v. Omega oil and Gas Ltd., 1988 CanLII 103 (SCC), [1988] 1 SCR 348, <<https://canlii.ca/t/1fthh>>, retrieved on 2024-04-25

Most recent unfavourable mention: 337965 B.C. Ltd. v. Tackama Forest Products Ltd., 1991 CanLII 1436 (BC SC)

molchan v. omega oil and gas ltd., [1988] 1 S.C.R. 348

Myron L. Molchan

Appellant

v.

Omega Oil and Gas Ltd., Omega Oil & Gas Ltd. carrying on business pursuant to the Limited Partnership Omega Oil and Gas Fund 1, Omega Hydrocarbons Ltd. and Thomas Jack Hall (otherwise known as Thomas J. Hall and Jack Hall)

Respondents

INDEXED AS: MOLCHAN v. OMEGA OIL AND GAS LTD.

File No.: 19687.

1987: October 23; 1988: February 25.

Present: Beetz, Estey, McIntyre, Lamer and Wilson JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ALBERTA

Partnership -- Relationship between general and limited partners -- Partnership's capital exhausted and certain operations ceased -- General Partner buying partnership's non-producing lands in return for common shares in parent company -- Lands in turn sold to parent company -- Whether or not general partner in breach of statutory duty not to do any act making it impossible to carry on the ordinary business of the limited partnership -- Whether or not General Partner in breach of fiduciary duty to Limited Partner -- Partnership Act, R.S.A. 1980, c. P-2, s. 55(b).

Courts -- Appellate court jurisdiction -- Whether or not appellate court's powers of review properly exercised -- Judicature Act, R.S.A. 1980, c. J-1, s. 3 -- Alberta Rules of Court, Rules 505, 518.

Omega Oil and Gas Fund 1 was a limited partnership consisting of 60 units with a 70 per cent interest in the partnership, and respondent Omega Oil and Gas Ltd. was a general partner with a 30 per cent interest in the partnership. When the partnership had exhausted all its apparent sources of capital for the partnership and discontinued drilling operations, the General Partner offered to purchase the Limited Partners' units with common shares in its parent company, Omega Hydrocarbons Ltd. A direct form of buy-out was precluded by tax considerations. The General Partner then sold all the non-producing lands of the partnership to Hydrocarbons and the proceeds were applied to the reduction of bank debt. No issue was raised as to the adequacy of such price. The partnership retained certain lands.

The appellant rejected the offer to purchase and commenced an action. The case was ordered to proceed on the issue of liability only, with an accounting to be held by subsequent trial if the plaintiff were successful on the issue of liability. At the trial as to liability, it was found that (1) the sale of the non-producing lands breached the *Partnership Act*; (2) the partnership continued to subsist; (3) Hydrocarbons and the General Partner were *de facto* one entity; and (4) Hydrocarbons acquired the non-producing lands knowing that the transfer was in breach of the Act. An accounting was ordered. The Alberta Court of Appeal did not directly reverse the finding that sale of these lands breached the *Partnership Act* but rather considered the fiduciary duty arising in the operation of the Limited Partnership. It dismissed appellant's claim for the return of the non-producing lands to the General Partner.

Held (Wilson J. dissenting): The appeal should be dismissed.

Per Beetz, Estey, McIntyre and Lamer JJ.: The plaintiff can only complain of the General Partner's sale of assets if the partnership agreement was breached or if the sale contravened a statute or some rule of common law.

The partnership is still in existence and is in receipt of oil and gas revenue. Neither the producing lands nor an interest in lands were conveyed away or otherwise disposed of by the General Partner. The disposition of the non-producing properties, by itself, did not make it impossible to carry on the ordinary business of the partnership and the announcement of present plans not to drill was not by itself conclusive evidence of the impossibility of conducting the ordinary business of the partnership. Section 55(b) of the *Partnership Act* does not require that all facets of the ordinary business of the partnership be rendered impossible but rather refers to a substantial portion of its ordinary business.

The condition prescribed in s. 55(b) has, by necessary implication, not been met. The ongoing income of the partnership from oil and gas properties, the ownership of interests in oil and gas properties, and the ownership of capped gas wells must form a part of the expression "operating oil, gas and other mineral properties and interests" used in the limited partnership agreement in defining the objects and the undertaking of the partnership.

The partnership agreement, while granting power of sale to the General Partner, contained no express term whereunder the General Partner could sell partnership assets to itself. Special provisions in the partnership agreement recognize that the General Partner may carry on transactions with the partnership or otherwise which may conflict with the interests of the partnership and the other partners.

The highest status of the General Partner under the limited partnership is assumed to be that of a trustee holding the properties of the partnership on behalf of all other partners. A purchase of trust property by a trustee is voidable within a reasonable time at the instance of any beneficiary. This rule as applied to corporate fiduciaries, however, is subject to exceptions when those to whom the duty is owed have agreed to such exceptions or have consented to a sale of assets to the fiduciary with full knowledge of that sale. Further, in certain special circumstances a court of equity may approve a sale of trust assets to a trustee and there was no justification for a denial of that approval if sought. Canadian courts have indicated *ex post facto* approval of sales to a trustee will be given in exceptional circumstances.

Respondent owed appellant a fiduciary duty but that duty was not breached by the sale of the non-producing lands. There was no evidence or finding of bad faith or of any attempt to pay inadequate compensation. The sale was in the partnership's best interest, given its strained financial situation, and the partnership agreement provided the General Partner with power to dispose of properties at its discretion.

At the time of its approval of this sale the Court of Appeal was not in a position that it had no alternative but to approve. The Court of Appeal by dismissing appellant's action thereby denied his claim for an order directing the return of the non-producing lands to the General Partner. It therefore necessarily determined that the sale breached no fiduciary duty arising in the respondent General Partner in favour of the appellant, or at least did not do so in the special relationships here existing between the parties. Assuming such transfer requires judicial approval, it follows that the retrospectivity of that approval would not, in the Court of Appeal's view, be a bar.

Per Wilson J. (dissenting): The trial judge found on the evidence that the sale of the non-producing lands of the partnership made it impossible to carry on the ordinary business of the partnership as reflected in its constitutive documents. Where a trial judge makes a finding of fact based in part on the credibility of witnesses, an appeal court should not overturn that finding unless it can be shown that the finding was "palpably wrong". The Court of Appeal did not expressly overturn the trial judge's finding. Even if it could be said that it did so impliedly by dismissing the appellant's action, it did so without identifying any palpable error. The trial judge was entitled to make the finding he did on the evidence and, having made a finding of liability, made a valid order for accounts and inquiries pursuant to the *Partnership Act* and the *Alberta Rules of Court*.

The Court of Appeal, having found no error by the trial judge, in effect conducted a trial *de novo* on the issue of breach of fiduciary duty, a matter not canvassed at all by the trial judge. Finding no breach, it dismissed the appellant's action. Accordingly, after succeeding at trial the appellant found himself out of court, not because the Court of Appeal found the trial judge erred in finding liability for breach of the *Partnership Act*, but because the Court of Appeal could find no liability for breach of fiduciary duty.

The *Partnership Act* gives limited partners broad rights of account and information when circumstances, such as a breach of s. 55(b) of the Act, render it just and reasonable. It is not necessary to seek a dissolution. An accounting without a dissolution is appropriate where, as in this case, the propriety of a specific transaction only is attacked. The partners can then sue for an accounting to obtain whatever benefit is due to them as a result of that transaction. The trial judge's order was also a reasonable exercise of the trial judge's discretion to direct accounts or inquiries under the *Alberta Rules of Court*.

On the issue of breach of fiduciary duty the sale by the General Partner of the non-producing lands of the partnership to itself, without the consent of all the Limited Partners, is a classic breach. The fiduciary must not sell to himself or herself property which rightly belongs to the *cestui que trust*. Any such sale is voidable at the instance of the limited partners even if the General Partner acted in good faith and paid a fair consideration for the property. It would take the clearest of language in the constitutive documents of the partnership to permit such a sale and no such language is present. The partnership agreement did not go so far as to permit the sale of partnership assets by the General Partner to itself.

This was not an appropriate case for *ex post facto* court approval. Respondent could not show that the sale of the property was necessary, that no other purchaser was forthcoming or was likely to come forward within a reasonable time and that its offer in the circumstances was a favourable one. The onus of establishing this was on the respondents and not on the appellant to show prejudice from the sale of the partnership's non-producing assets. Moreover, it was an almost impossible onus for the respondents to meet having regard to the trial judge's finding that the sale violated s. 55(b) of the *Partnership Act*. Indeed, if the trial judge is correct and his finding in that regard has not been reversed, the jurisdiction of a court to give retrospective approval to such a sale may be a matter of considerable doubt.

Cases Cited

By Estey J.

Referred to: *Lumley v. Wagner* (1852), 1 De G. M. & G. 604, 42 E.R. 687; *Lumley v. Gye* (1853), 2 El. & Bl. 216, 118 E.R. 749; *Ex P. James* (1803), 8 Ves. Jun. 337, 32 E.R. 385; *Aberdeen Railway Co. v. Blaikie Brothers* (1854), 1 Macq. 461; *Holder v. Holder*, [1968] Ch. 353; *Regal (Hastings), Ltd. v. Gulliver*, [1942] 1 All E.R. 378; *Act Oils Ltd. v. Pacific Petroleum Ltd.* (1975), 1975 CanLII 1011 (AB CA), 60 D.L.R. (3d) 658; *Midcon Oil & Gas Ltd. v. New British Dominion Oil Co.*, 1958 CanLII 42 (SCC), [1958] S.C.R. 314; *In re Baskerville Estate*, 1946 CanLII 122 (SK KB), [1946] 3 W.W.R. 347; *Re Courtney and Mackie* (1972), 1972 CanLII 837 (SK KB), 23 D.L.R. (3d) 564; *Campbell v. Walker* (1800), 5 Ves. Jun. 678, 31 E.R. 801; *Farmer v. Dean* (1863), 32 Beav. 327, 55 E.R. 128; *Tennant v. Trenchard* (1869), 4 Ch. App. 537.

By Wilson J. (dissenting)

Stein v. The Ship "Kathy K", 1975 CanLII 146 (SCC), [1976] 2 S.C.R. 802; *Métivier v. Cadorette*, 1975 CanLII 2 (SCC), [1977] 1 S.C.R. 371; *Jaegli Enterprises Ltd. v. Taylor*, 1981 CanLII 26 (SCC), [1981] 2 S.C.R. 2; *Doerner v. Bliss & Laughlin Industries Inc.*, 1980 CanLII 50 (SCC), [1980] 2 S.C.R. 865; *Schreiber Brothers Ltd. v. Currie Products Ltd.*, 1980 CanLII 11 (SCC), [1980] 2 S.C.R. 78; *Lewis v. Todd*, 1980 CanLII 20 (SCC), [1980] 2 S.C.R. 694; *Wire Rope Industries of Canada (1966) Ltd. v. B.C. Marine Shipbuilders Ltd.*, 1981 CanLII 182 (SCC), [1981] 1 S.C.R. 363; *Lensen v. Lensen*, 1987 CanLII 4 (SCC), [1987] 2 S.C.R. 672; *Colberg v. Braunberger's Estate* (1978), 1978 ALTASCAD 307 (CanLII), 12 A.R. 183; *Carter v. Ferguson*, 1943 CanLII 463 (AB CA), [1943] 2 W.W.R. 38; *Clarke v. Gerbrandt* (1984), 1984 ABCA 305 (CanLII), 34 Alta. L.R. (2d) 289; *Angus v. City of Edmonton* (1977), 1977 ALTASCAD 61 (CanLII), 3 A.R. 116; *Ex. P. James* (1803), 8 Ves. Jun. 337, 32 E.R. 385; *Aberdeen Railway Co. v. Blaikie Brothers* (1854), 1 Macq. 461; *Act Oils Ltd. v. Pacific Petroleum Ltd.* (1975), 1975 CanLII 1011 (AB CA), 60 D.L.R. (3d) 658; *Malone's Guardian Ad Litem v. Malone*, 73 S.W.2d 38 (1934); *Honeywell v. Dominick*, 76 S.E.2d 59 (1953); *Clay v. Thomas*, 198 S.W. 762 (1917); *Morse v. Hill*, 136 Mass. 60 (1883); *Farley v. Davis*, 116 P.2d

263 (1941); *Campbell v. Walker* (1800), 5 Ves. Jun. 678, 31 E.R. 801; *Farmer v. Dean* (1863), 32 Beav. 327, 55 E.R. 128; *Tenant v. Trenchard* (1869), 4 Ch. App. 537; *Holder v. Holder*, [1968] Ch. 353; *Re Courtney and Mackie* (1972), 1972 CanLII 837 (SK KB), 23 D.L.R. (3d) 564; *Re Mitchell Estates* (1956), 1956 CanLII 181 (SK KB), 19 W.W.R. 86; *Re Nathanson* (1971), 1971 CanLII 1079 (NS SC), 18 D.L.R. (3d) 495.

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APPEAL from a judgment of the Alberta Court of Appeal (1985), 1985 ABCA 202 (CanLII), 63 A.R. 369, 40 Alta. L.R. (2d) 251, allowing an appeal from a judgment of Shannon J., 1984 CanLII 1143 (AB KB), [1984] 3 W.W.R. 246, 51 A.R. 54, 30 Alta. L.R. (2d) 161, on the issue of liability. Appeal dismissed, Wilson J. dissenting.

Marvin V. McDill, Q.C., and *Leslie L. Fryers*, for the appellant.

Gerard C. Hawco and *Randall Block*, for the respondents.

The judgment of Beetz, Estey, McIntyre and Lamer JJ. was delivered by

1. ESTEY J.--This appeal raises issues under the law related to limited partnerships in the Province of Alberta and most particularly the conduct of certain oil and gas development operations pursuant to a limited partnership agreement between the parties to this appeal and others. The limited partnership consists of 60 units, originally held by a group of Limited Partners, which represent in all a 70 per cent interest in the partnership, and a General Partner (the respondent Omega Oil and Gas Ltd.) which owns 30 per cent of the partnership. By the time these proceedings were commenced the parent company of the General Partner (Omega Hydrocarbons Ltd.) had bought 59 of the 60 limited partner units leaving the plaintiff as the only continuing "outside" Limited Partner. The plaintiff holds one of the 60 units.

2. The statement of facts recited by the trial judge and added to but not rejected by the Court of Appeal reveals that after a general discussion between the General Partner and the Limited Partners, the General Partner considered what might be done to improve the position of the Limited Partners who were seeking some realization on their interest units. At that time the partnership had expended all the moneys advanced to its capital account by the Limited Partners, had expended all the moneys borrowed by the partnership from the bank and from Hydrocarbons, and there were no other apparent sources of capital for the partnership. Accordingly, drilling operations were discontinued. The direct solution to the problem of the Limited Partners would have been to have Hydrocarbons reacquire the assets of the partnership so as to return to the Limited Partners on a cessation of the partnership some part at least of the moneys paid into the venture by those partners. It is said in the judgment of the Court of Appeal, and no issue was taken before this Court by any counsel, that tax implications for the Limited Partners were unfavourable and accordingly this direct route could not be followed.

3. As a result it was apparently agreed between some of the Limited Partners and the General Partner that Hydrocarbons would make an offer to purchase the units held in the partnership by the Limited Partners. Accordingly an offer was made for the purchase of those units by the delivery to the unitholders of common shares in Hydrocarbons for each of the 60 units. This offer was accepted by the holders of 59 of the 60 units, the one rejection coming from the appellant. According to his evidence, the appellant rejected the offer from Hydrocarbons because the conversion rate on the market for the offered shares was too low and therefore did not equal his view of the value of his unit. The Limited Partners had contributed \$25,000 to the capital of the partnership for each unit. At the time of the share exchange the shares had a market value of approximately \$25,120 for each unit. At the time of trial the market value was approximately \$130,000. Apparently no issue was taken by the appellant at that time as to the illegality of such an offer by Hydrocarbons. Thereafter, on August 18, 1981 the General Partner sold to Hydrocarbons all the non-producing lands of the partnership for \$315,581 which was applied to the reduction of bank debt. The price was established by independent valuation and no issue is raised in these proceedings as to the adequacy of such price. The partnership retained certain lands.

4. The appellant in the rather lengthy amended statement of claim asked the Court to restore all the mineral properties which had been, at the time of the formation of the partnership, assigned to the General Partner on behalf of the partnership; for an order that all benefits received by Hydrocarbons from lands surrounding the partnership lands be held in trust for the appellant, that Hydrocarbons account to the appellant for all revenues received on the partnership account after May 15, 1981, and that the General Partner distribute to the appellant his share of revenues received by the partnership; for damages; and finally for "an order requiring the defendants [respondents] to specifically perform their duties and obligations pursuant to Fund 1

(the partnership agreement)". It is noted that the appellant in his statement of claim does not ask either for a dissolution of the partnership or for an order reversing the purchase by Hydrocarbons of the 59 units held by the other Limited Partners.

5. In response to these pleadings and the record established at a trial of the issue of liability only, the learned trial judge set out the following issue at the outset of his reasons for judgment:

What are the rights of a Limited Partner when the limited partnership has been effectively terminated in these circumstances:

- (a) the assets of the limited partnership were sold and transferred by the General Partner without his consent;
- (b) all of the other partners concurred in the transaction and exchanged their interests for shares of the company that purchased the assets; and
- (c) the General Partner contends that the transactions were in the best interests of all interested parties due to the financial inability of the limited partnership to carry on its normal business.

6. While the issue is framed essentially in the form of a finding, the judgment does not go on to make precise or express findings with reference to the opening expression "the limited partnership has been effectively terminated". The trial proceeded solely on the issue of liability pursuant to a pre-trial order, and the question of an accounting was left to a subsequent trial if liability be found in the defendants or any of them. The trial judge reached the following conclusions with reference to liability:

1. The sale by the General Partner of the non-producing lands was in breach of s. 55(b) of the *Partnership Act*;
2. The partnership though inactive is still in existence;
3. The parent and subsidiary, Omega Hydrocarbons and Omega O&G (the General Partner), were *de facto* one and the same entity so that the parent, Hydrocarbons, was "the *de facto* General Partner";
4. Hydrocarbons acquired the non-producing lands knowing that their transfer was in breach of the *Partnership Act*.
7. The question ultimately answered by the trial judge was that the respondent had, by the sale of certain non-producing lands of the partnership, made it "impossible to carry on the ordinary business of the limited partnership" and this amounted to a violation of s. 55(b) of the *Partnership Act*.
8. The trial judge thereupon ordered an accounting pursuant to s. 57 of the *Partnership Act* and Rule 418 of the *Alberta Rules of Court* against all the defendants and directed the taking of accounts with reference to profits, losses and revenues received as a result of partnership operations as follows:

- (1) All profits realized by Omega Hydrocarbons Ltd. from the non-producing lands since the date of their acquisition;
- (2) The losses, if any, which resulted from a failure on the part of the defendants to exercise option rights or participation rights with respect to the original Fund lands, option lands, lands adjacent and contiguous, and lands defined in contractual areas of mutual interest;
- (3) Gross and net revenues received from oil and gas wells during the currency of the Fund;
- (4) The number and value of shut-in gas wells belonging to the Fund;
- (5) All deposits and withdrawals from the Bank account of the Fund

An accounting was also directed with respect to:

- (6) The adequacy of the evaluations provided by Supplementary Land Services and the D & S Group as a basis for the shares for units exchange and the transfer of the non-producing lands of the Fund.

9. As noted above no issue was taken in the pleadings with respect to the purchase by Hydrocarbons of the 59 units held by all Limited Partners other than the plaintiff who rejected the offer. No finding was made in any of the courts below that Hydrocarbons could not in law acquire the units held by the Limited Partners

in the partnership or that the exchange of 59 of those units for issued and outstanding shares of Hydrocarbons was unlawful or should or could be set aside. Accordingly, it is difficult to find any root in the facts or in the applicable law for the first part of accounting no. 6 directed by the trial judge.

10. The plaintiff can complain of the sale of assets made by the General Partner only if the partnership agreement has been breached or if the sale was in contravention of a statute or some rule of the common law. Before dealing with the issue arising under s. 55(b) of the *Partnership Act*, certain parts of the partnership agreement should be examined.

11. Article XII of the partnership agreement provides in part as follows:

The General Partner is hereby vested with the power to manage the affairs of the Partnership, to acquire or sell or otherwise dispose of on behalf of such Partnership oil, gas or mineral properties or other interests upon such terms as it shall deem advisable ... to execute and deliver, and to receive or pay the consideration for, all deeds and assignments of properties or other interests transferred or acquired by the Partnership [Emphasis added.]

The Offering Circular distributed in the course of the formation of the partnership provided that the General Partner "reserves the right to add and/or delete or substitute a prospect at its discretion without the approval of the Limited Partners". The provisions in Article XII of the agreement appear to include a broader power of sale than even that described in the Offering Circular.

12. Under Article XV the General Partner has the power to terminate the partnership. The Article provides in part:

... unless on or before [December 31, 2009] the General Partner shall declare the Partnership to be terminated ... on the date set forth in such Declaration of Termination

This is followed by Article XVI which provides in part:

The General Partner shall be in charge of and direct such termination and dissolution. Before making any distributions, the General Partner may sell or convey any of the Partnership properties to third parties on such terms as it may deem advisable. [Emphasis added.]

If this sale of the non-producing lands is tantamount to a termination as the trial judge has effectively found, it is surprising that the appellant has not asked for a judicial dissolution of the partnership which in his pleadings he has not done. It is perhaps equally surprising that the respondent in the face of these difficulties did not exercise the power of termination. On the contrary, the appellant, by his pleading, insists upon a continuance of the partnership under the partnership agreement and for that purpose that the lands of the partnership heretofore transferred by the General Partner to Hydrocarbons be restored to the partnership. An order is sought by the appellant "... requiring the defendants to specifically perform his duties and obligations pursuant to Fund 1 [the partnership]". This type of order as far back as *Lumley v. Wagner* (1852), 1 De G. M. & G. 604, 42 E.R. 687, and *Lumley v. Gye* (1853), 2 El. & Bl. 216, 118 E.R. 749, the courts have declined to grant.

The Issue Arising under s. 55(b), the Partnership Act

Section 55(b) of the *Partnership Act* provides as follows:

55 A general partner in a limited partnership has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership without limited partners except that, without the written consent to or ratification of the specific act by all the limited partners, a general partner has no authority to

...

(b) do any act which makes it impossible to carry on the ordinary business of the limited partnership. . . .

13. The trial judge found that the sale of the non-producing lands violated the statute and that:

Omega Hydrocarbons Ltd. acquired the non-producing lands of the limited partnership with full knowledge that such a transfer was in breach of The Partnership Act and that it rendered the partnership incapable of carrying on its ordinary business as specified in the prospectus, the partnership agreement, and the certificate of partnership. In such circumstances it holds such properties in trust for the limited partnership.

The trial judge did not find that this sale and transfer to Hydrocarbons was rendered invalid by reason of any breach of a trust or fiduciary duty owed by the General Partner to the partnership and specifically to the appellant.

14. The Court of Appeal, however, did not in so many words reverse the conclusion of the trial court that the sale of these lands breached s. 55(b) of the *Partnership Act* but took as its starting point and as the central issue in the appeal "... the nature and extent of the fiduciary duty that arises in the operation of the drilling fund in the circumstances" The essential facts on the s. 55(b) issue may be briefly stated. The partnership successfully drilled oil and gas wells and some of the latter were capped for lack of market. All this activity was duly reported by the General Partner to all unit holders in the limited partnership including the appellant in eleven reports. After the partnership had expended its capital and all the funds it could borrow and after Hydrocarbons had purchased all the interests of the Limited Partners except the appellant's, the General Partner sold a block of non-producing lands to Hydrocarbons. As a result of this and other arrangements, the indebtedness of the partnership was substantially retired and drilling operations came to a halt. Both courts are in agreement that the partnership is extant but no drilling activity is underway and indeed in the words of the President of the General Partner, there would never be drilling "ever again".

15. There is no evidence that the partnership is without any interest in lands. Indeed, as already observed, it is clear that there are producing lands or interests in producing lands and capped gas wells in the partnership. There is nothing in the record to indicate that these producing lands or interests in lands have been conveyed away or otherwise disposed of by the General Partner. The partnership must have continued to hold oil and gas lands or interests in such lands. If this were not so it would not have been necessary to describe the lands being sold as "non-producing lands".

16. Article III sets out the objects and business of the partnership according to the Articles of Limited Partnership:

CHARACTER AND BUSINESS PURPOSE

The purposes for which said Limited Partnership has been created are to acquire, develop and operate oil, gas and other mineral properties and interests located within Canada, including, but not limited to, evaluation of properties (including seismic operations thereon), the purchase, sale and exploitation of real property, oil, gas and mineral leasehold estates, royalties, mineral interest, production payments, and overriding royalty interests, including the power to engage in such operations by itself, in association with others, or as a limited partner in other partnerships (to the extent permitted by law) and to take such actions which may be incidental to the aforesaid general purposes as the General Partner may see fit

17. On the record established at trial the appellant did not discharge any onus which may have arisen in him to demonstrate the allegation with reference to s. 55(b) on a balance of probabilities or indeed on almost any other variant of the ordinary civil onus. It will be seen that there are many branches of the business of the partnership in addition to the drilling operations discussed by the witness Hall (President of the General Partner). The Offering Circular described the limited partnership as being "formed for the purpose of acquiring, exploring and developing oil and gas properties in Canada". The Certificate of Partnership provides in part as follows:

The Partnership is formed for the purpose of acquiring, developing and operating oil, gas and other mineral properties and interests located within the Dominion of Canada.

18. The statement of Mr. Hall mentioned above with reference to the discontinuance of drilling may or may not entitle the appellant to apply for a dissolution of the partnership under the statute or for some other remedy or relief but it is by no means, at least taken by itself, proof that the main purpose for which the partnership was established cannot possibly be carried on in the future.

19. It is thus clear from exhibits and scattered testimony that the partnership is still in existence and indeed is in receipt of oil and gas revenue presumably from interests in lands acquired or drilled alone or in association with other entities. The record is silent as to what is done with these funds but there has apparently been no distribution of any earning accumulations to date. The record is also silent as to what revenues are now flowing into the partnership from its interest in oil and gas lands. Neither counsel for the appellant nor for the respondent could assist the Court as to the present level of earnings or as to what disposition was being made of these accumulating earnings. The last financial statements reveal that substantial moneys, variously described as revenue or earnings, were received by the partnership in the fiscal year 1980. The gross revenue of the Fund during the last two years prior to trial was as follows:

20. 1979: \$183,915

21. 1980: \$672,345

There is nothing in the record to indicate that the producing lands or interest in lands have been conveyed away or otherwise disposed of by the General Partner. Again neither counsel was able to assist the Court in describing the state of affairs of the partnership in respect of land holdings. All parties were in agreement that the partnership was still in existence.

22. There was no evidence that the disposition, by itself, of the non-producing properties has made it impossible to carry on the ordinary business of the partnership. Indeed the accumulations which are apparently continuing from prior drilling activities will produce funds which could be used to finance additional drilling or participation in ventures with others. The receipt of royalties and other forms of income from interests in oil and gas properties is, of course, part of the announced purposes of the limited partnership. In my view, the announcement of present plans not to drill is not by itself conclusive evidence of impossibility of conducting the ordinary business of the partnership which is the requirement of s. 55.

23. There are two questions of interpretation to be settled. Does the subsection require that all facets of the ordinary business of the partnership be rendered impossible? The second question is the plain meaning of the phrase "makes it impossible to carry on". The plan of the statute is to establish a code for the formation, operation and dissolution of partnerships for the conduct of enterprises generally. By its nature such a statute is entitled to attract a beneficial interpretation by the courts. Where the partners are free to enter into an agreement according a power of termination to the General Partner, as is the case here, it is difficult to interpret s. 55 as prohibiting such a clause or as requiring the partnership to carry on a temporary or otherwise improvident undertaking in order to demonstrate that the standards of s. 55(b) have not been infringed. At its highest, s. 55(b) cannot be read as prohibiting a termination clause but rather as permitting the partnership to conduct some substantial and significant part of its undertaking without violating s. 55(b), unless termination has occurred. Reference to the ordinary business of the organization may be fairly read as referring to a substantial portion but not necessarily every single facet, however small, of its ordinary business.

24. Applied in its simplest form, the language of s. 55(b), namely "do any act which makes it impossible to carry on the ordinary business of the limited partnership" must, as indicated in the Oxford Dictionary, mean "not possible to carry on such business". See the *Shorter Oxford English Dictionary* (1959), p. 969. In my view no significant part of the ordinary business of the partnership became "impossible" on the sale of the non-producing assets. The sale of the producing assets of the partnership by the General Partner would have been more likely to have contributed to a breach of s. 55(b).

25. The appellant is, of course, free to move under ss. 38 and 57(c) of the Alberta legislation or otherwise for termination of the partnership and for an accounting of assets and income and for the distribution of net assets as realized in the liquidation process. This the appellant has not sought to do. In all of this the onus is upon the appellant as plaintiff to show that such a condition has resulted. The learned trial judge did not indicate the basis upon which s. 55 has been violated or the evidence which has demonstrated the "impossibility" to the level required in civil proceedings. It may be that the trial court found that the cessation of the drilling activity "makes it impossible to carry on the ordinary business of the limited partnership". The omission of this link in the reasoning of the learned trial judge in disposing of the s. 55(b) issue overlooks all the other continuing activities of the partnership embraced in its ordinary business.

26. The Court of Appeal, on the other hand, by necessary implication has found that the condition prescribed in s. 55(b) has not been met. With respect I agree with this conclusion.

27. The ongoing income of the partnership from oil and gas properties, the ownership of interests in oil and gas properties, and the ownership of capped gas wells must surely form a part of the expression "operating oil, gas and other mineral properties and interests" used in the limited partnership agreement in defining the objects and the undertaking of the partnership.

28. The Court of Appeal, in dismissing the appellant's action, has by necessary implication, left the appellant to its own resources as to whether or not in these circumstances he should move for a termination or dissolution of the partnership in order to retrieve all or part of his capital investment from the liquidation process.

Breach of Fiduciary Duty on Sale of Partnership Lands

29. The Court of Appeal considered that the central issue arising in this appeal "deals with the nature and extent of the fiduciary duty that arises in the operation of the [partnership]" in the circumstances here existing.

30. That the General Partner has the power of sale of the assets of the partnership has already been discussed above and is undoubted. Furthermore, there is no issue as to the valuation placed on these lands by independent valuers. The question arises, however, as to whether in these circumstances the General Partner can sell the non-producing lands to its parent company which, by an undisturbed finding by the trial court, is one and the same legal entity for these purposes as the General Partner. Put in its essential terms, can the General Partner sell these lands to itself?

31. The second question is whether or not judicial approval of such a sale can be granted after the sale has been completed. This question is discussed later.

32. The Court of Appeal has dealt in great detail with the operations undertaken by the partnership with respect to the "five prospects" assigned to the partnership on its formation. After a thorough and detailed examination of the "prospects" and the transactions of the partnership, one by one, the Court of Appeal found several mistakes or errors in an evaluation report which resulted in a restoration to the partnership by the consent of all parties of several parcels of land in one or more of the "prospects". This reduced the price payable on the sale of these lands by the purchaser. The dismissal of the action by the Court of Appeal necessarily means that the Court of Appeal found no breach of a fiduciary duty by the General Partner in connection with the sale of the non-producing lands. As to the adequacy of the sale price (to which the only objection taken in the extensive amended statement of claim was that the evaluation report should have been updated for the three months before closing), it might be observed that the evidence before the courts below included that of the President of the General Partner who stated that there was no ready market for these lands.

33. With respect I accept the analysis by the appellate court and the conclusions drawn therefrom including the admission on the record before the courts below made on behalf of the respondent that the valuation of the four parcels of the Provost property required the removal of these lands from the transaction and a reduction of the price payable. The learned trial judge makes no finding of any breach of fiduciary duty and indeed makes no special reference to the fact of sale by the General Partner to its parent company, the price payable on such sale, or the question of retrospective judicial approval by reason of a breach of a fiduciary duty.

34. The partnership agreement, while granting power of sale to the General Partner, contains no express term whereunder the General Partner may sell partnership assets to itself. There are, however, special if not unusual provisions in the partnership agreement which recognize that the General Partner may carry on transactions with the partnership or otherwise which may conflict with the interests of the partnership and the other partners. There is a finding in the Court of Appeal that the appellant was fully aware of the terms of the partnership agreement, including their application in the special circumstances existing in the oil exploration and development business. The partnership agreement which was signed by the appellant included several very particular and perhaps unusual provisions relating to the role and authority of the General Partner.

35. Article X provides in part as follows:

CONFLICT OF INTEREST

The General Partner is presently engaged in and intends to continue in the oil and gas business and will have to divide its time between the program for the Partnership properties and in its other operations in which the Partnership will not have an interest. During the life of the Limited Partnership, the General Partner shall have the right to act as partner or joint venturer with other oil companies and private or public investors in other ventures formed to search for oil and gas. The General Partner's action in connection with the foregoing shall be deemed not to be a conflict of interest with respect to this Limited Partnership or its operations or its Limited Partners. If the General Partner determines that this Limited Partnership should participate in any prospect to an extent of less than 100% of the Working Interest, the General Partner may dispose of the balance of the interest by sale of such interest to other partnerships or entities managed by the General Partner or retain the balance of such interest for its own account. In any such event, any affiliated partnership or entity shall pay for its share of the acquisition, drilling and completion costs of any wells on not more favourable terms than those borne by the Partnership. The General Partner may sell a portion of prospects in which the Limited Partner is a participant to unaffiliated parties, thus benefiting the General Partner and not the Limited Partners. [Emphasis added.]

Article XII provides in part as follows:

... it is understood and agreed that the General Partner is engaged, and intends to continue, in the oil and gas business and must necessarily divide its time between this and other programs, and that the General Partner may, during the life of this Partnership, acquire oil and gas interests and not offer the same to his Partnership.

Article XIV provides in part as follows:

The General Partner shall never be liable to the Partnership or Limited Partners, or any of them, for any acts done or omitted to be done in good faith in the performance of any of the provisions of this Agreement.

These Articles bring into focus some of the actions of the General Partner here.

36. For these purposes I assume the highest status of the General Partner under the limited partnership, namely that of a trustee holding the properties of the partnership on behalf of all other partners. The general rule is that a trustee may not purchase trust property, whether or not the sale is made honestly, at a fair price, and in good faith (*Ex P. James* (1803), 8 Ves. Jun. 337, 32 E.R. 385; *Aberdeen Railway Co. v. Blaikie Brothers* (1854), 1 Macq. 461). In *Snell's Principles of Equity* (27th ed. 1973), p. 239, it is pointed out that the true rule is not that a trustee may not purchase trust property; it is that a purchase of trust property by a trustee is voidable within a reasonable time at the instance of any beneficiary. (See *Holder v. Holder*, [1968] Ch. 353 (*per* Danckwerts L.J. at p. 398).) Similarly, the rule as applied to corporate fiduciaries is subject to exceptions when those to whom the duty is owed have agreed to such exceptions or have consented to a sale of assets to the fiduciary with full knowledge of that sale. In *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378, Viscount Sankey states at p. 383:

In these circumstances, and bearing in mind that this evidence was accepted, it is clear that he took the shares with the full knowledge and consent of Regal and that he is not liable to account for profits made on their sale. The appeal against the decision in his favour should be dismissed.

37. In Canada, Sinclair J.A., in *Act Oils Ltd. v. Pacific Petroleums Ltd.* (1975), 1975 CanLII 1011 (AB CA), 60 D.L.R. (3d) 658, recognizes limits to the strict application of the general principle in the following terms at p. 674:

To summarize, it seems beyond question that a trustee must not sell property to himself, whether or not he makes a profit, except under the most stringent of conditions. The rule equally applies to sales to persons, to firms or to companies in which the trustee is interested. These general principles are accepted by both sides, provided, of course, that the arrangement or relationship in existence between the parties is such that they ought to apply.

The nub of the problem concerns the nature of that relationship. [Emphasis added.]

The importance of the terms of agreement was emphasized by this Court in *Midcon Oil & Gas Ltd. v. New British Dominion Oil Co.*, 1958 CanLII 42 (SCC), [1958] S.C.R. 314, by Locke J. at p. 327.

38. *Scott on Trusts* (4th ed. 1987), at p. 339, states that in certain special circumstances a court of equity may approve a sale of trust assets to a trustee:

Not only may the court authorize a sale of trust property to the trustee personally, but after such a sale has taken place the court may approve the sale, if it still appears that the sale is for the best interest of the trust estate [*Honeywell v. Dominick*, 223 S.C. 365, 76 S.E. 2d 59 (1953)].

It would seem, however, that where the sale was made without the authorization of the court, the court will not later approve it if at the time when such approval is asked the property has so increased in value that at that time the sale does not appear to be advantageous to the trust estate.

The record on this appeal reveals no justification for a denial of approval by a court if sought. Canadian courts have indicated *ex post facto* approval of sales to a trustee will be given in exceptional circumstances in analogous proceedings.

39. In *In re Baskerville Estate*, 1946 CanLII 122 (SK KB), [1946] 3 W.W.R. 347, Taylor J. at p. 347 states:

In my view the power to confirm must be exercised only when there is a corresponding power to refuse to sanction the sale, and here, the executors having already taken an irrevocable act, they cannot escape the responsibility thereof by an order confirming the sale.

...

The power on originating notice is to sanction a proposed sale, and does not include consideration of an alleged breach of trust.

In *Re Courtney and Mackie* (1972), 1972 CanLII 837 (SK KB), 23 D.L.R. (3d) 564, Disbery J. states at p. 566:

Except in exceptional circumstances the application to approve a sale should be made at a time when the Court is free to either approve or refuse to approve. The Court should be asked to approve a *proposed* sale or a sale made subject to the obtaining of the Court's approval thereto; and on the hearing of such applications all interested non-concurring parties would have an opportunity to be heard. [Underlining added.]

In the event the court there declined to grant *ex post facto* approval because of the serious intervening lapse of time. On this appeal the sale of the non-producing lands back to Hydrocarbons is not an irrevocable act and the Court of Appeal was not faced with a *fait accompli* which was immune from possible judicial intervention.

40. In England there is a line of cases in which the courts have approved the sale before it was made: (*Campbell v. Walker* (1800), 5 Ves. Jun. 678, 31 E.R. 801; *Farmer v. Dean* (1863), 32 Beav. 327, 55 E.R. 128, and *Tennant v. Trenchard* (1869), 4 Ch. App. 537). A 1975 *Practice Direction*, [1975] 1 All E.R. 255, allows Masters to make an order "approving purchases of trust property of any description by executors, administrators or trustees, but only in clear cases". There is nothing in principle to deny the authority of a court to approve of such sales of trust property where the court is free in the circumstances either to approve or to deny approval according to the special circumstances existing in each case.

41. The Court of Appeal in *Holder v. Holder*, *supra*, refused to set aside a purchase by a beneficiary who had been appointed executor and trustee (with two others) of a will but who renounced the position and played no real part in the administration of the estate. Danckwerts L.J. states at p. 399:

... the plaintiff is claiming equitable relief against Victor, who is the legal owner of the farms and is in occupation of them. He has paid what was a good price at the time of the sale. Much hardship would be caused to Victor if the transaction was set aside now

Sachs L.J. states at pp. 402-3:

Thus the rigidity of the shackles imposed by the rule [i.e. that trustees not purchase trust property] on the discretion of the court may perhaps before long be reconsidered as the courts tend to lean more and more against such rigidity of rules as can cause patent injustice

42. On the facts before the Court on this appeal, and applying the law thereto as examined shortly above, I conclude that the General Partner owes a fiduciary duty to Molchan, the one remaining Limited Partner, but in the circumstances of this case there is no breach of that duty in the sale of non-producing lands because:

i. there is no evidence of bad faith of the General Partner and neither Shannon J. nor Prowse J.A. made any such finding;

ii. there has been no attempt by the appellant to demonstrate that Hydrocarbons paid an inadequate consideration for the non-producing lands;

iii. the General Partner's assertion that the sale was in the best interests of the partnership is supported by evidence at trial which indicates the strained financial circumstances of the partnership and the difficulty of selling the lands to third parties because of the encumbrances upon the lands; and

iv. the terms of the agreement, of which Molchan was fully aware, provided the General Partner with the power to dispose of properties at its discretion.

43. In the peculiar circumstances existing here I conclude that at the time of its approval of this sale the Court of Appeal was not in a position that it had no alternative but to approve. There is no evidence of subsequent disposition by the transferee of the lands in question. Nor indeed is there any evidence of any significant alteration of market price of the non-producing lands. In my opinion it will, indeed, be a rare case where approval will be given to a sale of trust assets by a trustee to himself. The circumstances of this case are such, however, that approval should be given. The general partnership agreement gives extraordinary powers to the general partner which are of such nature as to put this case on the footing of one where a specific consent has been given by the *cestui que* trust to the sale.

44. It may not be without relevance that the appellant stated that he rejected the offer of purchase of his unit only because in his view the conversion rate on the shares being issued to him did not equal his view of the value of his unit. Had the appellant accepted the share for unit exchange offered by Hydrocarbons, his original investment of \$25,000 would have been worth approximately \$130,000 at the time of trial.

45. The Court of Appeal by dismissing the action of the appellant thereby denied the claim by the appellant for an order directing the return of the non-producing lands to the General Partner. The Court of Appeal therefore necessarily determined that the sale breached no fiduciary duty arising in the respondent General Partner in favour of the appellant, or at least did not do so in the special relationships here existing between the parties. Assuming such transfer requires judicial approval (see *Snell's Principles of Equity, supra*, at p. 290,

and *Halsbury's Laws of England*, vol. 48, 4th ed., para. 808, p. 436) one must necessarily conclude that the retrospectivity of that approval would not, in the view of the Court of Appeal, be a bar. With respect I agree with these conclusions.

46. For all these reasons, I would dismiss the appeal with costs in this Court to the respondents.

The following are the reasons delivered by

47. WILSON J. (dissenting)--I have had the benefit of the reasons for judgment of my colleague, Justice Estey, but find myself unable to agree with his conclusions. The appeal raises a variety of issues relating to the respective rights and duties of limited and general partners in the Province of Alberta and to the role of appellate courts when a trial judge has made a finding of liability based on a breach of the governing statute and followed it with an order for an accounting. The case has had a somewhat peculiar procedural history. I set out the relevant facts.

I The Facts

48. The limited partnership consisted originally of 60 units held by a group of limited partners (of whom the appellant was one) and representing a 70 per cent interest in the partnership. The General Partner, the respondent Omega Oil and Gas Ltd. ("Omega"), owned the remaining 30 per cent interest. The partnership,

known as Omega Oil and Gas Fund 1, was formed in February 1978 "for the purpose of acquiring, developing and operating oil, gas and other mineral properties and interests located within the Dominion of Canada". The fund operated with mixed results until November 1980. It acquired mineral properties, developed and continues to operate some revenue-producing oil wells, and discovered gas wells which, according to the evidence, were uneconomic to operate because of market conditions. By the autumn of 1980 the money invested by the partners was exhausted and the partnership was heavily in debt to the Toronto-Dominion Bank and to Omega Hydrocarbons Ltd., Omega's parent company. The respondent Hall was president of both Omega and Hydrocarbons.

49. With no further capital available to the partnership drilling operations were discontinued and a group of the Limited Partners approached Hall to discuss how they might realize their partnership interests. One obvious method would have been to have Hydrocarbons reacquire the assets of the partnership so as to return to the Limited Partners on a dissolution some part at least of the moneys paid into the venture by those partners. The Court of Appeal found, and it was not disputed before this Court, that this solution was rejected because of the unfavourable tax implications for the Limited Partners.

50. It was then agreed between some of the Limited Partners and the General Partner that Hydrocarbons would make an offer to purchase the limited partners' units. This was done. Hydrocarbons offered to purchase the units in exchange for common shares in Hydrocarbons. The offer was accepted by the holders of 59 of the 60 units, the one rejection coming from the appellant. The appellant testified that he rejected the offer because the conversion rate on the market for the Hydrocarbons shares was too low and what was offered did not, in his view, equate the value of his unit. The Limited Partners had contributed \$25,000 to the capital of the

partnership for each unit. At the time of the offer the Hydrocarbons shares had a market value of approximately \$25,120 for each unit. By the time of trial their market value was approximately \$130,000. No issue was taken by the appellant at that time as to the legality or otherwise of the Hydrocarbons offer.

51. On August 18, 1981 Hall in his capacity as president and director of Hydrocarbons made an offer to Omega to purchase all the non-producing lands of the partnership for \$315,581. The offer was accepted by Hall in his capacity as president and director of Omega. The price was established by independent valuation and the proceeds were applied to the reduction of the bank debt. The sale is attacked by the plaintiff and its propriety is the main issue on this appeal. The partnership retained the oil wells which were already in production as well as the uneconomic gas wells.

II The Procedural History

52. The appellant commenced an action on November 5, 1982 alleging, *inter alia*, that:
- (1) following the sale of the non-producing lands to Hydrocarbons the Fund ceased all exploratory activity, thereby breaching the *Partnership Act*, R.S.A. 1980, c. P-2 and the terms of the Limited Partnership Agreement;
 - (2) Hydrocarbons had, subsequent to the sale, carried out its own successful drilling program on the sold-off lands and on lands "contiguous and adjacent" to them which ought to have been acquired for the Fund;
 - (3) confidential information relating to prospects held by the Fund had been improperly passed on to Hydrocarbons;

- (4) the evaluation of the non-producing lands was "improper and out-dated";

- (5) on a number of occasions the General Partner had not done all that it could and should have done to acquire and develop prospects for the Fund;

- (6) in the above particulars, and in its general failure to maintain the Fund in operation, the General Partner had breached its fiduciary obligations to the limited partners.

The appellant claimed the following relief:

- (a) a declaration that the sale of the non-producing lands to Hydrocarbons...is in breach of the terms of the Certificate of Limited Partnership; the Articles of Limited Partnership, the Partnership Act, the Securities Act or any combination of the foregoing and an order setting aside the sale and restoring all prospects to the Fund;

...

- (c) an order declaring that all benefits received by [Hydrocarbons]... from the lands transferred...as well as benefits received from contiguous and adjacent lands are held in trust for the Fund and the plaintiff and an order requiring [Hydrocarbons]...and the General Partner to account to the plaintiff with respect to all revenues received subsequent to May 15, 1981 to the date of trial;

- (d) ...an order requiring the corporate Defendants...or either of them to distribute to the plaintiff his pro rata share of revenues received from the lands herein described pursuant to the provisions of Fund 1;

- (e) in the alternative, general damages against the corporate defendants in the sum of \$500,000 jointly and severally;

- (f) a declaration that the personal defendant is in breach of the fiduciary duty owed to the defendant General Partner and damages against the personal defendant in the sum of \$50,000.00;

53. On September 22, 1983 Sulatycky J., in Chambers, ordered that the case should proceed on the issue of liability only, "an accounting to be held by subsequent trial in the event that the plaintiff is successful on the issue of liability". The trial as to liability took place before Shannon J. and occupied five days (1984 CanLII 1143 (AB KB), [1984] 3 W.W.R. 246, 51 A.R. 54, 30 Alta. L.R. (2d) 161). The judge reached four conclusions:

- (1) The sale of the non-producing lands breached s. 55(b) of the *Partnership Act, supra*. It reads as follows:

55 A general partner in a limited partnership has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership without limited partners except that, without the written consent to or ratification of the specific act by all the limited partners, a general partner has no authority to

...

- (b) do any act which makes it impossible to carry on the ordinary business of the limited partnership....

Shannon J. found that the sale of the non-producing lands of the partnership made it impossible to carry on the ordinary business of the partnership as reflected in its constitutive documents.

(2) The partnership, though inactive, was still in existence. It had never been formally dissolved due to the dispute as to the validity of the sale of the non-producing lands and the uncertainty as to the outcome of the litigation.

(3) Hydrocarbons and the General Partner were *de facto* one and the same entity so that the parent Hydrocarbons was "the *de facto* General Partner".

(4) Hydrocarbons acquired the non-producing lands of the limited partnership with full knowledge that such a transfer was in breach of the *Partnership Act* and that it rendered the partnership incapable of carrying on its ordinary business as specified in the prospectus, the Partnership Agreement, and the Certificate of Partnership. In such circumstances Hydrocarbons holds such properties in trust for the limited partnership.

54. Consequent on these findings Shannon J. ordered an accounting under s. 57(b) of the *Partnership Act* and "necessary inquiries" under Rule 418 of the *Alberta Rules of Court*. Section 57(b) reads as follows:

57 A limited partner has the same right as has a general partner

...

(b) to be given, on demand, true and full information of all things affecting the limited partnership, and to be given a formal account of partnership affairs whenever circumstances render it just and reasonable....

Rule 418 of the *Alberta Rules of Court* provides:

418. The court may at any stage in an action direct that necessary accounts or inquiries be taken or made.

The order was framed as follows:

As against all of the defendants, this court directs the following accounts and inquiries:

- (1) All profits realized by Omega Hydrocarbons Ltd. from the non-producing lands since the date of their acquisition;
- (2) The losses, if any, which resulted from a failure on the part of the defendants to exercise option rights or participation rights with respect to the original Fund lands, option lands, lands adjacent and contiguous, and lands defined in contractual areas of mutual interest;
- (3) Gross and net revenues received from oil and gas wells during the currency of the Fund;
- (4) The number and value of shut-in gas wells belonging to the Fund;
- (5) All deposits and withdrawals from the Bank account of the Fund; and

- (6) The adequacy of the evaluations provided by Supplementary Land Services and the D & S Group as a basis for the shares for units exchange and the transfer of the non-producing lands of the Fund.

The parties may apply for modification or clarification of the foregoing directions from time to time.

55. The defendants appealed both the order for the accounting and "the whole of the judgment" of Shannon J. The Alberta Court of Appeal ((1985), 1985 ABCA 202 (CanLII), 63 A.R. 369, 40 Alta. L.R. (2d) 251 [hereinafter cited to 63 A.R.]), *per* Prowse J.A., did not deal with the question whether the *Partnership Act* had been breached which was, of course, the basic finding of the trial judge. After listing the six areas of inquiry ordered by the trial judge, Prowse J.A. stated at p. 372:

It follows from this statement that the trial judge did not limit the remedy he proposed to damages arising from a breach of s. 55 of the **Partnership Act**. He did not however set out the breaches he had in mind in assessing the damages under (2) and one is left with the impression that he found breach or breaches on the part of Hall and Omega in acting in circumstances in which a conflict of interest arose.

This was Prowse J.A.'s only reference to s. 55 of the *Partnership Act*. I am accordingly unable to agree with my colleague that the Court of Appeal impliedly overturned the finding of breach of the statute. If one can read anything into the passage quoted above, it seems to be that the Court of Appeal accepted the trial judge's finding that the *Partnership Act* had been breached but felt that the inquiries he ordered went beyond those appropriate for such a breach. The Court concluded, therefore, that the trial judge must have found breaches of fiduciary duty in addition to breach of the statute. As a consequence almost the entire judgment of the Court of Appeal is devoted to an analysis of the nature of the fiduciary duty owed by partners to each other, culminating in the conclusion that there was no breach of fiduciary duty by the General Partner on the facts of this case. The Court of Appeal then dismissed Molchan's action in its entirety (save for the correction of minor errors in transferring some producing lands along with the non-producing lands) without ever

having addressed its mind to the basis of liability found by the trial judge and the remedies appropriate to that breach. The Court of Appeal, in effect, conducted a trial *de novo* on the issue of breach of fiduciary duty, an issue not canvassed at all by the trial judge. Shannon J. found as a fact that the ordinary business of the partnership could no longer be carried on once the non-producing lands were sold off. Section 55(b) of the *Partnership Act* was accordingly violated. The Court of Appeal did not even discuss, let alone reverse, that finding. My colleague has found, however, a reversal "by necessary implication" by virtue of the Court of Appeal's dismissal of Molchan's action in its entirety.

III The Jurisdiction of the Court of Appeal

56. In my view, the correct approach for this Court to take in such unusual circumstances is to reinstate the order of the trial judge. I say this for two reasons. First, as noted above, the trial judge's finding of a breach of the *Partnership Act* was not impugned at all in the Court of Appeal. While that Court has broad powers when a judgment is appealed to it, it cannot fail to address the central issue remitted to it. In this case it did exactly that. Moreover, it acted as a court of first instance on an entirely different issue from the one dealt with by the trial judge and quashed the trial judge's order on the basis of its determination of that issue.

57. Second, even if my colleague, Estey J., is correct in concluding that the Court of Appeal impliedly reversed the trial judge's finding of fact, that implied reversal, it seems to me, was an improper exercise of the Court of Appeal's powers of review. I reach this conclusion on a consideration of three factors, namely:

(a) the scope of the Court of Appeal's powers of review;

(b) the nature of the finding of breach of statute by the trial judge;

(c) the propriety of the order for an accounting and inquiries following the finding of the breach.

(a) *The Scope of Appellate Review*

58. The Court of Appeal for Alberta enjoys a broad jurisdiction. The *Judicature Act*, R.S.A. 1980, c. J-1, s. 3, states:

3 The Court of Appeal

(a) has all the jurisdiction and powers possessed by the Supreme Court of the Northwest Territories en banc immediately before the Court's organization, and

(b) has jurisdiction and power, subject to the Rules of Court, to hear and determine

(i) all applications for new trials,

(ii) all questions or issues of law,

(iii) all questions or points in civil or criminal cases,

(iv) all appeals or motions in the nature of appeals respecting a judgment, order or decision of

(A) a judge of the Court of Queen's Bench, or

(B) a judge of a court of inferior jurisdiction when an appeal is given by any other Act,

59. The provisions of the *Judicature Act* are supplemented by the *Alberta Rules of Court*, in particular Rules 505 and 518, which read:

505. (1) Except as otherwise provided, an appeal lies to the court from the whole or any part of any judgment, order, direction or finding of a judge sitting in court or the verdict or finding of a jury or from the judgment, order or direction of a judge sitting in chambers.

518. The court may:

(a) direct amendment of any proceeding before it;

(b) receive further evidence either by oral examination, by affidavit, upon commission or otherwise;

(c) draw inferences of fact;

(d) direct a new trial;

(e) give any judgment and make any order which ought to have been made and make such further or other order as the case may require;

(f) make such order as to costs as to it seems just but where the court is equally divided, the costs shall follow the event of the appeal.

60. These broad powers must, however, be read in light of the principles guiding appellate review as laid down by this Court. In particular it has been said on a number of occasions that where a trial judge makes a finding of fact based on the credibility of witnesses, an appeal court should not overturn that finding unless it can be shown that the finding was "palpably wrong": *Stein v. The Ship "Kathy K"*, 1975 CanLII 146 (SCC), [1976] 2 S.C.R. 802. This principle has been frequently reaffirmed by this Court: see *Métivier v. Cadorette*, 1975 CanLII 2 (SCC), [1977] 1 S.C.R. 371; *Jaegli Enterprises Ltd. v. Taylor*, 1981 CanLII 26 (SCC), [1981] 2 S.C.R. 2; *Doerner v. Bliss & Laughlin Industries Inc.*, 1980 CanLII 50 (SCC), [1980] 2 S.C.R. 865; *Schreiber Brothers Ltd. v. Currie Products Ltd.*, 1980 CanLII 11 (SCC), [1980] 2 S.C.R. 78; *Lewis v. Todd*, 1980 CanLII 20 (SCC), [1980] 2 S.C.R. 694; and *Wire Rope Industries of Canada (1966) Ltd. v. B.C. Marine Shipbuilders Ltd.*, 1981 CanLII 182 (SCC), [1981] 1 S.C.R. 363. It was most recently applied in relation to the powers of the Saskatchewan Court of Appeal, which possesses by statute a jurisdiction comparable to that of Alberta. In *Lensen v. Lensen*, 1987 CanLII 4 (SCC), [1987] 2 S.C.R. 672, Chief Justice Dickson stated at p. 683:

It is a well-established principle that findings of fact made at trial based on the credibility of witnesses are not to be reversed on appeal unless it can be established that the trial judge made some "palpable and overriding error which affected his assessment of the facts". . . .

61. The Alberta Court of Appeal has itself applied this restriction on a number of occasions. In *Colberg v. Braunberger's Estate* (1978), 1978 ALTASCAD 307 (CanLII), 12 A.R. 183, Moir J.A. said at p. 190:

In my respectful opinion the learned trial judge could have found that there was an acceptance of the appellant's offer by the respondent. He did not do so. Rather, he chose to accept the evidence given by the respondent in chief. He heard the witness. It was for the trial judge to decide if he accepted the whole of the respondent's evidence, part of it, or none of it. Clearly he accepted the respondent's evidence in chief only.

The question is are we entitled to reverse that finding when there is evidence to support that finding? As I read the authorities, particularly the Supreme Court of Canada in *Stein v. The Ship "Kathy K"* (1975), 1975 CanLII 146 (SCC), 6 N.R. 359; [1976] 2 S.C.R. 802, we can only do so if the learned trial judge was "palpably wrong". I do not think that he was, particularly in the light of the whole of the cross examination. The learned trial judge had an advantage that we can never have. He saw and heard the respondent give the evidence. I am not prepared to say that he lost the advantage by making the finding he made.

Similar cautionary comments may be found in *Carter v. Ferguson*, 1943 CanLII 463 (AB CA), [1943] 2 W.W.R. 38 (Alta. C.A.); *Clarke v. Gerbrandt* (1984), 1984 ABCA 305 (CanLII), 34 Alta. L.R. (2d) 289 (C.A.), and *Angus v. City of Edmonton* (1977), 1977 ALTASCAD 61 (CanLII), 3 A.R. 116 (C.A.) In the last two decisions the Court of Appeal did overturn the findings of a trial judge, but in *Clarke* on the ground that there was no evidence at all to support the finding and in *Angus* on the ground that the finding was based on expert evidence where credibility was not a factor. Such circumstances constitute exceptions to the general rule requiring palpable and overriding error.

(b) *The Trial Judge's Finding of Breach*

62. Applying this principle to the present case, it seems to me that the Court of Appeal, if it did impliedly overturn the trial judge's finding, did so without identifying any palpable error. Whether or not the acts of the General Partner were such as to make it "impossible to carry on the ordinary business of the limited partnership" is primarily an issue of fact. While it is true that the trial judge must examine the constitutive documents of the partnership in order to discern what its ordinary business is, this was a perfectly straightforward task in this case. The ordinary business of the partnership was the purpose for which it was created. Once the trial judge has decided what the partnership's ordinary business is, he must then determine on the basis of the evidence whether that business can any longer be carried on. Shannon J. found that it could not. He was obviously influenced to this conclusion by the testimony of the defendant Hall to the effect that no further land acquisition, exploration or drilling would ever take place. The business of the partnership was therefore reduced from exploration, acquisition, development and production to production from the currently producing mines only. Moreover, the evidence persuaded the trial judge that this was not just a temporary measure, a short-term response to a changing business climate; it was a firm and unequivocal decision for the future. The General Partner's conduct in attempting to terminate the partnership by buying out all the Limited Partners and then selling off all the lands which had been acquired for purposes of future exploration and development, when taken together with Hall's evidence that there would never be any more drilling, convinced the trial judge that there was no possibility of the partnership business continuing. This was a finding he was fully entitled to make on the evidence. If the Court of Appeal did in fact reverse that finding, it did so without identifying any palpable error on the part of the trial judge. It acted in contravention of well-established principles of appellate review.

63. My colleague has reviewed the finding of the trial judge and concluded that s. 55(b) of the *Partnership Act* is not breached if "some substantial and significant part" of the partnership business can still be carried on. The partnership, in his view, does not need to be involved at all times in every facet of its business operation. It is enough, he suggests, that it can continue to be involved in production from its currently producing mines. I agree that it may be a matter of degree although this is easier to argue in the case of a corporation with a wide range of objects than it is in the case of a partnership formed for a specific purpose. Moreover, it seems to me that where the evidence clearly indicates that there is no intention ever to reinstate any of the other facets of the ordinary business of the partnership, the trial judge was entitled to make the finding he did. There was evidence to support it. This Court should not "second guess" him, particularly if, as I believe to be the case, the Court of Appeal did not see fit to do so.

(c) *The Order for an Accounting and Inquiries*

64. Accepting then that the trial judge's finding of liability should stand, was his order for an accounting and inquiries appropriate? The Court of Appeal clearly thought that it was not, but that it would have been appropriate if the trial judge had found liability based on breach of fiduciary duty. Item two seemed to the Court of Appeal to point directly to breach of fiduciary duty. I wonder if the Court is correct in this. It must be recalled that the Chambers Judge had ordered a trial as to liability only, to be followed by an accounting. This was the process in which the trial judge was engaged. He fully intended that, following the accounting, he would proceed to the assessment of damages. In other words, the accounting and inquiries were to disclose the possible heads of damage flowing from the breach of the *Partnership Act* and the quantum arising under these heads. In his view, the ordinary business of the partnership could no longer be carried on due to the conduct of the General Partner and he had to determine what loss had been suffered by the plaintiff as a consequence

of the unlawful termination of the partnership business. In order to do this he had to inquire into the past profitability of the business, assuming it was properly managed, as a guide to its financial prospects for the future.

65. The trial judge started from the proposition that the sale of the non-producing lands was an unlawful act and that it was known to Hydrocarbons at the time of the sale that it was an unlawful act. He concluded that in these circumstances Hydrocarbons held the non-producing lands on a constructive trust for the partnership. Having so concluded, he then ordered the accounting and inquiries to see what loss the plaintiff had suffered not only by virtue of the unlawful sale but also by virtue of the termination of the partnership business which flowed from it. The trial judge did not discuss whether the breach of the statute also constituted in the circumstances of this case a breach of fiduciary duty. Any sale which made it impossible for the ordinary business of the partnership to be carried would obviously be a violation of the Act. A sale by the General Partner to itself might in addition (subject to the general law and the provisions of the partnership agreement) be a breach of fiduciary duty. The trial judge did not make this finding. He found liability only on the basis of breach of the statute.

66. Does it make any difference to the assessment of damages whether the sale of the non-producing lands which, in effect, brought the partnership business to an end, constituted only a breach of the *Partnership Act* or a breach of fiduciary duty as well because of the fact that the sale was made to the General Partner? If the trial judge is correct that a sale made to a transferee who knows that the sale is in breach of the Act results in the transferee's holding the lands on a constructive trust for the partnership, then it probably makes little difference. If, however, as the Court of Appeal appears to assume, a breach of s. 55(b) of the *Partnership Act* would give rise only to a claim for damages, it may indeed make a difference. I question, however, whether it makes

any difference to the plaintiff's right to an accounting and inquiries into the circumstances surrounding the respondent's dealing with the properties and assets of the partnership and this is what we are dealing with. This is as far as the trial judge had gone when the respondents instituted their appeal. It is an interesting question whether, if the inquiries disclosed breach of fiduciary duty, relief could be awarded on that basis. But that is not before us. The assessment of damages has not yet taken place. The course being followed by the trial judge was frustrated by the respondent's appeal and the Court of Appeal's dismissal of the appellant's entire case. After succeeding at trial the appellant finds himself out of court, not because the Court of Appeal found the trial judge was wrong in finding liability for breach of the *Partnership Act*, but because the Court of Appeal could find no liability for breach of fiduciary duty.

67. While the *Partnership Act* contains no specific remedies for breach of its limited partnership provisions, s. 57(b) does give Limited Partners broad rights of account and information:

57 A limited partner has the same right as has a general partner

...

- (b) to be given, on demand, true and full information of all things affecting the limited partnership, and to be given a formal account of partnership affairs whenever circumstances render it just and reasonable, and

While I would not wish to attempt an exhaustive definition of "just and reasonable circumstances", it seems to me that breach of s. 55(b) would certainly be such a circumstance. Section 55(b) confers on the General Partner the duty to refrain from doing any act which makes it impossible to carry on the ordinary business of the partnership. It confers a special duty on one type of partner in addition to the other duties all partners have at common law, in equity, and by statute. I see no reason why such a statutory duty should not be enforced in the same way as these others. Section 80 of the Act provides:

80 The rules of equity and of common law applicable to partnership continue in force except where they are inconsistent with the express provisions of this Act.

It is trite law that where one partner breaches one of the many duties it owes to another the law will impose a constructive trust on any property affected and will grant the injured party the right to a full accounting of all necessary aspects of the partnership: see *Lindley on Partnership* (14th ed. 1979), p. 553. Such an accounting need not be accompanied by a dissolution and the General Partner has not sought to dissolve the partnership pursuant to its power to do so under Articles XV and XVI of the Partnership Agreement. In *Lindley, supra*, the author states at p. 556:

It was formerly considered that no account between partners could be taken in equity, save with a view to a dissolution, and a bill praying an account but not a dissolution has been held bad on demurrer. But this rule has been gradually relaxed; for it has been felt that more injustice frequently arose from the refusal of the court to do less than complete justice, than could have arisen from interfering to no greater extent than was desired by the suitor aggrieved.

...

The old rule, therefore, that a decree for an account between partners will not be made save with a view to the final determination of all questions and cross-claims between them, and to a dissolution of the partnership, must be regarded as considerably relaxed, although it is still applicable where there is no sufficient reason for departing from it.

Lindley then goes on to discuss the situations in which an accounting without a dissolution is appropriate and one of them is where the propriety of a specific transaction only is attacked, as in this case. The partners can then sue for an accounting to obtain whatever benefit is due to them as a result of that transaction. This is what the appellant did.

68. I believe also that Shannon J.'s order can be upheld as a reasonable exercise of the trial judge's discretion under the *Alberta Rules of Court*. Rule 418 confers a very broad discretionary power by which a trial judge may order "accounts and inquiries" at "any stage in an action". The Alberta courts have not generally limited the discretion of a trial judge in applying this Rule of Court and the decision of the Court of Appeal in this case does not do so. Moreover, the order itself authorizes an application for modification or clarification of its provisions. This would have been open to the respondents.

IV Conclusions

(1) The trial judge made a valid finding of fact on the evidence that it was impossible for the partnership to carry on its ordinary business and that s. 55(b) of the *Partnership Act* had accordingly been breached.

(2) That finding of fact was not interfered with by the Court of Appeal. That Court did not address the issue of breach of the Act at all and certainly found no "palpable and overriding error" by the trial judge. The finding should therefore not be interfered with by this Court.

(3) The trial judge, having made a finding of liability, made a valid order for accounts and inquiries pursuant to the *Partnership Act* and the *Alberta Rules of Court*.

V Disposition

69. In light of these conclusions I would allow the appeal, set aside the judgment of the Court of Appeal, and remit the matter back to the trial judge so that damages, if any, may be assessed following the accounting and inquiries. I would do this without prejudice to the rights of the respondents to apply to the trial judge for modification or clarification of his order for an accounting and inquiries if so advised. I would award the appellant his costs both here and in the court below.

VI Breach of Fiduciary Duty

70. In light of my disposition of this appeal as outlined above it is perhaps unnecessary for me to address the issue dealt with by the Court of Appeal, namely whether the General Partner breached its fiduciary duty to the plaintiff apart from its breach of s. 55(b) of the *Partnership Act*. The Court of Appeal found no such breach. With respect, I take a different view and, were it necessary to do so, I would reverse the Court of Appeal on this issue also.

71. It is my view that the sale by the General Partner of the non-producing lands of the partnership to itself, without the consent of all the Limited Partners, is a classic breach of fiduciary duty. I agree with Estey J. that one of the cardinal rules to be observed by one who stands in a fiduciary position--be it trustee, partner or director--is that the fiduciary must not sell to himself or herself property which rightly belongs to the *cestui que trust*--be it beneficiary, partnership or corporation (*Ex P. James* (1803), 8 Ves. Jun. 337, 32 E.R. 385 (Ch.); *Aberdeen Railway Co. v. Blaikie Brothers* (1854), 1 Macq. 461). In *Act Oils Ltd. v. Pacific Petroleum Ltd.* (1975), 1975 CanLII 1011 (AB CA), 60 D.L.R. (3d) 658 (Alta. C.A.), Sinclair J.A. said at p. 674:

To summarize, it seems beyond question that a trustee must not sell property to himself, whether or not he makes a profit, except under the most stringent of conditions. The rule equally applies to sales to persons, to firms or to companies in which the trustee is interested.

Any such sale is voidable at the instance of the limited partners even if the General Partner acted in good faith and paid a fair consideration for the property. It would take the clearest of language in the constitutive documents of the partnership to permit such a sale and, in my opinion, no such language is present. I agree with my colleague that the partnership agreement gives the General Partner the power to acquire and dispose of partnership lands and that it contemplates and

authorizes the General Partner to be in a conflict of interest position *vis-à-vis* the partnership in conducting its own business. It does not, however, go so far as to permit the sale of partnership assets by the General Partner to itself. The Court of Appeal was, in my view, in error in thinking that it did.

72. My colleague, however, has discussed the possibility of this Court's giving *ex post facto* judicial approval to the sale made in breach of the General Partner's fiduciary duty. The respondents submitted that this was in fact what the Court of Appeal did. If this is, indeed, what the Court of Appeal did, it certainly gave no hint of it in its reasons and it seems quite inconsistent with its conclusion that the respondents committed no breach of fiduciary duty. Why would court approval be needed in those circumstances?

73. In any event, I do not believe that this is an appropriate case for *ex post facto* court approval. Such approval is only given in very exceptional circumstances. My colleague relies on various American authorities cited in *Scott on Trusts*, vol. 2A (4th ed. 1987), at p. 339, where it is stated:

Not only may the court authorize a sale of trust property to the trustee personally, but after such a sale has taken place the court may approve the sale, if it still appears that the sale is for the best interest of the trust estate.

However, the cases cited by Scott demonstrate that the courts require compelling evidence not only that the sale is the best bargain for the estate but also that there are exceptional circumstances. In *Malone's Guardian Ad Litem v. Malone*, 73 S.W.2d 38 (Ky. 1934), for example, a scheme to sell part of an estate to the executrix was instigated and brought to

fruition by a beneficiary who subsequently became insane. Moreover, the sale was for the purpose of disencumbering the beneficiary's land from a mortgage on it. These circumstances permitted Richardson J. to conclude that the trustee (p. 41):

...has not trafficked in the estate for her own emolument nor has she designedly acquired an interest opposite the devisees She has merely perfected his own plan, formulated by him when of sound mind. The unusual and peculiar facts herein and the necessities of equity clearly take this case out of the general rule that a trustee cannot buy from himself the trust property

74. Similarly unusual circumstances prevailed in *Honeywell v. Dominick*, 76 S.E.2d 59 (S.C. 1953), where the sale of property relieved the estate of a considerable financial burden and the only "objections" came from beneficiaries not yet born. These potential beneficiaries were represented by a third party who attempted to evade a contract he had signed to buy the land by impugning the transaction by which the vendor had acquired it over a decade before.

75. There are many other cases in which U.S. courts have refused retrospective approval: see *Clay v. Thomas*, 198 S.W. 762 (Ky. 1917); *Morse v. Hill*, 136 Mass. 60 (1883). Indeed, some of the cases cited in *Scott, supra*, do not support his general proposition: see *Farley v. Davis*, 116 P.2d 263 (Wash. 1941), where the purchaser was held not to be a trustee.

76. English and Canadian courts have, if anything, applied an even stricter test for *ex post facto* approval. While the prohibition against purchase may be avoided by a court order (*Halsbury's Laws of England*, vol. 48, 4th ed., p. 436), the cases reveal that this order must be sought prior to the sale: *Campbell v. Walker* (1800), 5

Ves. Jun. 678, 31 E.R. 801, *per* Lord Arden, M.R. at p. 681 Ves. Jun., 802 E.R.; *Farmer v. Dean* (1863), 32 Beav 327, 55 E.R. 128; *Tennant v. Trenchard* (1869), 4 Ch. App. 537. Only in *Holder v. Holder*, [1968] Ch. 353 (C.A.), described in *Halsbury's, supra*, at p. 437 as a unique case, was *ex post facto* approval given by an English court. But in that case there was such a degree of involvement in the sale by the beneficiary that the court considered that he "must be taken to have acquiesced in or to have confirmed the sale and cannot now claim to have the sale set aside", *per* Danckwerts L.J. at p. 399.

77. Canadian courts have also applied a very strict test. Indeed, I have found no case in which retrospective approval was granted. The decision of Disbery J. in *Re Courtney and Mackie* (1972), 1972 CanLII 837 (SK KB), 23 D.L.R. (3d) 564 (Sask. Q.B.), cited by my colleague, does not assist the respondents here. The power to grant approval was conferred by statute in that case but the court nevertheless refused retrospective endorsement, holding that the application to the court should have been made prior to the sale. Disbery J. stated at p. 566:

Except in exceptional circumstances the application to approve a sale should be made at a time when the Court is free to either approve or refuse to approve. The Court should be asked to approve a *proposed* sale or a sale made subject to the obtaining of the court's approval thereto; and on the hearing of such applications all interested non-concurring parties would have an opportunity to be heard. This application is an attempt to obtain *ex post facto* approval for a sale . . . I decline in the circumstances of this case to give such *ex post facto* approval . . . [Emphasis in original.]

78. Similarly, in *Re Mitchell Estates* (1956), 1956 CanLII 181 (SK KB), 19 W.W.R. 86 (Sask. Q.B.), a case which predated the statute considered in *Re Courtney, supra*, Thomson J. stated at p. 89:

I recognize that there may be cases in which it would be to the advantage of an estate to permit an executor or administrator to purchase property of the estate but those are special cases and *prima facie* no sale of estate property to the executor or administrator by which the estate is being administered can be treated as a good and valid sale unless all those entitled to share in the distribution of the estate consent thereto or unless the sale is first approved by a court of competent jurisdiction . . . [Emphasis added.]

In *Re Mitchell* one of the next-of-kin had not consented to the sale of property of the estate to the administrator of the estate nor had the administrator attained prior court approval. However, Thomson J. made an order permitting the administrator to apply for *ex post facto* court approval. He said at p. 89:

In this case the respondent Helen E. Falconer has refused to consent to the sale. Unless, therefore, the appellant can obtain an order of the Court of Queen's Bench approving the sale of the land to her, she would *prima facie* have to account on the basis that there had been no sale of the land to her. Among other things, that would mean that she would have to account for the rents and profits since she assumed the administration of the estate.

...

In this case, however, the appellant has evidently assumed that she had the right to take over the land and I am of the opinion that in fairness to her she should have an opportunity of applying to the Court of Queen's Bench for an order determining what right, if any, she has in the said land or alternatively for an order approving the sale thereof to her.

I can find no record of such an application having been made.

79. Even were this Court to entertain an application for *ex post facto* approval, the circumstances of this case surely do not warrant the grant of such an order. An applicant for prospective court approval of a sale must show that a sale of the property was necessary, that no other purchaser was forthcoming or was likely to come forward within a reasonable time and that his offer in the circumstances was a favourable one: see *Waters, Law of Trusts in Canada*, at p. 630. For a case in which this stringent onus was met, see *Re Nathanson* (1971), 1971 CanLII 1079 (NS SC), 18 D.L.R. (3d) 495 (N.S.S.C.) It certainly cannot be met by the respondents in this case. And the burden is on the respondents to show that the sale meets this stringent onus and not, as my colleague suggests, on the appellant to show prejudice to him. Moreover, it seems to me to be an almost impossible onus for the respondents to meet having regard to the trial judge's finding that the sale violated s. 55(b) of the *Partnership Act*. Indeed, if the trial judge is correct, and (as already pointed out) his finding in that regard has not been reversed, the jurisdiction of a court to approve such a sale may, to say the least, be a matter of considerable doubt.

80. I see no ground, therefore, on which this Court could approve the sale by the General Partner of the non-producing lands of the partnership to itself if such an application were to be made. I should add that the trial judge was, through his order for an accounting and inquiries, attempting to obtain information which might shed some light on the state of the partnership accounts and assets and the circumstances surrounding the sale. There is certainly a dearth of information in the record as my colleague has pointed out. The procedure followed by the respondents in this case has, however, successfully frustrated the trial judge's efforts. If they are now seeking the Court's approval to the sale, I do not think the Court is in a position to give it.

81. For these reasons also I would dispose of the appeal as previously indicated.

82. *Appeal dismissed with costs, WILSON J. dissenting.*

Solicitors for the appellant: Ballem, McDill & MacInnes, Calgary.

Solicitors for the respondents: Howard, Mackie, Calgary.

TAB 8

At para(s) 36

Rochweg v. Truster, 2002 CanLII 41715 (ON CA)

Date: 2002-04-08
File number: C33317
Other citations: 58 OR (3d) 687 — 112 ACWS (3d) 962 — 158 OAC 41 — 23 BLR (3d) 107 — [2002] OJ No 1230 (QL)
Citation: **Rochweg v. Truster, 2002 CanLII 41715 (ON CA),**
<<https://canlii.ca/t/1db42>>, retrieved on 2024-04-25

Rochweg et al. v. Truster et al.
[Indexed as: Rochweg v. Truster]

58 O.R. (3d) 687

[2002] O.J. No. 1230

Docket No. C33317

Court of Appeal for Ontario

Charron, MacPherson and Cronk JJ.A.

April 8, 2002

Partnership -- Fiduciary duties -- Duty to account -- Partner was director of two companies which were clients of his accountancy partnership -- Partner disclosed his directorship to partners but not his entitlement under companies' Key Employee Stock Plan to certain shares and stock options -- Partnership subsequently dissolved -- Partner's acceptance of directorships and his activities as director did not place him in position of conflict with partnership so as to give rise to obligation to account under s. 30 of Partnerships Act -- Partner had duty to account to his former partners under s. 29(1) of Act -- Partnerships Act, R.S.O. 1990, c. P.5, ss. 29(1), 30.

The individual parties were chartered accountants and practised accountancy together in a partnership, RTZ. The corporate parties were holding companies which provided management and accounting technician services to RTZ. The respondent R was a partner in RTZ and director of two companies, TI Inc. and T Inc., which were clients of RTZ. He disclosed his directorships to his partners but did not tell them prior to the dissolution of RTZ that, as a director of the companies, he was entitled under TI Inc.'s Key Employee Stock Plan to certain shares and stock options in TI Inc. After the dissolution of RTZ, the issue

arose as to whether the appellants (R's partners and their holding companies) were entitled to an accounting from R for his shares and stock options of TI Inc. A trial of that issue was ordered and the claim for an accounting was dismissed. The appellants appealed.

Held, the corporate appellants' appeal should be dismissed; the individual appellants' appeal should be allowed in part.

No written partnership agreement existed. Consequently, the mutual rights and duties of the partners were governed by the Partnerships Act.

At all times while he was a partner of RTZ, R owed his partners duties of loyalty, utmost good faith and avoidance of conflict and self-interest. In equity and under the Act, partners are subject to a strict duty of disclosure concerning full information of all things affecting their partnership. Under s. 29(1) of the Act, where undisclosed benefits are derived by a partner from a transaction "concerning the partnership", or from use by a partner of the "partnership property, name or business connection", a duty to account will arise. Liability to account may attach to a partner under either branch of s. 29(1). In addition, under s. 30 of the Act, a partner may be required to account to his/her co-partners for undisclosed profits where the partner carries on a business of the same nature as, and competing with, that of the partnership. This obligation flows from a partner's duty to avoid conflicts of interest. R's acceptance of directorships in the companies and his activities as director did not place him in a position of conflict with RTZ, or in respect of his duties as a partner of RTZ, and did not give rise to a duty to account under s. 30 of the Act.

However, R's entitlement to the TI Inc. shares and stock options derived from his directorships in the companies and formed part of his compensation as a director, although in non-fee income form, paid or made available to him by a client of RTZ. As such, the shares and stock options constituted compensatory benefits in a manner "affecting" and "concerning" the partnership which he was obliged to disclose to his partners under s. 28 of the Act, and for which he was required to account under the first branch of s. 29(1) of the Act. To trigger an obligation to account under the first branch of s. 29(1), transactions "concerning the partnership" need not, although they may, relate to transactions or dealings falling within the scope of the partnership's activities or services. So long as the transaction at issue concerns the partnership, liability to account under the first branch of s. 29(1) can relate to benefits derived from dealings outside the "scope of the partnership".

Moreover, R became a director of the companies only because of his previous role, through RTZ and its predecessor partnerships, as their accountant and valued advisor. When R joined the RTZ partnership and the companies became clients of that firm, his prior connection and association with the companies became a business connection of RTZ with two of its clients. Accordingly, R's benefits under the Key Employee Stock Plan were benefits derived from his use of a "partnership . . . business connection" within the meaning of the second branch of s. 29(1) of the Act. Consequently, R was also liable to account to his former partners for the shares and stock options on this additional ground. The second branch of s. 29(1) is not confined to misuse in situations falling within the "scope of the partnership".

APPEAL from a judgment of Mandel J. (1999), 1999 CanLII 14935 (ON SC), 1 B.L.R. (3d) 257 (S.C.J.) dismissing an appellants' claim for an accounting.

Regal (Hastings) Ltd. v. Gulliver, [1942] 1 All E.R. 378, [1967] A.C. 134n (H.L.), *consd* Other cases referred to Aas v. Benham, [1891] 2 Ch. 244, 65 L.T. 25 (C.A.); Advanced Realty Funding Corp. v. Bannink (1979), 1979 CanLII 1681 (ON CA), 27 O.R. (2d) 193, 106 D.L.R. (3d) 137, 9 B.L.R. 161, 12 R.P.R. 17 (C.A.); Asamera Oil Corp. Ltd. v. Sea Oil & General Corp. and Baud Corp., N.V., 1978 CanLII 16 (SCC), [1979] 1 S.C.R. 633, 89 D.L.R. (3d) 1, 23 N.R. 181, [1978] 6 W.W.R. 301, 5 B.L.R. 225 (sub nom. Baud Corp., N.V. v. Brook); Boardman v. Phipps, [1967] 2 A.C. 46, [1966] 3 All E.R. 721, [1966] 3 W.L.R. 1009, 110 Sol. Jo. 853 (H.L.); Cameron v. Julien, 1957 CanLII 367 (ON CA), [1957] O.J. No. 242, 9 D.L.R. (2d) 460, [1957] O.W.N. 430 (C.A.); Canadian Aero Service Ltd. v. O'Malley, 1973 CanLII 23 (SCC), [1974] S.C.R. 592, 40 D.L.R. (3d) 371, 11 C.P.R. (2d) 206; Canson Enterprises Ltd. v. Boughton & Co., 1991 CanLII 52 (SCC), [1991] 3 S.C.R. 534, 61 B.C.L.R. (2d) 1, 85 D.L.R. (4th) 129, 131 N.R. 321, [1992] 1 W.W.R. 245, 9 C.C.L.T. (2d) 1, 39 C.P.R. (3d) 449, 43 E.T.R. 201; Davis v. Ouellette (1981), 1981 CanLII 626 (BC SC), 27 B.C.L.R. 162 (S.C.); Dean v. McDowell (1878), 8 Ch. D. 345, 47 L.J. Ch. 537, 38 L.T. 862, 42 J.P. 580, 26 W.R. 486 (C.A.); Helmore v. Smith (No. 1) (1887), 35 Ch. D. 436, 56 L.T. 535, 36 W.R. 3 (C.A.); Latta v. Kilbourn, 150 U.S. 524 (1893); Metcalfe v. Bradshaw, 145 Ill. 124 (S.C. 1893); Nowegijick v. R., 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29, 144 D.L.R. (3d) 193, 46 N.R. 41, 83 D.T.C. 5041; Olson v. Gullo (1994), 1994 CanLII 1268 (ON CA), 17 O.R. (3d) 790, 113 D.L.R. (4th) 42, 1 L.W.R. 417, 20 B.L.R. (2d) 47, 54 C.P.R. (3d) 497, 2 E.T.R. (2d) 286, 38 R.P.R. (2d) 204 (C.A.) [Leave to appeal to S.C.C. refused (1994), 20 O.R. (3d) xv, 41 R.P.R. (2d) 317, 4 E.T.R. (2d) 280n, 179 N.R. 400n, 20 B.L.R. (2d) 47n]; Parker v. McKenna (1874), 10 Ch. App. 96, 44 L.J. Ch. 425, 31 L.T. 739, 23 W.R. 271 (L.C. & L.J.); Shrader v. Downing, 79 Wash. 476 (S.C. 1914); Slattery (Trustee of) v. Slattery, 1993 CanLII 73 (SCC), [1993] 3 S.C.R. 430, 139 N.B.R. (2d) 246, 106 D.L.R. (4th) 212, 158 N.R. 341, 357 A.P.R. 246, 21 C.B.R. (3d) 161, 93 D.T.C. 5443; Truman v. Martin, 212 Neb. 52 (S.C. 1982) Statutes referred to Partnership Act, 1890, 53 & 54 Vict., c. 39, ss. 19, 28, 29(1), 30, 46 Partnership Act, S.O. 1920, c. 41, ss. 29, 30(1), 31 Partnerships Act, R.S.O. 1990, c. P.5, ss. 20, 24, 28, 29(1), 30, 32, 33(1), 43, 44, 45 Authorities referred to Banks, R.C.I., Lindley & Banks on Partnership, 17th ed. (London: Sweet & Maxwell, 1995) Drake, C.D., Law of Partnership, 3rd ed. (London: Sweet & Maxwell, 1983) Gower, L.C.B., Pollock on the Law of Partnership, 15th ed. (London: Stevens & Sons Ltd., 1952) Manzer, A.R., and M. Ellis, A Practical Guide to Canadian Partnership Law (Aurora: Canada Law Book Inc., 2001) Morse, G., Partnership Law and Practice in England and Scotland (London: Sweet & Maxwell, 1980) Treitel, G.H., The Law of Contract, 4th ed. (London: Stevens & Sons, 1975)

T. Kerzner, for appellants.

A.M. Robinson and B.D. Moldaver, for respondents.

The judgment of the court was delivered by

CRONK J.A.: --

I. INTRODUCTION

[1] This appeal involves the obligation of a partner in a now-dissolved chartered accountancy firm to account to his former partners for shares and stock options acquired by him from a corporate client of the firm, when he was both a partner of the firm and a director of the client. If he is obliged to account, secondary issues are the proper extent of the accounting and whether the other partners had a duty to mitigate their losses.

[2] The individual parties are chartered accountants. They practised accountancy together in a partnership known as Rochweg Truster Zweig ("RTZ") from January 1, 1993 to July 31, 1996, when Cecil Rochweg ("Rochweg") left the firm and the partnership was dissolved. The corporate parties, family holding corporations of the individual parties, provided management and accounting technician services to RTZ, through a partnership known as Coldstream Consultants.

[3] Teklogix International Inc. ("Teklogix") and its wholly- owned subsidiary Teklogix Inc. were clients of the RTZ partnership. In July 1995, Rochweg became a director of both companies. He made timely disclosure to his partners of his directorships, and remitted his first year's directors' fees to the firm. However, he did not tell his partners prior to the dissolution of RTZ that, as a director of Teklogix and Teklogix Inc., he was entitled to certain shares and stock options in Teklogix.

[4] After the dissolution of RTZ, various issues arose concerning its winding-up, including whether the appellants were entitled to an accounting from the respondents for Rochweg's shares and stock options in Teklogix. On May 23, 1997, Matlow J. directed the trial of various issues, including:

Whether [Rochweg] is required to account to the partnership for any interest he or Julie Rochweg [his wife], or any other family member or any other non-arms length party may have in certain shares and/or options to purchase the shares of Teklogix.

[5] By judgment dated November 18, 1999, Mandel J. dismissed the appellants' claims for an accounting in relation to the Teklogix shares and stock options, amongst other matters. The appellants appeal that decision and the award of party and party costs against them in respect of the action and their counterclaim. For the reasons that follow, I would dismiss the appeal of the corporate appellants and allow, in part, the appeal of the individual appellants against Rochweg.

II. THE ISSUES

[6] Three main issues arise on this appeal:

(a) Was Rochweg obliged to disclose his shares and stock options in Teklogix to his partners in RTZ?

(b) Is Rochweg obliged to account to his former partners for any benefits or profits derived by him in connection with his directorships in the Teklogix companies including, in particular, for the Teklogix shares and stock options?

(c) If an obligation to account arises, what is the extent of the required accounting?

III. CONTEXT AND OVERVIEW OF CONCLUSIONS

(1) The Legal Context

[7] No written partnership agreement existed among the partners of RTZ. Accordingly, the mutual rights and duties of the partners are governed by the Partnerships Act, R.S.O. 1990, c. P.5 (the "Act").

[8] Sections 20, 28, 29(1), 30 and 45 of the Act are of particular relevance to the issues raised on this appeal. As discussed later in these reasons, they derive from the 19th- century law of partnership as developed in England. They state:

20. The mutual rights and duties of partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either expressed or inferred from a course of dealing.

.....

28. Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or the partner's legal representatives.

29(1) Every partner must account to the firm for any benefit derived by the partner without the consent of the other partners from any transaction concerning the partnership or from any use by the partner of the partnership property, name or business connection.

.....

30. If a partner, without the consent of the other partners, carries on a business of the same nature as and competing with that of the firm, the partner must account for and pay over to the firm all profits made by the partner in that business.

.....

45. The rules of equity and of common law applicable to partnership continue in force, except so far as they are inconsistent with the express provisions of this Act.

[9] As appears from these sections, the Act permits partners to vary by consent their mutual rights and duties as otherwise established by agreement between them or by the statute (s. 20). That did not occur in this case. The Act also imposes certain specific duties on partners, including disclosure obligations (s. 28) and an obligation to account in certain circumstances (ss. 29(1) and 30). Section 45 of the Act is of particular importance. It recognizes that the statute is not a complete codification of the law of partnership in Ontario, and it adopts and continues the rules of equity and of common law, save as they are inconsistent with the express provisions of the statute, as part of Ontario's law of partnership. As a result, the caselaw concerning partnerships developed over the last century continues to inform and, in some instances, to govern, the relations among partners.

(2) The Facts

[10] Rochweg was a partner of various accounting firms for approximately 25 years prior to the creation of the RTZ partnership. From its inception in 1967, Teklogix Inc., a high technology company, was a client of the various firms in which Rochweg was a partner, as was Teklogix, the holding company for various subsidiaries in the Teklogix group of companies, following its formation in 1983. For most of those years, Rochweg was the main partner contact with the Teklogix companies. Both companies became clients of RTZ following its creation in 1993.

[11] The RTZ partnership had no established securities investment policy. To the extent that there were any precedents for investments in securities by the partners of the firm, they were confined to two situations described by the trial judge. Neither situation established any course of dealing from which the mutual rights and duties of the partners could be inferred, within the meaning of s. 20 of the Act.

[12] In addition, directorships were not normal incidents of the RTZ accountancy practice. The record discloses no directorships held by any RTZ partner other than Rochweg's directorships in the Teklogix companies, which were his first directorships.

[13] RTZ provided a variety of normal accounting and auditing services to Teklogix. In addition, it advised on tax issues and an estate freeze plan involving the shares of some of the company's principals, prepared valuation reports, and provided financial data concerning the raising of capital from various banking institutions, offers to purchase by other companies, budgeting, and valuations by other firms. During the years that RTZ served as auditor to the Teklogix companies, neither RTZ nor Rochweg played any role in their management.

[14] In the fall of 1993 and throughout part of 1994, Teklogix contemplated an initial public offering ("IPO") of its shares and changed auditors from RTZ to a national accounting firm. However, RTZ remained the auditor of Teklogix Inc. An IPO did not proceed at that time but, by May and June of 1995, it was again under consideration. To that end, the assembly of information for the preparation of a prospectus commenced, and RTZ's retainer as auditor to Teklogix Inc. was terminated.

[15] On July 8, 1995, Rochweg became a director of both Teklogix and Teklogix Inc. As a director, he was eligible to participate in Teklogix's key employee stock plan (the "KESP"), which entitled him to subscribe for 8,000 common shares in Teklogix and, upon subscription, to acquire the Escrow Shares and the IPO Stock Option, as described later in these reasons.

[16] Rochweg informed the appellant, Perry Truster ("Truster"), of his appointments as a director and further told him that, as he would be attending directors' meetings during firm time, his directors' fees would be paid to the firm. However, Rochweg did not inform his RTZ partners, including Truster, of his investment rights under the KESP. They learned of his shares and stock options in Teklogix in the fall of 1996, after dissolution of RTZ and following an inquiry by Truster of Rochweg's solicitors.

[17] John Coutts ("Coutts"), one of the founders of Teklogix Inc., testified that after Rochweg became a director of the Teklogix companies, RTZ continued to perform some professional services for them, although at a reduced level due to RTZ's loss of the Teklogix audits. The record before this court does not establish the nature and scope of the services provided by the firm to the Teklogix companies after July 8, 1995.

[18] Similarly, few details regarding the nature of the services furnished by Rochweg as a director of Teklogix and Teklogix Inc. are evident from the record save that, effective with his appointment as a director, Rochweg became a member and, subsequently, the Chair of Teklogix's Audit Committee. In addition, in August or September of 1996, after dissolution of the RTZ partnership, he assisted Teklogix with a research matter involving Revenue Canada. Truster was involved in one meeting regarding that project but had no further involvement with it or Teklogix.

[19] Despite the lack of detail on the nature of Rochweg's services as a director, it is clear that retention of Rochweg's advice and counsel after full severance of the Teklogix group's audit relationship with RTZ was the purpose of Rochweg's appointments as a director of the Teklogix companies. Coutts testified that Rochweg was offered the directorships because of the desire of the Teklogix principals to retain the "same counsel" they had previously received from Rochweg during his long association with them. He indicated that Rochweg was a "trusted advisor", they wanted "to maintain a relationship so that he could continue to give the kind of advice that he had given in the past" as might be requested, and the directorships were offered "to lock in the continuation of that counsel and advice".

[20] On July 24, 1985, Rochweg borrowed funds from a bank and subscribed for 8,000 common shares of Teklogix at an aggregate cost of \$39,600. With the knowledge of Teklogix, the shares were registered in the name of Rochweg's wife. In August 1995, Rochweg signed an option and escrow agreement concerning the Escrow Shares and the IPO Stock Option. The following month, Teklogix made an IPO at an IPO or "strike" price of \$12 per common share.

[21] In early July 1996, Rochweg gave notice of his intention to withdraw from the RTZ partnership, effective July 31, 1996. The RTZ partnership was dissolved on that date.

(3) Overview of Conclusions

[22] Equitable principles recognized by the courts during the last 100 years impose on partners duties of loyalty, utmost good faith and avoidance of conflict and self-interest. In Ontario, the principles which inform these duties are partially reflected in the Act. At all times while Rochweg was a partner of RTZ, he owed these duties to his partners.

[23] In equity and under the Act, partners are subject to a strict duty of disclosure concerning full information of all things affecting their partnership. Rochweg's failure to disclose his interest in the Teklogix shares and stock options to his partners (until after dissolution of RTZ), and the consequences of such failure in the circumstances, if any, lay at the heart of the issues raised on this appeal.

[24] In a proper case, a breach of a partner's disclosure duty may give rise to liability in damages for the loss suffered by those to whom the duty was owed. This remedy is distinct from the obligation to account established by the rules of equity, and by ss. 29(1) and 30 of the Act, and is not the subject-matter of this appeal.

[25] Under s. 29(1), where undisclosed benefits are derived by a partner from a transaction "concerning the partnership", or from use by a partner of the "partnership property, name or business connection", a duty to account will arise. Liability to account may attach to a partner under either branch of s. 29(1). In addition, under s. 30 of the Act, a partner may be required to account to his/her co-partners for undisclosed profits where the partner carries on a business of the same nature as, and competing with, that of the partnership. This obligation flows from a partner's duty to avoid conflicts of interest.

[26] In these reasons, I consider whether Rochweg's acceptance of directorships in the Teklogix companies, and his activities as a director, placed him in a position of conflict with the RTZ partnership, or in respect of his duties as a partner of RTZ, giving rise to an obligation to account under s. 30 of the Act. I conclude that it did not and, in this respect, I agree with the trial judge's conclusion.

[27] In this case, however, Rochweg's entitlement to the Teklogix shares and stock options derived from his directorships in the Teklogix companies and formed part of his compensation as a director, although in non-fee income form, paid or made available to him by a client of RTZ. As such, in my view, the Teklogix shares and stock options constituted compensatory benefits in a matter "affecting" and "concerning" the partnership which he was obliged to disclose to his partners under s. 28 of the Act, and for which he must account under the first branch of s. 29(1) of the Act.

[28] Moreover, Rochweg became a director of the Teklogix companies only because of his previous role, through RTZ and its predecessor partnerships, as their accountant and valued advisor. When Rochweg joined the RTZ partnership and the Teklogix companies became clients of that firm, his prior connection and association with the Teklogix companies became a business connection of RTZ with two of its clients. Accordingly, I conclude that Rochweg's benefits under the KESP were benefits derived by him from his use of a "partnership . . . business connection" within the meaning of the second branch of s. 29(1) of the Act. Consequently, Rochweg is also liable to account to his former partners for the Teklogix shares and stock options on this additional ground.

IV. ANALYSIS

(1) The Claim for an Accounting

(a) The positions of the parties

[29] The appellants assert that Rochweg, as a partner of RTZ, owed them a fiduciary duty and a duty of utmost good faith, and that his failure to disclose to them the investment opportunities or benefits provided to him by Teklogix constituted a breach of such duties thereby giving rise to an obligation to account.

[30] In turn, the respondents argue that no obligation to account arises. They acknowledge that partners owe a fiduciary duty to one another. They argue, however, that this duty is confined to matters falling within the "scope of the partnership", or to the conduct of a business of the same nature as, and competing with, the partnership business. They submit that neither situation arose in this case.

(b) The decision of the trial judge

[31] The Act is not mentioned in the reasons of the trial judge. Rather, his decision, which is likely responsive to the parties' arguments, is premised on an examination of the activities falling within, or outside, the "scope of the business of the partnership". He found [at p. 276 B.L.R.] that:

[T]he appointment of Rochweg as a director; his duties as such; his duties on the Audit Committee; the advice and counsel that he gives; and the shares and options that he invested in are outside the scope of the partnership. I further find that there was no competition with the business of the partnership and as stated in the Aas case [Aas v. Benham, [1891] 2 Ch. D. 244 (C.A.)] at p. 260, "The position of director of that company is not inconsistent with that of a partner in the firm" and I so specifically find. Nor did Rochweg act as agent of the partners; nor were the shares and options acquired for or on behalf of the partners. I find that the individual defendants do not and did not have any interest in such shares and options.

With respect, for the reasons that follow, I disagree with several of these conclusions.

(c) The corporate parties

[32] In their Notice of Appeal, and in oral argument before this court, the appellants do not distinguish between the corporate and individual appellants for the purpose of the claim for an accounting.

[33] The trial judge found that none of the corporate appellants had any interest in the Teklogix shares or stock options, and he dismissed their claims. Similarly, he held that Mymyk Corp., Rochweg's family holding corporation controlled by his wife, had never owned or held an interest in the Teklogix shares or stock options, and he dismissed the claims of the appellants against it.

[34] On the record before this court, in my view, there is no basis on which the corporate appellants could assert an interest in the Teklogix shares or stock options as against either of the respondents. I see no reason, therefore, to disturb the trial judge's dismissal of the claims by and against the corporate parties. Accordingly, the issues on this appeal are confined to the claims of the individual parties.

(d) The origins of the modern partnership rules

[35] As I stated earlier in these reasons, partnership law in England has had a substantial influence on the development of partnership law in Ontario. The Act derives both from the English caselaw and the 1890 Partnership Act, 53 & 54 Vict., c. 39. Under s. 45 of Ontario's Act, the English jurisprudence

remains relevant to Ontario's law of partnership. (See M. Ellis and A. Manzer, *A Practical Guide to Canadian Partnership Law* (Aurora: Canada Law Book Inc., 2001), at 5-9.) It follows, in my view, that the starting point for analysis of the issues in this case, is the origins of the modern partnership rules.

[36] It has long been established that partners owe a fiduciary duty to each other, and that equitable principles hold fiduciaries to a strict standard of conduct, encompassing duties of loyalty, utmost good faith and avoidance of conflict of duty and self-interest. These are well recognized, core principles of the law of partnership.

[37] In the early case of *Dean v. MacDowell* (1878), 8 Ch. D. 345, 47 L.J. Ch. 537 (C.A.), James L.J. described the operative principles as follows (at pp. 350-51 Ch. D.):

[I]t is quite clear also that in partnership matters there must be the utmost good faith, and that there is to that extent a fiduciary relation between the parties. That is to say, one partner must not directly or indirectly use the partnership assets for his own private benefit. He must not, in anything connected with the partnership, take any profit clandestinely for himself, nor must he carry on the business of the partnership or any business similar to the business of the partnership in his own or another name separate from it, otherwise than for the benefit of the partnership.

(Emphasis added)

These principles preclude a partner from using partnership assets for personal gain, from making secret profits in "anything connected with the partnership", and from engaging for his/her personal benefit in competing or similar businesses to that of the partnership.

[38] The concurring reasons of Cotton L.J. emphasized that ". . . the business in which the Defendant engaged was in no way within the scope of the partnership" (at p. 353 Ch. D.). He elaborated (at p. 354 Ch. D.):

There are clear rules and principles which entitle one partner to share in the profits made by his co-partners. If profit is made by business within the scope of the partnership business, then the partner who is engaging in that secretly cannot say that it is not partnership business. It is that which he ought to have engaged in only for the purposes of the partnership . . . So, again, if from his position as partner he gets a business which is profitable, or if from his position as partner he gets an interest in partnership property, or in that which the partnership require for the purposes of the partnership, he cannot hold it for himself, because he acquires it by his position of partner, and acquiring it by means of that fiduciary position, he must bring it into the partnership account.

(Emphasis added)

[39] Thesiger L.J., in his concurring reasons, identified three core principles governing the law of partnership (at pp. 355-56 Ch. D.):

The first of those principles is that a partner shall not derive any exclusive advantage by the employment of the partnership property. . . . The second principle . . . is, that a partner is not to derive any exclusive advantage by engaging in transactions in rivalry with the firm. . . . The third principle . . . is, that a partner is not allowed in transacting the partnership affairs to carry on for his own sole benefit any separate trade or business which, were it not for his connection with the partnership, he would not have been in a position to carry on.

[40] *Aas v. Benham*, [1891] 2 Ch. 244, 65 L.T. 25 (C.A.) further confirmed the principles discussed in *Dean v. MacDowell*. In that case, Lindley L.J. stated (at pp. 255-56 Ch.):

It is clear law that every partner must account to the firm for every benefit derived by him without the consent of his co-partners from any transaction concerning the partnership or from any use by him of the partnership property, name or business connection . . . It is equally clear law that if a partner without the consent of his co-partners carries on business of the same nature as, and competing with that of the firm, he must account for and pay over to the firm all profits made by him in that business . . . As regards the use by a partner of information obtained by him in the course of the transaction of partnership business, or by reason of his connection with the firm, the principle is that if he avails himself of it for any purpose which is within the scope of the partnership business, or of any competing business, the profits of which belong to the firm, he must account to the firm for any benefits which he may have derived from such information, but there is no principle or authority which entitles a firm to benefits derived by a partner from the use of information for purposes which are wholly without the scope of the firm's business . . . To hold that a partner can never derive any personal benefit from information which he obtains as a partner would be manifestly absurd.

[41] *Dean v. MacDowell* and *Aas v. Benham* established that a partner could engage in activities outside of the "scope of the business of the partnership" for his/her own benefit or profit without liability to account. In the former case, this rule applied notwithstanding that the involved partner had covenanted, by the articles of partnership, to devote his whole time to the partnership business. In these circumstances, while damages for breach of the covenant might have been obtained, the courts did not recognize a strict obligation to account. These principles were approved and followed in several cases in the United States, relied upon by the respondents on this appeal. (See *Latta v. Kilbourn*, 150 U.S. 524 (1893); *Metcalf v. Bradshaw*, 145 Ill. 124 (S.C. 1893); *Shrader v. Downing*, 79 Wash. 476 (S.C. 1914); and *Truman v. Martin*, 212 Neb. 52 (S.C. 1982)).

[42] After commencement of the action in *Aas v. Benham*, the Partnership Act of 1890 was introduced in England. It sought to codify many aspects of the law of partnership and, in so doing, imposed a strict obligation of full disclosure on partners, in relation to co-partners. Section 28 provided:

28. Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.

[43] The drafters of the 1890 statute recognized, however, that much of the law relating to partnerships emanated from caselaw (see C.D. Drake, *Law of Partnership*, 3rd ed. (London: Sweet & Maxwell, 1983), at p. 27). For this reason, s. 46 of the Partnership Act of 1890 preserved the application of the rules of equity and common law applicable to partnerships, except as they were inconsistent with the express provisions of the statute.

[44] A significant restatement and application of the rules of fiduciary law was made by the House of Lords in *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378, [1967] A.C. 134n (H.L.), a case relied upon by all parties to this appeal. In *Regal (Hastings)*, four directors of the company derived profits from their acquisition of shares in another company, which the board of directors of Regal had intended to acquire for Regal. It was accepted that, in subscribing for the shares, the Regal directors had acted in good faith, intending to further the interests of Regal. Nonetheless, Lord Russell of Killowen observed "they may be liable to account for the profits which they have made, if, while standing in a fiduciary relationship to Regal, they have by reason and in the course of that fiduciary relationship made a profit" (at p. 385 All E.R.). He then stated, in an oft-quoted passage (at p. 386 All E.R.):

[t]he rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.

(Emphasis added)

[45] In holding the Regal directors accountable for the profits realized, Lord Russell of Killowen (at p. 388 All E.R.) and Lord Wright (at p. 393 All E.R. of his concurring reasons), relied upon the following view of James L.J. expressed in *Parker v. McKenna* (1874), 10 Ch. App. 96 at p. 124, 44 L.J. Ch. 425:

[I]t appears to me very important that we should concur in laying down again and again the general principle that in this court no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge of his principal; that the rule is an inflexible rule, and must be applied inexorably by this court . . .

(Emphasis added)

[46] The obligation of an agent to his principal, as discussed in *Parker v. McKenna* and endorsed in *Regal (Hastings)*, enjoys special relevance in partnership law. As stated by L.C.B. Gower in *Pollock on the Law of Partnership*, 15th ed. (London: Stevens & Sons Ltd., 1952) (at pp. 84-85):

The general principle is one of those which the law of partnership takes from agency, considering each partner as agent for the firm; or it is perhaps better to say that it is established in both these branches of the law [equity and agency] on similar grounds. The rule that an agent must not deal on his own account or make any undisclosed profit for himself is a stringent and universal one [Story on Agency, ss. 210, 211], and extends not only to cases in which the profit is made out of the business in which he is employed, but also to cases in which it is made as a result of a misuse of the principal's property, even although for a purpose entirely disconnected with the business [Reading v. The King, [1951] A.C. 507 (H.C.)].

(Emphasis added)

[47] Under English caselaw, therefore, the equitable obligation to account for secret profits has been based, variously, on agency principles, the separate but related ground of fiduciary relations, or the law of trusts.

[48] The principles in *Aas v. Benham and Regal (Hastings)* were considered by the House of Lords in *Boardman v. Phipps*, [1967] 2 A.C. 46, [1966] 3 All E.R. 721 (H.L.) in relation to a claim for an accounting of profits made by the appellants as a result of a transaction entered into by reason of information obtained by them in the course of their fiduciary duties. Lord Hodson, in writing one of the majority opinions, described the proposition of law in *Regal (Hastings)* as follows (at p. 105 A.C.):

[N]o person standing in a fiduciary position, when a demand is made upon him by the person to whom he stands in the fiduciary relationship to account for profits acquired by him by reason of his fiduciary position and by reason of the opportunity and the knowledge, or either, resulting from it, is entitled to defeat the claim upon any ground save that he made profits with the knowledge and assent of the other person.

[49] Lord Hodson further reasoned (at p. 111 A.C.): "The appellants obtained knowledge by reason of their fiduciary position and they cannot escape liability by saying that they were acting for themselves and not as agents of the trustees." The appellants relied on *Aas v. Benham* in support of their contention that they were not liable to account because the transaction they had entered into was outside the scope of the fiduciary relationship existing between them and the respondents. The House of Lords, by majority opinion, disagreed, finding that the fiduciary relationship in question was general in nature, and not as readily defined as that between the partners in *Aas v. Benham*. In either case, the extent of the obligation depended on the scope of the fiduciary relationship.

[50] The principles established by these cases were embodied in ss. 29(1) and 30 of the 1890 Partnership Act in England. In 1920, they were incorporated, in virtually identical language, in ss. 30(1) and 31 of Ontario's Partnership Act, S.O. 1920, c. 41, and have remained unchanged, save for the renumbering of the sections, in Ontario's legislation to date. Under the current Act, they are reflected in ss. 29(1) and 30. In addition, the disclosure obligation imposed on partners under s. 28 of the 1890 Partnership Act in England was originally introduced in Ontario, in identical language, by s. 29 of the Partnership Act of 1920. It is currently embodied in s. 28 of the Act. Finally, s. 20 of the Act, which

recognizes that partners are free to regulate their dealings with one another and with third parties by agreement, derives from s. 19 of the English Partnership Act of 1890. (See also, ss. 24, 32, 33(1), 43 and 44 of the Act).

(e) The approach in Ontario

[51] Little jurisprudence regarding ss. 28, 29(1) and 30 of the Act has developed in Ontario. In considering the import of those provisions, and their application to this case, it is important to recognize the distinctions between ss. 29(1) and 30.

[52] First, an obligation to account arises under s. 29(1) without proof of a competing activity. In contrast, the obligation to account established by s. 30 of the Act requires proof of competition.

[53] Second, s. 29(1) has two branches. An obligation to account may arise wherever a benefit has been derived by a partner, without the consent of the other partners, from "any transaction concerning the partnership" or from "any use . . . of the partnership property, name or business connection".

[54] In this case, the trial judge's analysis of Rochweg's obligation to account focused in significant part on whether Rochweg's activities as a director of the Teklogix companies came within the "scope of the [RTZ] partnership". That focus is understandable given the prominence of that term in the established English cases. However, the trial judge failed to consider that that term does not encompass the entire basis for accountability that was recognized by the English courts, and that informed the scope of Ontario's legislation. Indeed, it is not clear on the record before this court, whether the provisions of the Act were drawn to the attention of the trial judge, or whether the distinctions between the two branches of s. 29(1) of the Act, or between ss. 29(1) and 30, and their relationship to s. 28 of the Act, were argued before him.

[55] The trial judge's decision that Rochweg was not obliged to account to his former partners for the Teklogix shares and stock options was anchored in his conclusions that Rochweg's activities with, and his investments in, the Teklogix companies were "outside the scope of the partnership" and that "there was no competition with the business of the partnership". While I agree with the latter conclusion, which relates to liability to account under s. 30 of the Act, with respect, I do not agree that the former conclusion is dispositive of the issue of liability to account under s. 29(1) of the Act.

[56] In my view, to trigger an obligation to account under the first branch of s. 29(1) of the Act, transactions "concerning the partnership" need not, although they may, relate to transactions or dealings falling within the scope of the partnership's activities or services. Rather, so long as the transaction at issue "concern[s]" the partnership, liability to account under the first branch of s. 29(1) can relate to benefits derived from dealings outside the "scope of the partnership". I reach this conclusion for the following reasons.

[57] The phrase, "scope of the partnership" does not appear in s. 29(1) despite its frequent usage in the caselaw prior to the introduction of the current Act and its predecessors in Ontario, commencing as early as 1876 with the decision in *Dean v. MacDowell*. In that case, and in related subsequent cases, the

phrase "scope of the partnership" was defined according to the nature of the business activities or services at issue, contrasted with those of the relevant partnership. This approach is reflected in the language of s. 30 of the Act, which expressly refers to "a business of the same nature as . . . that of the firm". Thus, a s. 30 analysis specifically requires examination, and a comparison, of the nature of the business of the partnership and the allegedly competing business. (See, for example, *Aas v. Benham*).

[58] The first branch of s. 29(1), however, uses different language and does not refer to "a business of the same nature as . . . that of the firm". It must be taken, therefore, that a different meaning may attach to the phrase "concerning the partnership". In my view, the word "concerning", as used in s. 29(1), means "relating to", "in respect of", "referring to" or "connected to" in the sense of a transaction affecting the interest of, or important to, the partnership. Such words, in their ordinary and legal usage, enjoy a wide connotation and have been interpreted by the courts as having the "widest possible scope . . . of any expression intended to convey such connection between two related subject matters". (See *Nowegijick v. R.*, 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29, 144 D.L.R. (3d) 193, per Dickson J. at p. 200; *Slattery (Trustee of) v. Slattery*, 1993 CanLII 73 (SCC), [1993] 3 S.C.R. 430, 106 D.L.R. (4th) 212; J.R. Nolan and J.M. Nolan- Haley, *Black's Law Dictionary*, 6th ed. (St. Paul: West Publishing, 1996); W. Little, H.W. Fowler, J. Coulson and C.T. Onions, *The Shorter Oxford English Dictionary*, 3rd ed., vol. 1 (Oxford: Clarendon Press, 1973); and *Canadian Dictionary of the English Language* (Toronto: ITP Nelson, 1998).) Accordingly, while a transaction "concerning the partnership" requires a link between the transaction and the partnership, that link can include, but is not limited to, activities or services within the "scope of the [partnership] business".

[59] Similarly, in my view, the second branch of s. 29(1), which contemplates misuse of the "partnership property, name or business connection", is not confined to misuse in situations falling within the "scope of the partnership". The language of s. 29(1) does not import such a requirement, either expressly or by implication. Indeed, if s. 29(1) were so interpreted, it would significantly narrow those situations involving misuse of the "partnership property, name or business connection" which would ground an obligation to account, and would permit such misuse so long as it occurred in a transactional or business context dissimilar from that of the partnership. Such an interpretation would result in commercial absurdity and considerable injustice in the law of partnership. It is, therefore, to be rejected.

[60] A third distinction between ss. 29(1) and 30 exists. Liability to account under the second branch of s. 29(1) is based on usage of the "partnership property, name or business connection". In contrast, s. 30 of the Act does not require proof of any use of partnership assets. As observed by R. Burgess and G. Morse, *Partnership Law and Practice in England and Scotland* (London: Sweet & Maxwell, 1980) with reference to the corresponding provisions of the English statute (at p. 141):

[S]ections 29 and 30 must therefore be kept distinct. The latter simply requires competition without proof of any misuse of the partnership business connection, etc., the former requires such misuse but no element of competition.

[61] In *Cameron v. Julien*, 1957 CanLII 367 (ON CA), [1957] O.J. No. 242, 9 D.L.R. (2d) 460 (C.A.), Schroeder J.A. stated on behalf of this court (at paras. 8 and 9, pp. 465-66 D.L.R.):

When a dispute arises between partners, the tribunal charged with the duty of determining the rights of the parties must approach a consideration of the issues with certain firmly established equitable principles in mind. In Halsbury's Laws of England, 2nd Ed. Vol. 24, at p. 449, para. 860, the basis of the relationship between partners is defined as follows:

Ordinary partnerships are by the law presumed to be based on the mutual trust and confidence of each partner, not only in the skill and knowledge but also in the integrity of every other partner. The utmost good faith is requisite in the relations between partners inter se.

This relationship is sometimes spoken of as "fiduciary" and in *Cassels v. Stewart* (1881), 6 App. Cas. 64, Lord Blackburn at p. 79 said of a partner that it is "because he is an agent that the fiduciary character arises".

.....

In Henderson and Davidson on the Canadian Law of Partnership [sic] at p. 70 the following comment is made on those sections of the Partnership Act [sic] relating to the duties of partners to account to each other:

These sections are founded on the "broadest principle of equity that from every person standing in a situation of trust and confidence with respect to another a conduct marked with the most scrupulous good faith shall be required".

[62] The fiduciary duty between partners thus arises not only from the reciprocal agency relationship between them but, also, from the duty of utmost good faith which each partner owes to the other. Fundamental to this overarching fiduciary duty is the requirement that each partner place the interests of the partnership, and the avoidance of situations which create, or could create, a conflict between fiduciary duty and the interests of the partnership, ahead of a partner's private interests. Accordingly, partners are required to prefer the interests of the partnership over their own personal interests. The scope of the fiduciary duty in partnerships is of the broadest nature. As stated by Vice-Chancellor Bacon in *Helmore v. Smith* (No. 1) (1887), 35 Ch. D. 436 at p. 444, 56 L.T. 535 (C.A.):

If fiduciary relation means anything I cannot conceive a stronger case of fiduciary relation than that which exists between partners. Their mutual confidence is the life blood of the concern. It is because they trust one another that they are partners in the first instance; it is because they continue to trust one another that the business goes on.

(See R.C.I. Banks in Lindley & Banks on Partnership, 17th ed. (London: Sweet & Maxwell, 1995), at 16-03).

[63] Mutual trust, confidence and good faith are the cornerstones of the modern professional services partnership. Without them, the very essence of the partnership arrangement is eroded and, ultimately, destroyed. In my view, the equitable principles developed over the last century concerning the fiduciary obligations of partners continue to control contemporary partnerships. They may require, however,

flexible application to respond to changing partnership structures, activities and settings. Support for this approach is found, in my opinion, in the observations of Laskin J. (as he then was) in *Canadian Aero Service Ltd. v. O'Malley*, 1973 CanLII 23 (SCC), [1974] S.C.R. 592, 40 D.L.R. (3d) 371 when discussing the principles applied in *Regal (Hastings)* (at pp. 608-09 S.C.R., p. 383 D.L.R.):

What I would observe is that the principle, or, indeed, principles, as stated, grew out of older cases concerned with fiduciaries other than directors or managing officers of a modern corporation, and I do not therefore regard them as providing a rigid measure whose literal terms must be met in assessing succeeding cases. In my opinion, neither the conflict test, referred to by Viscount Sankey [in *Regal (Hastings)*], nor the test of accountability for profits acquired by reason only of being directors and in the course of execution of the office, reflected in the passage quoted from Lord Russell of Killowen [in *Regal (Hastings)*], should be considered as the exclusive touchstones of liability. In this, as in other branches of the law, new fact situations may require a reformulation of existing principle to maintain its vigour in the new setting.

Although Laskin J.'s comments concerned the responsibilities of directors and officers of corporations, and the appropriation of maturing corporate opportunities, in my view, they apply with equal force to the definition of fiduciary concepts and their application to modern partnerships. (See *Davis v. Ouellette* (1981), 1981 CanLII 626 (BC SC), 27 B.C.L.R. 162 (S.C.), at p. 176, per McEachern C.J.S.C.).

(f) Application of the operative principles to this case

[64] It was open to the partners of RTZ under s. 20 of the Act to enter into a written partnership agreement defining their mutual rights and duties, including their mutual expectations and responsibilities concerning securities investments and directorships. They elected not to do so. Further, the record before this court reveals no oral agreement or established policy or practice amongst the RTZ partners regarding directorships or investments in the securities of current or former clients.

[65] A full answer to a claim for an accounting in equity or under ss. 29(1) or 30 of the Act would have been afforded if the consent of his partners had been obtained by Rochweg to his acquisition of the Teklogix shares and stock options. This defence does not arise on the facts of this case, nor is it asserted. As the basis for liability in this case, in my view, is found under ss. 28 and 29(1), I will first deal with s. 30 as rejection of its application can be quickly accomplished.

(i) Competition: s. 30 of the Act

[66] The trial judge found that RTZ and the Teklogix companies did not carry on the same business and, hence, were not competitors. This finding was supported by the evidence. The trial judge also found that Rochweg's activities as, and associated with, his position as a director of Teklogix and Teklogix Inc. did not constitute "competition with the business of the partnership" and, on the authority of *Aas v. Benham*, that his position as a director "is not inconsistent with that of a partner in the firm". These conclusions directly address the fiduciary concepts reflected in s. 30 of the Act, and I agree with the trial judge's conclusions in this regard.

[67] In my view, subject to professional standards and the existence of a partnership agreement which provides to the contrary, the roles of partner in a professional services partnership and director or officer of a public or private company, are not inherently competitive or inconsistent, unless the company and the partnership provide the same type of professional services. Indeed, in contemporary times, it could be argued that one of the legitimate client development or business promotion activities of a professional services partnership is to encourage partners to take an active role in the business community through the assumption of directorships in public and private companies. Where this is an intended or recognized activity, such positions are consistent, and not inconsistent, with the business objectives of the partnership, and carry with them attendant obligations to account to the partnership for fee income and non-fee benefits realized from such directorships on such terms as may be agreed upon by the partners, or otherwise determined at law. The sharing of such income and benefits among partners serves as a disincentive to partners becoming professional directors for their own financial gain, without regard to the interests of the partnership and their obligations to the partnership business.

[68] Where such a partnership renders professional services to a company in which a partner becomes a director, professional standards and ethical obligations must also be satisfied to ensure that the nature of the services rendered by the partnership to the company, and the independence of the partners performing the services, does not conflict with the partner's role and responsibilities as a director. This was recognized in this case as, according to Coutts, the principals of Teklogix and Teklogix Inc. held the view that Rochweg could not serve as a director of those companies so long as RTZ performed auditing services for either company.

(ii) Benefits derived: s. 29(1) of the Act

[69] The trial judge also concluded, however, that Rochweg's appointment "as a director; his duties as such; his duties on the Audit Committee; the advice and counsel that he gives; and the shares and options that he invested in are outside the scope of the partnership" [p. 276 B.L.R.]. Although the trial judge made no mention of the Act, I understand his quoted observations to be a conclusion that the fiduciary concepts embodied in s. 29(1) of the Act, and Rochweg's fiduciary duties to his partners, were not offended in the circumstances. With respect, for the reasons that follow, I disagree. Since it is my view that many of the principles underlying the s. 28 duty of disclosure are linked, in this case, to the scope of the obligation to account under s. 29(1), it is useful to begin with consideration of the former section.

The duty to disclose

[70] The appellants argue before this court, in their factum, that Rochweg was obliged to disclose to them the opportunities presented to him "in the course of and in consideration for or response to, professional services that [Rochweg] is rendering to someone with whom the partnership has or had a professional relationship".

[71] Section 28 of the Act puts disclosure obligations among partners on a statutory footing. In his text *Lindley & Banks on Partnership*, R.C.I. Banks suggests that the disclosure requirement in s. 28 of the English Partnership Act of 1890 reflected the fundamental obligation imposed at law on a partner "to display complete good faith towards his co-partners in all partnership dealings and transactions" (at 16-01 and 16-02).

[72] While resort may be had to s. 28 of Ontario's Act to obtain access to the books and records of a partnership, and to ensure that those partners with access to, or particular knowledge about, the finances, accounts and business of a partnership can be made to disclose such information to other partners, in my view its reach is not limited to such matters. Rather, on a plain reading of the section, it extends to "full information of all things affecting the partnership".

[73] The duty of disclosure imposed by s. 28 of the Act is one aspect of a partner's fiduciary duty to his/her partners. It flows from the fiduciary obligations of utmost good faith and loyalty which this court has recognized to be requisite in the relations between partners (see *Cameron v. Julien*). It is one of the building blocks necessary to establish and maintain mutual trust and confidence among partners.

[74] In *Advanced Realty Funding Corp. v. Bannink* (1979), 1979 CanLII 1681 (ON CA), 27 O.R. (2d) 193, 106 D.L.R. (3d) 137 (C.A.), a secret commission case involving a mortgage broker, Arnup J.A. stated on behalf of this court in connection with the fiduciary obligations of an agent (at pp. 196-97 O.R.):

One of the prime fiduciary duties of an agent is that of full disclosure. Wherever it appears that the agent is going to profit from the agency over and above the remuneration agreed to be paid by the principal, the duty of disclosure must be rigorously enforced by the Court, and it must be shown that after full disclosure, the principal has expressly or by necessary implication consented to the agent making a profit.

.....

On the authorities, the Court does not engage in speculation as to what the principal might have done if disclosure had been made, nor is it an essential part of the relevant principle that there must have been detriment to the principal as a result of the non-disclosure.

(See also M. Ellis and A. Manzer, *A Practical Guide to Canadian Partnership Law*, [supra], at 5-13 and 5-21).

[75] As a director of the Teklogix companies, Rochweg was entitled to receive fees in the amount of \$1,000 for each directors' meeting which he attended, plus a further annual amount of \$10,000. His directors' fees for the year 1995 to 1996, in the aggregate amount of \$16,000, were paid to RTZ following their receipt by Rochweg.

[76] Rochweg clearly recognized that he had an obligation to disclose to his partners his appointments as a director of Teklogix and Teklogix Inc. In addition, he recognized his obligations to disclose that he would be receiving directors' fees from Teklogix and Teklogix Inc., and to account to the partnership for

such fee income. By such disclosure, Rochweg effectively accepted that the income derived from his directors' fees was partnership property. In my view, he was right to do so. He did not recognize or accept, however, that his entitlements under the KESP formed any part of RTZ's assets, nor did he acknowledge or act on any obligation to disclose them to his partners.

[77] Rochweg's entitlements under the KESP, flowing from his directorships, permitted him to acquire both the 8,000 common shares of Teklogix purchased by him in July 1995 and the Escrow Shares and the IPO Stock Option. It is necessary, therefore, to consider the nature of his full rights under the KESP.

[78] The KESP was offered in anticipation of Teklogix's IPO. It was approved by the directors of the company before Rochweg became a director, but was adopted and approved by Teklogix's shareholders in August 1995. It had the following stated purposes:

- (a) to reward contributions through participation in the growth of the company,
- (b) to promote ownership of company stock and foster a sense of identification with the organization,
- (c) to focus attention on longer-term objectives, and
- (d) to assist the corporation and its subsidiaries in attracting and retaining the human resources they require.

[79] The KESP consisted of the right to subscribe for the purchase of common shares in Teklogix, combined with a tandem grant of stock options based on the number of shares purchased and the method chosen to finance the acquisition of the shares. Participation in the share subscription offer under the KESP was open for acceptance from July 1 to July 31, 1995.

[80] Rochweg was eligible to subscribe for 8,000 common shares in Teklogix, at a price of \$4.95 per share. If he subscribed, he was also entitled to an option to acquire an additional 24,000 common shares of Teklogix at a price of \$4.95 per share. This option feature was cancelled and replaced on July 22, 1995 with the following:

- (a) for every two options cancelled, an option was granted for one common share of Teklogix at a price of \$0.01 per share, exercisable immediately. Upon issuance, the shares were to be held in trust, subject to later release (the "Escrow Shares"); and
- (b) one option for common shares in Teklogix exercisable at the greater of \$10 and Teklogix's IPO price, once determined (the "IPO Stock Option").

[81] When Rochweg acquired the 8,000 Teklogix common shares, the company's plan to make an IPO had been confirmed by its directors but the IPO strike price had not yet been set.

[82] Under the terms of the KESP, the Escrow Shares could be released from trust at the rate of 25 per cent per year, commencing July 31, 1997. The IPO Stock Option was exercisable on the same dates as the trust release dates for the Escrow Shares and in the same proportions, namely 25 per cent, on July 31st in each of the years 1997 to 2000. Thus, none of the Escrow Shares could be released, and no part of the IPO Stock Option could be exercised, until July 31, 1997, that is, two years after their acquisition by a key employee, including a director.

[83] These features of the Escrow Shares and the IPO Stock Option, and the stated purposes of the KESP, had clear retention objectives. Coutts described this retention focus in his evidence:

The purpose of any share distribution plan with options attached to them is the retention of employees. And there was, I guess, an added bite put into the [KESP], in that they could not exercise any of them for 2 years . . .

.

[T]he theory is that vice-presidents are a little more important, and that they should be -- held their feet to the fire a little bit longer, so to speak.

[84] The Escrow Shares and the IPO Stock Option were also subject to various other conditions. In the former case, if the purchaser left Teklogix before all of his/her shares had been released from trust, Teklogix had the right to buy back the shares on certain terms. In the case of the IPO Stock Option, if the purchaser left Teklogix, he/she had 30 days to exercise any option vested as of the date of termination with Teklogix. Any unvested options expired. The IPO Stock Option expires, in any event, on July 31, 2002.

[85] Rochweg's subscription for the 8,000 common shares in Teklogix entitled him to purchase 12,000 Escrow Shares at a price of \$0.01 per share and to an IPO Stock Option for 12,000 additional common shares exercisable at the greater of \$10 or the strike price, once determined, per share. Under the option and escrow agreement signed by Rochweg in August 1995, he agreed to exercise all options to purchase the Escrow Shares and his entitlement to the IPO Stock Option was confirmed.

[86] Rochweg was a partner of RTZ when he subscribed for the 8,000 common shares in Teklogix and, consequently, when he became entitled to the Escrow Shares and the IPO Stock Option.

[87] On October 25, 1995, while Rochweg was still a partner of RTZ, he purchased 12,000 Escrow Shares at a total cost of \$120. Upon issuance, the shares were held in trust by an escrow agent under the terms of the KESP. The IPO strike price was set at \$12 per share, resulting in an acquisition price in the same amount for Rochweg under the IPO Stock Option.

[88] Rochweg and RTZ played no part in setting the original share acquisition price of \$4.95 per share. Coutts testified that this value was determined by the board of directors of Teklogix based on a valuation formula contained in the 1967 incorporation documents of Teklogix Inc. Similarly, Rochweg and RTZ had no involvement in setting the IPO strike price.

[89] During the period September 29, 1995 to September 17, 1999, Teklogix common shares fluctuated in value from \$2.58 to \$22.75 per share. The appellants acknowledged shortly before trial that Mrs. Rochweg had disposed of 5,700 common shares in Teklogix at an average price of \$17 per share.

[90] Rochweg explained his failure to disclose his investments in Teklogix on the basis that they were a "personal investment" having "nothing to do with the firm", he was not deriving a "benefit" therefrom as he was paying fair market value for the shares, and he had received legal advice confirming his view that the investments were personal to him.

[91] While it is correct that Rochweg subscribed for the initial block of 8,000 shares in Teklogix at the then prevailing fair market value, as determined independently of Rochweg by a formula utilized by the principals of Teklogix, the price for the Escrow Shares was \$0.01 per share. Although the record reveals that the value of the Teklogix shares fluctuated materially in the years after Rochweg became a director, at no time were the shares valued as low as \$0.01 per share. Moreover, acquisition of the Escrow Shares was not tied to exercise of the IPO Stock Option. Either, both, or neither could be taken up by Rochweg, at his election. The acquisition price of the Escrow Shares, therefore, did not reflect fair market value, either in July 1995 when Rochweg became entitled to the option concerning the Escrow Shares, or in October 1995 when he purchased the Escrow Shares.

[92] In addition, the Escrow Shares, the original block of 8,000 shares in Teklogix and the shares which can be acquired upon exercise of the IPO Stock Option all represent tangible, although fungible, assets. Rochweg became entitled to subscribe for or acquire them because he was a director, and remained so entitled only so long as he continued as a director, of the Teklogix companies. In my view, such assets are properly characterized as "benefits" in Rochweg's hands, deriving solely from his directorships.

[93] Rochweg became a director and acquired rights under the KESP to the Teklogix shares and stock options when he was a partner of RTZ. Accordingly, at the time of his acquisition of these rights, he clearly owed fiduciary duties, including obligations of the utmost good faith and full disclosure, to the other partners of RTZ. He acquired the Teklogix shares and stock options secretly. While he may have done so in the honest belief that they were a personal investment and that he was not obliged to disclose his rights under the KESP, *Regal (Hastings)* and related cases confirm that bad faith, fraud or the deliberate withholding of information are not necessary to found liability to account (see *Regal (Hastings)*, at p. 386 All E.R., per Lord Russell of Killowen, and at p. 392 All E.R., per Lord Wright). He was obliged under s. 28 of the Act and under his duty of utmost good faith to disclose his rights under the KESP if they "affect[ed] the partnership".

[94] In my view, both in equity and under s. 28 of the Act, Rochweg was obliged to disclose to the other partners of RTZ full information concerning his directorships in Teklogix and Teklogix Inc., and the benefits associated with those directorships, for the following reasons.

[95] First, the entitlements of key employees and directors under the KESP were intended, in part, to "reward contributions" to Teklogix. The trial judge was correct, in my view, in treating this purpose of the KESP as a "reward for work". As such, the entitlements conferred under the KESP on Rochweg, formed part of his compensation as a director, although in non-fee income form.

[96] Moreover, both the KESP generally, and the stock options specifically, were designed to ensure the retention of services regarded by Teklogix as important to, or desirable for, the company. These retention features are also associated with a "reward for work", that is, with compensation designed to ensure the continuation of services by personnel whose services are regarded as valuable to the company. Under the terms of the KESP, such personnel expressly included directors. Indeed, the objective of retaining the services of directors, such as Rochweg, was precisely the reason why directors were eligible participants under the KESP. For this reason, as well, the benefits of the KESP must be viewed as compensatory in nature.

[97] Second, Teklogix was a client of RTZ when Rochweg became a director of the Teklogix companies, and remained so thereafter, although apparently at a less significant level. It follows, in my view, that the compensation paid to Rochweg as a director by a client of the firm was a matter "affecting the partnership" within the meaning of s. 28 of the Act. As the right to acquire the Teklogix shares and stock options formed part of Rochweg's compensation as a director, absent agreement among the partners to the contrary, he was obliged under s. 28 to provide "full information" of such compensation to the other partners of RTZ. (See *Davis v. Ouellette*, at pp. 176-77 B.C.L.R., per McEachern C.J.S.C.).

[98] The standards imposed on partners are of the highest order. As a result, every partner is bound to disclose to his/ her other partners any facts which are material to the partnership and its business. Generally, a partner's dealings with a client are matters which may affect the partnership. Where the dealings between the partner and the client involve the payment of compensation by the client to the partner for services rendered or work performed, the partner's dealings do affect the partnership. It is the duty of partners to refrain from concealment of such information.

Transactions "concerning the partnership"

[99] Does this mean, however, that an obligation to account arises in equity or under s. 29(1) of the Act? I conclude that the answer is "yes".

[100] Similar reasoning to that underlying the disclosure obligation established by s. 28 of the Act applies to the analysis of Rochweg's obligations under s. 29(1). The Teklogix shares and stock options formed part of Rochweg's compensation package as a director, paid to him by a firm client. While not every transaction between a partner and a firm client need be a matter "concerning the partnership", where the transaction concerns compensation paid by the client to the partner for services rendered or work performed, in my view, it is a matter "concerning the partnership". Consequently, the Teklogix shares and stock options were "benefits" in Rochweg's hands arising from a transaction "concerning the partnership" within the meaning of those words in the first branch of s. 29(1) of the Act.

Accordingly, under that branch of s. 29(1), he is obliged to account to his partners for this undisclosed compensation. In this case, having disclosed his fee income derived from Teklogix, Rochweg is obliged also to account for his non-fee benefits, in the manner and to the extent later described in these reasons.

Use of partnership "business connection"

[101] Rochweg is also liable to account for such benefits under the second branch of s. 29(1) of the Act if they derived from any use of the "partnership property, name or business connection".

[102] Rochweg became a director of the Teklogix companies only because he had served in the past as their accountant and valued advisor. Once he became a partner of RTZ, these were activities which arose directly from his professional capacity as a partner and from the professional services rendered by him while a partner of RTZ, and its predecessor firms.

[103] Teklogix and Teklogix Inc. were not clients of Rochweg personally. They were clients of RTZ. When Rochweg joined the RTZ partnership and the Teklogix companies became clients of that firm, his prior connection and association with the Teklogix companies through his previous partnerships became a business connection of RTZ. This connection was one of the assets brought to the new firm, and to its predecessor partnerships. This flows, in my view, from the status of the Teklogix companies as clients of RTZ. Moreover, as I have said, Teklogix remained a client of RTZ after Rochweg became one of its directors, although its need of RTZ's professional services was reduced.

[104] The fact that Rochweg was involved in a professional capacity with Teklogix and its principals prior to the formation of RTZ and, indeed, prior to the formation of several predecessor accounting firms, does not vitiate the business connection established upon creation of RTZ. It was because Rochweg's association with the Teklogix companies continued during the currency of the RTZ partnership, and in his capacity as a partner of RTZ, that Rochweg remained a trusted professional advisor to the companies. The offer of the directorships derived from this association and business connection.

[105] It is irrelevant whether the opportunity to become a director or to acquire the Teklogix shares and stock options would, or could, have been available to the other partners of RTZ. It is also irrelevant that Rochweg, in acquiring the initial 8,000 Teklogix shares, arguably assumed a risk of financial loss to be occasioned by a downward turn in the market value of the shares. It is also irrelevant whether the other partners of RTZ, in fact, were damaged by the actions of Rochweg. On the authority of *Regal (Hastings)* and *Phipps v. Boardman*, these factors are all "outside considerations". (See *Regal (Hastings)*, at pp. 386 and 389 All E.R., per Lord Russell of Killowen; and *Phipps v. Boardman*, at p. 109 A.C., per Lord Hodson and at p. 117, per Lord Guest). Rather, the liability to account arises from the fact of realizing a benefit or a profit, if realized by Rochweg through use of his fiduciary position.

[106] Accordingly, in my view, the benefits derived by Rochweg under the KESP were benefits derived by him from his use of a "partnership . . . business connection" within the meaning of that phrase under the second branch of s. 29(1) of the Act. On this ground, as well, Rochweg is obliged to account to his former partners concerning the Teklogix shares and stock options.

[107] It is to be emphasized that an obligation to account may be avoided, if desired, by the simple devices of recording the mutual rights and duties of the partners in a written partnership agreement or by establishing a consensual policy or practice. The RTZ partners, including Rochweg, chose not to do so.

(2) The Extent of the Required Accounting

(a) The positions of the parties

[108] The appellants do not stipulate the manner of accounting sought but, rather, ask this court to set the accounting or to direct a new trial limited to the question of determining the manner and amount of the accounting. They also seek an order directing a set off of the amounts found by the trial judge on the partnership income allocation issues, and to be found on the accounting, to be owed by the appellants to Rochweg or Mymyk Corp., or either of them, against the amount found on the accounting to be owed to them by Rochweg.

[109] The respondents argue that if an obligation to account arises, as in my view it does, this court should either refer the matter to the trial judge for determination or set the damages on the basis that:

(a) the damages should be based on a price of \$17 per share as proposed by the appellants shortly before trial; and

(b) the damages should be limited to those shares in Teklogix which Rochweg owned on July 31, 1996, being the date of dissolution of the RTZ partnership, and should not extend to either the Escrow Shares or the shares which may be acquired under the IPO Stock Option.

[110] Finally, the respondents assert that the appellants had an obligation to mitigate their damages by purchasing replacement shares in the open market at a price of less than \$4.95 per share when the Teklogix shares were trading below that price.

(b) Rochweg's entitlement to share in the benefits

[111] In *Olson v. Gullo* (1994), 1994 CanLII 1268 (ON CA), 17 O.R. (3d) 790, 113 D.L.R. (4th) 42 (C.A.), application for leave to appeal to the Supreme Court of Canada dismissed, S.C.C. File no. 24176, this court held that the obligation to account is for the benefit of "the firm" under the provisions of both ss. 29(1) and 30 of the Act. Accordingly, as the obligation to account is to the partnership as a whole, the partner who has profited from his/ her wrong does not forfeit his/her entitlement to share in the profit. In this case, as Rochweg enjoyed a 2/9 proportionate share of the profits of the RTZ partnership at the

date of the firm's dissolution, his obligation is to account for 7/9 of the benefits realized by him. Rochweg's entitlement to his share of such benefits was recognized by the appellants in the finalized version of their pleading in this case.

(c) Mitigation

[112] By the time of the trial, Rochweg's direct or indirect holdings in shares and stock options related to Teklogix were as follows:

(a) His wife had sold 5,700 of the original block of 8,000 common shares, but continued to hold 2,300 shares;

(b) 9,000 Escrow Shares had been released from trust to Rochweg and the remaining 3,000 Escrow Shares were scheduled for release on July 31, 2000. None of the Escrow Shares had been sold; and

(c) None of the IPO Stock Option shares had been acquired, although 75 per cent of the IPO Stock Option had been "earned", in the sense of the passage of time while Rochweg was a director, entitling Rochweg to acquire 9,000 common shares. The remaining 3,000 shares could be acquired on July 31, 2000, so long as Rochweg remained a director on that date.

[113] The market value of the Teklogix shares fluctuated from a low of \$2.58 to a high of \$22.75 per share during the period September 29, 1995 (the date of Teklogix's IPO) to September 17, 1999. The individual appellants were free at any time after September 29, 1995 to purchase common shares of Teklogix on the open market at the then prevailing price. They did not do so. For a period of at least seven months, the market price was below \$4.95 per share. Truster testified that he would not have gone into the market to purchase Teklogix shares because, in his view, he already had an interest in the shares and stock options held by Rochweg.

[114] Rochweg relies on *Asamera Oil Corp. Ltd. v. Sea Oil & General Corp. and Baud Corp., N.V.*, 1978 CanLII 16 (SCC), [1979] 1 S.C.R. 633, 89 D.L.R. (3d) 1 as support for the proposition that the individual appellants had a duty to mitigate their losses by purchasing replacement Teklogix shares on the open market at an advantageous market price, when Rochweg failed to deliver any Teklogix shares to them or to otherwise account for his investments in Teklogix. In response, the individual appellants assert that a duty to mitigate does not arise on a claim for an accounting but, rather, only on a claim for damages.

[115] The concept of awarding "damages" for the breach by a partner of his/her fiduciary duty is misleading in some respects. The remedy for breach of a fiduciary duty by the realization of secret profits or benefits requires that the fiduciary be prevented from retaining any gain from the activity which arose from the breach of duty. The assessment of compensation for such breach focuses on the wrongdoer's gain, and not on the beneficiary's loss: "The concept of payment of profits made, rather than reimbursement for loss, is unique to the trustee or fiduciary" (M. Ellis and A. Manzer, *A Practical*

Guide to Canadian Partnership Law, at 5.570 and 5.210). Thus, the Act stipulates in ss. 29(1) and 30 that the remedy for breach of duty by a partner is an accounting for the "benefit" realized (s. 29(1)) or for "all profits made" (s. 30).

[116] In *Asamera*, a breach of contract case, the Supreme Court of Canada held that the appellant had a general duty to mitigate its losses by acquiring replacement shares on the open market within a reasonable time after the respondent's breach of contract. The appellant had sought specific performance of an agreement between the parties to require the delivery to it of shares acquired by the respondent in *Asamera*. In addition, the appellant claimed damages. Estey J., in delivering the judgment of the court concerning the assessment of contractual damages, referred to the following passage from G.H. Treitel, *The Law of Contract*, 4th ed. (London: Stevens & Sons, 1975), at p. 618 (at pp. 672-73):

In general, damages are based on loss to the plaintiff and not on gain to the defendant. They are not, in other words, based on any profit which the defendant may have made out of the breach.

[117] In this case, we are concerned not with any damages or losses allegedly sustained by the individual appellants but, rather, with the benefit or gain realized by Rochweg in consequence of his breach of fiduciary duty.

[118] Mitigation is a limitation on damages designed to compensate a successful litigant for all losses suffered as a result of the wrong occasioned by another. The assessment of compensation and the role of mitigation in cases where equitable relief is sought raises complex issues of law as illustrated by the decision of the Supreme Court of Canada in *Canson Enterprises Ltd. v. Boughton & Co.*, 1991 CanLII 52 (SCC), [1991] 3 S.C.R. 534, 85 D.L.R. (4th) 129. In that case, writing for the majority of the court, La Forest J. commented (at paras. 69 and 70, pp. 576-77 S.C.R.):

The appellants strongly emphasized that the courts of equity had, before the Judicature Act, [sic] no power to award damages, this being the exclusive domain of the common law, and the only statutory change to this regime was made by Lord Cairn's Act [sic] and its successors. Equity, they assert, was concerned with restoring a plaintiff to the position he or she was in before the breach of duty calling upon equity's intervention.

.....

There can be little doubt that damages come within the province of the common law . . . although some early transgressions appear to have taken place where equity awarded damages . . . Damages are a monetary payment awarded for the invasion of a right at common law. Equity aimed at restoring a person to whom a duty was owed to the position in which he or she would have been had the duty not been breached. This it did through a variety of remedies, including compensation.

[119] In his reasons in *Canson Enterprises*, La Forest J. also discussed the distinction between a situation where the wrongdoer, in breach of a fiduciary duty, has received some benefit, as in this case, and one where no benefit has been obtained by the wrongdoer. The measure of compensation differs depending on whether a benefit has been realized. He stated (at para. 72, p. 578 S.C.R.):

In the case of a trust relationship, the trustee's obligation is to hold the res or object of the trust for his cestui que trust, and on breach the concern of equity is that it be restored to the cestui que trust or if that cannot be done to afford compensation for what the object would be worth. In the case of a mere breach of duty, the concern of equity is to ascertain the loss resulting from the breach of the particular duty. Where the wrongdoer has received some benefit, that benefit can be disgorged, but the measure of compensation where no such benefit has been obtained by the wrongdoer raises different issues.

(Emphasis added)

[120] In this case, 5,700 of the original block of 8,000 Teklogix common shares have been sold. It is no longer possible, therefore, to effect restitution in specie to the individual appellants of their share of the 5,700 shares which have been sold. In any event, the entire block of 8,000 shares was acquired in the name of Mrs. Rochweg, who is not a party to this action. Moreover, as described below, the parties have agreed on the per share value of that block of shares. Accordingly, I conclude that the proper approach to Rochweg's accounting is to require him to compensate the individual appellants for their proportionate share of the worth of the benefits represented by the Teklogix shares and stock options in lieu of restitution in specie, in accordance with the reasons which follow.

[121] In my view, no discount to the restitutionary sums for which Rochweg is accountable is appropriate or necessary on account of mitigation principles. While it is true that the individual appellants were free, after September 29, 1995, to purchase Teklogix shares on the open market at a price which, at various times, was less than \$4.95 per share, it is also the case that Rochweg could have limited his exposure to the individual appellants at any time after September 29, 1995 by transferring to them the value of the shares in issue at a time when they were trading at or below \$4.95 per share on the open market. Neither party pursued these options. In the circumstances, therefore, it is appropriate that the individual appellants be afforded compensation for their share of the gain realized by Rochweg at the per share value that they have accepted, namely, \$17 per share. This approach achieves compensation for the individual appellants while requiring disgorgement by Rochweg of the value of the benefits wrongly derived by him. As stated by La Forest J. in *Canson Enterprises* (at para. 88, p. 589 S.C.R.): "Both the common law and equity sufficiently support the fiduciary position by compensating the victim of the breach of confidence". In this case, compensation equivalent to the individual appellants' share of the worth of the benefits derived by Rochweg, in the words of La Forest J., "would seem sufficient to meet both these ends" (at para. 88, p. 589 S.C.R.).

(d) The benefits subject to an accounting

[122] For what, then, is Rochweg required to account in this case?

[123] Rochweg argues that his accounting should be limited to the block of 8,000 common shares of Teklogix acquired by him, through his wife, on July 25, 1995 because these were the only assets actually "acquired" as at July 31, 1996, the date of dissolution of RTZ. With respect to those shares, Rochweg claims that the total "damages" are the net amount of \$84,388 being the total value of the shares at a price of \$17 per share (for an aggregate value of \$136,000), less the purchase price paid (in the sum of \$39,600) and the carrying costs of Rochweg's personal bank loan by which he financed the acquisition of the shares, calculated from the date of acquisition to the date of trial. Counsel for the individual appellants agreed during oral argument of this appeal, that the net sum of \$84,388 is the proper benchmark for compensation in connection with this block of shares. I agree. Accordingly, in respect of these 8,000 shares, Rochweg is obliged to account to the former partners of RTZ by paying to them the amount of \$65,635.10 (7/9 of the net sum of \$84,388).

[124] Rochweg also argues, however, that he should not be obliged to account for either the Escrow Shares or the shares associated with the IPO Stock Option because these shares had not been "earned" by him at the date of dissolution of the partnership and the options had not vested, in the sense of entitling him to possession of the shares and, in the case of the Escrow Shares, their release from trust.

[125] In my view, there is an important distinction to be drawn between the Escrow Shares and the shares associated with the IPO Stock Option.

[126] While Rochweg was not entitled to possession of the Escrow Shares on the date of dissolution of the RTZ partnership, he had elected to exercise the option pertaining to them by purchasing the Escrow Shares in October 1995 at a cost of \$120, subject to the trust terms of the KESP. While the retention features of the KESP prevented the release from trust of any of the Escrow Shares until July 31, 1997, and permitted the release on that date of only 3,000 shares (25 per cent of the total optioned shares), the grant of the option for the Escrow Shares served as a "reward for work", that is, as part of Rochweg's compensation as a director. By July 31, 1996, the date of dissolution of the RTZ partnership, Rochweg had completed his first year as a director of the Teklogix companies and, accordingly, had notionally "earned" 50 per cent of that portion of the Escrow Shares subject to release from trust on July 31, 1997, providing that Rochweg remained a director on that date. His additional work as a director during the period July 31, 1996 to July 31, 1997 entitled him to the release on the latter date of 3,000 of the Escrow Shares. Accordingly, in a notional sense, 50 per cent of the first 3,000 of the Escrow Shares (1,500 shares) had been earned on July 31, 1996 through Rochweg's contributions to Teklogix (subject to Rochweg continuing in office as a director until July 31, 1997), while the remaining 50 per cent was unearned.

[127] In these circumstances, Rochweg should account to the individual appellants for that portion of the Escrow Shares notionally earned by him while he was a partner of RTZ, that is, for 1,500 of the Escrow Shares, at the same per share value acknowledged by the individual appellants to be appropriate for the first block of 8,000 shares in Teklogix, namely, \$17 per share. This results in Rochweg being accountable to the individual appellants for \$19,713.33, that is, 7/9 of the further sum of \$25,500 (1500 x \$17) less the \$120 purchase price paid by Rochweg for the shares.

[128] In contrast to the option concerning the Escrow Shares, the IPO Stock Option had not been exercised by Rochweg on July 31, 1996. While it might be argued that he had notionally "earned" 50 per cent of the first 25 per cent of the 12,000 shares associated with the IPO Stock Option by his services to Teklogix during his first year as a director, he had not realized any benefit from the IPO Stock Option as at July 31, 1996, had not exercised that option and had not paid for any of the shares associated with it. Accordingly, in my view, his obligation to account to the individual appellants does not extend to the IPO Stock Option or the shares associated with it.

(3) Costs

[129] The trial judge awarded the respondents party and party costs against the appellants in respect of the action, the appellants' counterclaim, and an interlocutory motion. The appellants were awarded costs on a party and party basis concerning the respondents' motion at trial to amend their pleadings to allege a failure by the appellants to mitigate their losses. Before this court, the appellants seek costs of the trial and this appeal.

[130] The trial involved many complex issues unrelated to the claim for an accounting in relation to the Teklogix shares and stock options and, on the record before this court, it is unclear what proportion of the eight-day trial was devoted to the latter issue. Judgment was granted in favour of the individual appellants against Rochweg for \$565,422.54 plus prejudgment interest, while judgment was granted in favour of Mymyk Corp. against the corporate appellants for \$669,866 plus interest. Success at trial, therefore, was divided but Mymyk Corp. was more successful in monetary terms than the appellants. In addition, in arriving at his conclusions, the trial judge commented adversely on Truster's credibility and the reliability of his evidence.

[131] The effect of the decision on this appeal is to significantly narrow, but not to eliminate entirely, the difference between the respective monetary awards made by the trial judge in the exercise of his discretion. In all of the circumstances, I would not interfere with the trial judge's award of costs at trial.

V. CONCLUSION

[132] For the reasons given, I would dismiss the appeal of the corporate appellants and allow the appeal of the individual appellants, set aside the decision of the trial judge concerning the Teklogix shares and stock options and direct Rochweg to account to the individual appellants by paying to them the aggregate amount of \$85,348.43 in respect of the original block of 8,000 Teklogix shares and the Escrow Shares. The individual appellants are entitled to set off that amount against the sums found by the trial judge to be owed by them to the respondents. Further, the individual appellants are entitled to their costs of this appeal, on a partial indemnity basis.

[133] In order to comply with the rule that now requires this court to fix costs, if the parties cannot otherwise agree on a joint submission regarding the quantum of the awarded costs of this appeal and the delivery of same in writing to this court within ten days, the individual appellants are requested to

file a bill of costs with this court, in the appropriate form, within ten days. Rochweg may make submissions in writing thereon within ten days after filing and the individual appellants may reply in writing within five days thereafter.

Appeal of corporate appellants dismissed; appeal of individual appellants allowed in part.

TAB 9

At para(s) 44

Klana v. Jones, 2003 CanLII 42363 (ON SC)

Date: 2003-04-30
 File number: 02-CV-225587SR
 Other citation: 35 BLR (3d) 236
Citation: Klana v. Jones, 2003 CanLII 42363 (ON SC), <<https://canlii.ca/t/7b8c>>, retrieved on 2024-05-06

COURT FILE NO.: 02-CV-225587SR

DATE: 20030430

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

DAVID KLANA

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Plaintiff

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- and -

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| |) |
| |) |
| MURRAY JONES, MICHAEL CAVANAGH, WARREN BRUCE and JMS REAL ESTATE APPRAISERS & CONSULTANTS LIMITED |) James A. Tackaberry, for the Defendants |
| |) |
| |) |
| |) |
| |) |
| Defendants |) |
| |) |
| |) |
| |) HEARD: March 26, 27, April 28, 2003 |

WILSON J.

[1] David Klana seeks repayment of the sum of \$20,000 plus interest, as well as the sum of \$5,000 for mental anguish against the defendants Murray Jones, Michael Cavanagh and Warren Bruce. Mr. Klana relies upon the terms of a written agreement dated June 1, 2001 (the Agreement) and the principle of *contra proferentem*. Alternatively, he states that the personal defendants misrepresented the financial status JMS Real Estate Appraisers & Consultants Limited ("JMS") and induced Mr. Klana to enter into an unfair agreement. They, therefore, should be personally liable for the JMS debt.

The Parties

[2] Mr. Klana came to Canada in 1981. He grew up in Baghdad. He has a high school education. He runs a 24-hour convenience store at 210 Marlee Avenue in the City of Toronto.

[3] Warren Bruce was a long-term client of Mr. Klana.

[4] JMS was a corporation carrying on an appraisal and real estate consulting business in Toronto, Ontario. JMS is no longer carrying on business. In late 2001 or early 2002, JMS was restructured under a new name "JMS Canada Limited."

[5] At the time of the Agreement the defendants, Mr. Murray Jones and Mr. Michael Cavanagh, were the principals of JMS. Mr. Jones and Mr. Cavanagh are university-educated real estate appraisers. They also carry on work in some capacity as real estate consultants.

[6] Mr. Bruce was an associate affiliated with JMS when this cause of action arose. Mr. Bruce was an old friend of Mr. Jones, a principal of JMS. In the past, Mr. Bruce worked as a real estate consultant, as an avocado importer, in the furniture business and in the horse business.

The Dispute

[7] In April 2001, JMS was in some financial difficulty. The principals were unable to increase the line of credit at the bank without personal guarantees. Their bank line of credit was \$60,000.00. In early June prior to the loan the line of credit exceeded \$85,000.00. Both Messrs. Jones and Cavanagh wished to avoid personal exposure. In June 2001 they both confirmed that JMS had a significant cash flow problem caused by high accounts receivables.

[8] Mr. Bruce came to JMS as a "jack of all trades." He was paid consulting fees by JMS on a non-specific basis for bringing in appraisal business and collecting outstanding accounts receivables.

[9] In late April 2001, Mr. Bruce suggested to Mr. Klana that he ought to consider buying the building in which he carried on business rather than paying costly rent. Mr. Klana paid JMS \$2,500 for an appraisal on the building. Mr. Bruce suggested with a \$20,000 deposit he could arrange the funding for the rest of the financing in excess of one million dollars to enable Mr. Klana to purchase the building.

[10] Mr. Klana agreed to advance \$20,000 as a deposit for the building. He further agreed to use the deposit as a short-term loan for 30 days pending the purchase of the building. The loan was to JMS, but Mr. Klana states that he asked the principals of JMS to sign personally to guarantee the debt.

[11] On June 1, 2001, the principals of JMS, Messrs. Jones and Cavanagh, attended with Mr. Bruce at Mr. Klana's store where they signed the June 1, 2001 Agreement.

[12] On June 1, 2001, the principals of JMS gave Mr. Klana a postdated cheque dated June 30, 2001 for \$20,000 as repayment of the loan.

The Issues

[13] The following issues are raised by the parties in the amended amended statement of defence:

1. Applying the rule of *contra preferendum*, does the Agreement on its face impose personal liability upon Messrs Jones and Cavanagh?
2. Were the personal defendants in breach of their fiduciary duties and hence personally liable, by borrowing trust funds from a client of the firm?
3. Did the personal defendants misrepresent the financial status of JMS to justify piercing the corporate veil and imposing personal liability upon the directors?
4. If the personal defendants are held to be personally liable, did Mr. Klana fail to present the post-dated cheque for payment, thereby materially changing the risk to the defendants?
5. The amount of \$6000.00 was paid by JMS to Mr. Klana. Were these payments on the loan, or were they funds owed to Mr. Bruce made payable to Mr. Klana to reduce Mr. Bruce's personal debts unrelated to these proceedings?

Credibility

[14] Mr. Klana came across as a straightforward honest person. He did not exaggerate. He did not seek to answer in a way that would advance his position. He is a practical but unsophisticated businessman. English is his second language. Although he speaks English well, he had difficulty with complex language and nuance.

[15] I accept his evidence that he wanted the partners of JMS to agree to be personally liable for the loan. That is why he wanted to meet them and he insisted on their signatures. I accept his evidence that he thought that the Agreement drawn up by Mr. Cavanagh achieved his objectives.

[16] Mr. Cavanagh and Mr. Jones, by way of contrast, were not believable. They were in financial difficulties. They thought they had found a temporary solution to their cash flow problems. They misrepresented the nature of the Agreement to Mr. Klana. They did not suggest that he see a lawyer to review the Agreement even though they were proposing to borrow money from Mr. Klana who was at the time a client of JMS.

[17] Mr. Bruce was not believable. He appeared in the courtroom to be aligned with Mr. Jones. He was not able to explain the financial documents in a way that made any sense.

[18] At this time of signing the Agreement, Mr. Bruce was a consultant or associate of JMS. He was acting on behalf of Mr. Klana retained to negotiate the potential purchase of a building. This was done in the context of Mr. Bruce being part of JMS. Mr. Bruce gave Mr. Klana his business card which shows Mr. Bruce as a consultant to JMS. The negotiations with respect to the building and the loan were very much intertwined with Mr. Bruce's involvement with JMS. The \$20,000.00 were trust funds intended to be a deposit. Mr. Jones and Mr. Cavanagh were in a clear conflict of interest borrowing trust funds from a client of JMS.

[19] The most incredible and glaringly untrue statements made by Mr. Jones, Mr. Cavanagh, and Mr. Bruce were with respect to a cheque made payable to Mr. Bruce dated June 1, 2001. This was the same day as Mr. Jones and Mr. Cavanagh signed the Agreement and gave Mr. Klana a post-dated cheque for \$20,000.00.

[20] The \$2,000 cheque to Mr. Bruce was made out by the bookkeeper at JMS presumably on instructions from Mr. Jones or Cavanagh. The reference line on the cheque to Mr. Bruce states "consulting fee." Mr. Jones and Mr. Cavanagh suggested that this was really an interest payment for Mr. Klana with respect to the loan, but made payable to Mr. Bruce so as to avoid taxes. This convoluted explanation makes no sense whatsoever. In Mr. Klana's records of the personal loan owed by Mr. Bruce to Mr. Klana, is an entry dated June 1, 2001 for a credit of \$2000.00 reducing Mr. Bruce's debt to Mr. Klana. Clearly this \$2000.00 was a finder's fee or a consultant's fee payable to Mr. Bruce as compensation for finding the much-needed loan. He used these funds to reduce his personal loan to Mr. Klana.

[21] I note that Mr. Klana was never confronted or questioned with respect to this hollow theory of interest in cross-examination, or when he was called in reply. Following the rule in *Browne v. Dunn* (1893), 1893 CanLII 65 (FOREP), 6 R. 67 (H.L.), when a party fails to cross-examine a witness on a particular point, the contradictory evidence carries very little weight. The defendants' evidence on this point, and others, was not credible, and was not consistent with the documents.

[22] Where there is a conflict between the evidence of Mr. Klana and the three personal defendants, without hesitation, I accept the evidence of Mr. Klana.

The June 1, 2001 Agreement

[23] The Agreement provides:

JMS Real Estate Appraisers & Consultants Limited

245 Fairview Mall Drive, Suite 717

Toronto, Ontario M2J 4T1

June 1, 2001

David Klana

210 Marlee Avenue

Toronto, Ontario

Dear Mr. Klana,

Re: Loan

As per our verbal agreement, please allow this letter to confirm the terms of your loan to our firm. The total loan amount is to be twenty thousand dollars (\$20,000) which we have agreed to repay to you in full on demand as the monies are needed by you to fulfill the terms of your outstanding Agreement of Purchase Sale on 210 Marlee Avenue.

I trust the foregoing is satisfactory to you.

Sincerely,

Per:

Murray J. Jones

Partner

Per:

Michael W. Cavanagh

Partner

I, the undersigned, accept and agree with the terms as outlined above.

David Klana

Interpreting the Agreement: The Law of *Contra Proferentem*:

[24] Mr. Cavanagh drafted the Agreement.

[25] The *contra proferentem* doctrine, simply put, means that "in interpreting documents, ambiguities are to be construed unfavourably to the drafter." *Black's Law Dictionary*, 7 ed., St. Paul: West Group, 1999 at 328.

[26] In *Eli Lilly and Co. v Novopharm Ltd.*, 1998 CanLII 791 (SCC), 161 D.L.R. (4) 1 (S.C.C.), Iacobucci J. explained the rationale behind the rule at para. 53:

Contra Proferentem operates to protect one party to a contract from deviously ambiguous or confusing drafting on the part of the other party, by interpreting any ambiguity against the drafting party. [emphasis added]

[27] Waddams agrees that the doctrine has been applied to ensure fairness. "Few would dispute that the cases on ... construction *contra proferentem* ... are techniques used by the courts to control the use of unfair provisions in printed documents." S.M. Waddams, *The Law of Contracts*, 4 ed., Toronto: Canada Law Book, 1999 at s. 494 [emphasis added].

[28] It should be noted that the court must first find ambiguity in the contract before applying the doctrine of *contra proferentem*. As Fridman says, "It is necessary to find the ambiguity in the contract first, before applying the rule, not after:" G.H.L. Fridman, *The Law of Contract in Canada*, 4 ed., Toronto: Carswell, 1999 at 495. See *Arthur Andersen Inc. v. Toronto Dominion Bank* (1994), 1994 CanLII 729 (ON CA), 17 O.R. (3d) 363 (Ont. C.A.); additional reasons at (1994), 14 B.L.R. (2d) 1 at 49 (Ont. C.A.), leave to appeal to SCC refused (1994), 19 O.R. (3d) i page xvi.

[29] In my view, the Agreement is ambiguous. On one hand the Agreement is written on JMS corporate letterhead. The Agreement confirms that the loan is to the "firm," which may apply to a partnership or a corporation. The Agreement also states, "The total loan amount is to be twenty thousand dollars (\$20,000) which we have agreed to repay to you in full on demand." [emphasis added] The clear language of "guarantee" is not used. However, the simple language of "we [the undersigned partners] have agreed to repay you in full" may be interpreted as imposing personal liability.

[30] The word "partner" implies personal liability.

[31] Section 10 of Ontario's *Partnerships Act*, R.S.O. 1990, c. P.5 states that "every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while the person is a partner." A distinct feature of the law of partnership has always been the unlimited liability imposed on the partners for the debts and obligations of the firm: See *Lindley & Banks on Partnership*, 8 ed. (London: Sweet & Maxwell, 2002) at p. 380. This means that each partner in a firm is liable to the full extent of his or her personal assets for all debts and obligations of the firm incurred while a partner.

[32] In *Superstars Mississauga Inc. v. Ambler-Courtney Ltd.* (1993), 1993 CanLII 5459 (ON SC), 17 C.P.C. (3d) 27, 15 O.R. (3d) 437, Master Peppiatt held that "[a] partnership is not a person known to the law. It is simply a collective of persons, either natural or corporate, and it is they who are the owners of the partnership assets, and are responsible for the partnership's debts."

[33] *Black's Law Dictionary*, 7 ed. (St. Paul: West Group, 1999) at p. 1142 defines "general partner" as one who "is personally responsible for the partnership's debts and liabilities."

[34] When collecting from a partner, one should first look to the assets of the partnership. If the assets of the partnership are insufficient, then the partners are required to fund the loss. (See A. Manzer, *A Practical Guide to Canadian Partnership Law* (Aurora: Canada Law Book Inc., 1994) at p. 3-79.)

[35] Even if a person is not a partner but holds himself or herself out to be one, that person will likely be liable for partnership debts. In *Perry v. Johnston* (1928), 34 O.W.N. 82 (C.A.), Riddell J.A. held that either the person was a partner, in which case he was directly liable, or he represented himself as a

partner, in which case he was liable by estoppel. There must be clear notice that a person is not a partner in order to avoid liability for the partnership debts. (See A. Manzer, *A Practical Guide to Canadian Partnership Law* (Aurora: Canada Law Book Inc., 1994) at p. 3-22.4)

[36] In this case, Mr. Jones and Mr. Cavanagh explicitly held themselves out as "partners" in the Agreement. Even if they were not, in fact, partners in a partnership, they are personally liable due to estoppel.

[37] In my view, any ambiguity in the Agreement must be interpreted against the drafter of the Agreement. I can only conclude that Mr. Cavanagh was well aware that Mr. Klana wanted personal guarantees. Mr. Klana thought that was what he was getting when the two partners came to his store to sign. I conclude that the Agreement on its face, when applying the rule of *contra proferentem*, supports a conclusion that Mr. Jones and Mr. Cavanagh assumed personal liability for the loan.

Misrepresentation and Inducing the Plaintiff to Enter the Agreement

[38] Mr. Klana raises an alternate basis for his claim. He states that the principals of JMS knowingly misrepresented the financial health of the business and took advantage of their position to induce him to make the loan.

[39] I accept the evidence of Mr. Klana that the two principals and Mr. Bruce stated that the business was doing well, and that they were expanding their business across Canada. I accept that Mr. Bruce was introduced as a partner of JMS not an associate or independent consultant. The distinction matters not as the actions of Mr. Bruce bind as agent for JMS.

[40] At the time of the loan, Mr. Bruce was acting for Mr. Klana as a consultant or as an agent with respect to the potential purchase of his building. The loan funds were earmarked as trust funds for a deposit.

[41] I accept Mr. Klana's evidence that he was told by Mr. Bruce not to cash the cheque at the end of June, as there were not sufficient funds in the bank. I conclude contrary to their evidence that Mr. Jones and Mr. Cavanagh were well aware of what was going on and directed Mr. Bruce to communicate this information to Mr. Klana.

[42] The plan to purchase the building never materialized. Not surprisingly, Mr. Bruce was unable to arrange funding for a building being purchased for over one million dollars with a \$20,000 deposit.

Fiduciary Duty Owed by Agent to the Principal

[43] I conclude that Messrs Jones, Cavanagh and Bruce stood in a fiduciary relationship to Mr. Klana. Mr. Klana was a client of JMS. Mr. Bruce was advising Mr. Klana with respect to a potential purchase of a building. Mr. Bruce was held out to Mr. Klana to be a partner in the firm. The funds advanced as a short-term loan were also trust funds ear-marked as the deposit for the anticipated purchase. JMS had prepared an appraisal for Mr. Klana. The relationship between Mr. Klana and the

personal defendants was one involving trust beyond the usual arms-length relationship between a corporation and a creditor. They were acting as agent to Mr. Klana. Mr. Klana relied upon the integrity and advice of Mr. Bruce; he had a reasonable expectation that the defendants were acting his best interest. He invested \$20,000.00 of his \$50,000.00 life savings in the short-term loan and deposit. He was not advised to seek independent legal advice.

[44] The defendants were in a position of conflict of interest. The duty owed by an agent to its principal requires the agent to make full disclosure of material facts which place or may place the agent in a conflict of interest: see M.V. Ellis, *Corporate and Commercial Fiduciary Duties* (Toronto: Carswell, 1995) at p. 3-8; *Upper Canada College v. Jackson* (1852), 3 Gr. 171 (U.C.C.A.); *Ring v. Potts* (1903), 1903 CanLII 171 (NB KB), 36 N.B.R. 42 (C.A.). The duty of full disclosure extends to every material fact regarding the subject matter of the agency, which clearly would contemplate financial disclosure: see *Malcolm v. Dominion Fruit Exchange* (1910), 15 O.W.R. 652 (Ont. C.A.). The onus of proving that there was adequate disclosure lies with the agent: see *Charles Baker Ltd. v. Baker*, 1954 CanLII 92 (ON CA), [1954] 3 D.L.R. 432 (Ont. C.A.). It is not sufficient for the agent merely to disclose that he or she has an interest or to make a statement that would signal the principal should inquire: see F.M.B. Reynolds, *Bowstead and Reynolds on Agency*, 7 ed. (London: Sweet & Maxwell, 2001) at p. 189; *Imperial Mercantile Credit Association Co. v. Coleman* (1873) L.R. 6 H.L. 189 (H.L.); *Dunne v. English* (1874) L.R. 18 Eq. 524 (C.A. Eq.). “Material information means information that a reasonable person would consider likely to operate on the principal’s judgment.” See M. Ng, *Fiduciary Duties: Obligations of Loyalty and Faithfulness* (Aurora: Canada Law Book Inc., 2003) at p. 10-7. See also *Christie v. McCann* (1972), 1972 CanLII 409 (ON CA), 27 D.L.R. (3d) 544 (Ont. C.A.). The test for whether information is material is objective: *Ocean City Realty Ltd. V. A & M Holdings* (1987), 1987 CanLII 2872 (BC CA), 36 D.L.R. (4) 94 (B.C.C.A.).

[45] In order to ensure that the principal gives its informed consent in the case of a conflict of interest, the agent should make full disclosure regarding the conflict and the agent’s interest, and advise the principal to seek independent legal advice. If after full disclosure the principal declines to seek independent advice, the agent has not breached its fiduciary duty. See *Clark Boyce v. Mouat*, [1993] 4 All E.R. 268 (P.C.). An agent cannot borrow money from the principal without full and fair financial disclosure.

[46] The defendants failed to disclose the fact that their business was in financial difficulty. Had Mr. Klana known of their financial problems, he states that he would not have agreed to the loan. I conclude that Mr. Jones and Mr. Cavanagh misrepresented the financial viability of the business to the plaintiff. I find that the misrepresentation induced Mr. Klana to enter the Agreement and that he reasonably relied on the misrepresentation to his detriment.

[47] The personal defendants should have, at a minimum, arranged for independent legal advice.

[48] I conclude as well without hesitation that the personal defendants breached their fiduciary duties to Mr. Klana who was their client and their principal. Personal liability must flow from these breaches.

Directors' Duty to Creditors

[49] Counsel for the plaintiff suggested that the emerging principles enunciated by Ground J. with respect to a director's duties to creditors in *Canbook Distribution Corp. v. Borins* (1995), 1999 CanLII 15082 (ON SC), 45 O.R. (3d) 565 (S.C.) have application to this case. As Mr. Klana and the personal defendants were in a special relationship involving trust, there is clearly a duty owed by the defendants to Mr. Klana. Had there not been a clear fiduciary duty owed to Mr. Klana as a client, rather than an arms length creditor, I would have adopted the reasoning of Ground, J. in the facts of this case to justify piercing the corporate veil.

[50] Ground J. in *Canbook* referred to *Peoples Department Stores Inc. v. Wise*, 1998 CanLII 9390 (QC CS), [1998] Q.J. No. 3571 (C.Q.) where the Court notes that the British, Australian and New Zealand courts have all held that when a company is near insolvency, the directors' duties extend to act in the best interests of the company's creditors. In C. Hansell's *Directors and Officers in Canada: Law and Practice* (Toronto: Carswell, 1999) at page 1-56, the editors provide:

Based, it seems, on the *Peoples* decision alone, Ground J. observed that Canadian law is moving toward recognizing not just a duty, but a fiduciary duty on the part of directors to creditors:

In this action Canbook also seeks relief in its status as an ordinary creditor of EBAL presumably on the theory that Edward Borins and Eva Borins, as directors of EBAL, owed a fiduciary duty to the creditors of EBAL which duty was breached by EBAL entering into the transaction granting security to Edsed. Canadian law appears to be moving in the direction of recognizing such fiduciary duty, particularly in situations where the corporation was insolvent when it entered into the challenged transaction or the challenged transaction rendered the corporation insolvent. [emphasis added]

[51] In *Dylex Ltd. (Trustee of) v. Anderson*, 2003 CanLII 14551 (ON SC), [2003] O.J. No. 833 (Sup. Ct.), Lederman J. discussed the Quebec Court of Appeal's recent reversal of the trial level decision in *Peoples*. (See *Peoples Department Stores Inc. v. Wise*, [2003] Q.J. No. 390 (C.A.)) Even though the Quebec Court of Appeal overturned the decision in *Peoples*, "it remains to be seen whether [the appeal decision] will be followed in other jurisdictions or whether other Canadian courts will follow the lead of the British, Australian and New Zealand courts." Lederman J. concluded that it was possible that directors may owe a fiduciary duty to creditors.

[52] The law in Canada on this issue is developing. I adopt the principles enunciated by Ground, J. and Lederman, J. Although there is no evidence that JMS was insolvent, both partners acknowledged that at the time of the loan JMS was in financial difficulty. I accept Mr. Klana's evidence that had he been advised that JMS was in financial difficulty that he would never have considered a short-term loan.

Failure to present the cheque on June 30, 2001 constituting material change in risk

[53] I accept the evidence of Mr. Klana that he was advised by Mr. Bruce not to present the post-dated cheque dated June 30, 2001 to the bank as it would not clear. I also find that the other personal defendants were well aware of this fact. Mr. Klana began aggressively seeking repayment in September 2001, and the personal defendants did not return the numerous telephone calls. The material change in risk argument is without any merit.

Claims for Payments Made to Offset the Loan

[54] The personal defendants state that payments were made in the amount of \$7,500 (later revised to \$6000.00) that ought to be credited against the loan principal.

[55] I do not agree.

[56] The bookkeeper who kept records presumably at the direction of the principals and Mr. Bruce, was not called. I do not accept the evidence of either Mr. Jones or Mr. Cavanagh.

[57] Payments were made by JMS on a regular basis to Mr. Bruce for consulting fees and commissions earned. Mr. Bruce had a running account with Mr. Klana for food and products supplied as well as cash advances. Mr. Bruce had recently suffered from cancer. He said he needed money. Mr. Klana felt sorry for him. I accept Mr. Klana's accounting of funds advanced or credit offered to Mr. Bruce. I also accept Mr. Klana's accounting was an acknowledgement that payments made by a JMS cheque were funds owed by JMS to Mr. Bruce that he used to reduce his personal debt to Mr. Klana. Presently Mr. Bruce has arrears on his running account in excess of \$3,700.00 unrelated to this action.

[58] Although I conclude Mr. Jones was less than truthful in his first answer, I accept his second answer confirms that at times Mr. Bruce asked for funds owed by JMS to him, that the cheque to be made payable to Mr. Klana to reduce Mr. Bruce's personal debt.

[59] Mr. Jones stated in his evidence:

Q. Did Mr. Bruce ask you to make these cheques [referring to funds owed by JMS to Mr. Bruce] payable to Mr. Klana to pay off money owed from Mr. Klana to Mr. Bruce? Were these monies owing to Mr. Bruce that he asked you to pay to David Klana to discharge his debt to him?

A. No.

Q. There was never any indication to that nature?

A. In the past he had asked me for cheques along that line and I wouldn't do it. We weren't going to pay his debts.

[60] In fact, at least one of the cheques in the amount of \$1500.00 for which the defendants initially claimed credit was noted as payable to "Warren Bruce for David Klana December 10, 2001."

[61] I note that on the face of the cheques payable to David Klana dated October 5, 2001 and November 19, 2001 the re: line is not filled in by the bookkeeper. If this was for repayment of the loan, I conclude it would have been properly documented on the face of the cheque. As well the cheques would not have been handed to Mr. Bruce to give to Mr. Klana.

[62] Although all of the payments are not accounted for (on ex 9 \$4870.00 of the \$6000 is accounted for by large credits) in my view the onus of proof that payments were made on the loan is upon the personal defendants. They did not provide any sort of loan statement prepared by the bookkeeper. The financial statements of JMS were not produced, which presumably would have a reference to this loan. The *viva voce* evidence of all of the personal defendants was so suspect that I do not accept their version of events without clear contemporaneous documentation.

[63] I infer and conclude that Mr. Bruce directed the disputed payments due to him to be made payable to Mr. Klana to reduce Mr. Bruce's personal debt with Mr. Klana. I therefore conclude that the entire \$20,000.00 debt remains outstanding.

Conclusions

[64] For these reasons I conclude that all three individual defendants are personally responsible for repaying the full amount of \$20,000.

[65] In my view, the request of \$5,000 for mental anguish is not a claim sustainable in law.

[66] The loan was payable on demand. Clearly, by September 2001 Mr. Klana began vocally demanding the return of his money. Interest will run on the demand loan from September 1, 2001 to the date of judgment in accordance with the *Courts of Justice Act*.

[67] Post-judgment interest to run from the date of judgment, also in accordance with the *Courts of Justice Act*.

[68] Costs of this proceeding fixed payable by the personal defendants to the plaintiff in the amount of \$7000.00 inclusive of GST and disbursements.

Released: April 30, 2003

COURT FILE NO.: 02-CV-225587SR

DATE: 20030430

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

DAVID KLANA

Plaintiff

- and -

**MURRAY JONES, MICHAEL CAVANAGH,
WARREN BRUCE and JMS REAL ESTATE
APPRAISERS & CONSULTANTS LIMITED**

Defendants

REASONS FOR JUDGMENT

WILSON J.

Released: April 30, 2003

TAB 10

At para(s) 13, 16, 20, 25-27

Ontario Securities Commission v. Go-To Developments Holdings Inc., et al., 2023 ONSC 6578 (CanLII)

Date: 2023-11-09

File number: CV-21-00673521-00CL

Citation: **Ontario Securities Commission v. Go-To Developments Holdings Inc., et al., 2023 ONSC 6578 (CanLII), <<https://canlii.ca/t/k1968>>, retrieved on 2024-04-25**

CITATION: Ontario Securities Commission v. Go-To Developments Holdings Inc., et al., 2023 ONSC 6578

COURT FILE NO.:

CV-21-00673521-00CL

DATE: 20231109

SUPERIOR COURT OF JUSTICE – ONTARIO – COMMERCIAL LIST

RE: ONTARIO SECURITIES COMMISSION, Applicant

AND:

GO-TO DEVELOPMENTS HOLDINGS INC., OSCAR FURTADO, FURTADO HOLDINGS INC., GO-TO DEVELOPMENTS ACQUISITIONS INC., GO-TO GLENDALE AVENUE INC., GO-TO GLENDALE AVENUE LP, GO-TO MAJOR MACKENZIE SOUTH BLOCK INC., GO-TO MAJOR MACKENZIE SOUTH BLOCK LP, GO-TO MAJOR MACKENZIE SOUTH BLOCK II INC., GO-TO MAJOR MACKENZIE SOUTH BLOCK II LP, GO-TO NIAGARA FALLS CHIPPAWA INC., GO-TO NIAGARA FALLS CHIPPAWA LP, GO-TO NIAGARA FALLS EAGLE VALLEY INC., GO-TO NIAGARA FALLS EAGLE VALLEY LP, GO-TO SPADINA ADELAIDE SQUARE INC., GO-TO SPADINA ADELAIDE SQUARE LP, GO-TO STONEY CREEK ELFRIDA INC., GO-TO STONEY CREEK ELFRIDA LP, GO-TO ST. CATHARINES BEARD INC., GO-TO ST. CATHARINES BEARD LP, GO-TO VAUGHAN ISLINGTON AVENUE INC., GO-TO VAUGHAN ISLINGTON AVENUE LP, AURORA ROAD LIMITED PARTNERSHIP and 2506039 ONTARIO LIMITED, Respondents

BEFORE: JUSTICE JANA STEELE

COUNSEL: Counsel, Jeremy Nemers and Ian Aversa for the Court-Appointed Receiver, KSV Restructuring Inc.

Counsel, Gregory Azeff and Monica Faheim for the Respondent, Oscar Furtado

HEARD: October 31, 2023

ENDORSEMENT OF JUSTICE STEELE:

Overview

- [1] The Receiver brings this motion asking the Court to uphold the disallowance of Oscar Furtado’s claim against Go-To Stoney Creek Elfrida LP (“Stoney Creek LP”) and Go-To Stoney Creek Elfrida Inc. (“Stoney Creek GP”, and together with Stoney Creek LP, “Stoney Creek”).
- [2] Mr. Furtado was the principal of the 23 Receivership Respondents, including Stoney Creek LP and Stoney Creek GP.
- [3] Mr. Furtado was the president and sole director of Stoney Creek GP. Stoney Creek GP was the general partner of Stoney Creek LP.
- [4] Further background on this proceeding can be found in my decision in *Ontario Securities Commission v. Go-To Development Holdings Inc., et al*, 2023 ONSC 5921 and in Patillo J.’s endorsement, *Ontario Securities Commission v. Go-To Developments Holdings Inc.*, 2021 ONSC 8133. As noted in my decision, at para. 28, the receivership appointment in this case was made under the *Securities Act* following an application made by the Commission.
- [5] Further to the claims procedure set out in the Claims Procedure Order, dated April 7, 2022, Mr. Furtado submitted a proof of claim against Stoney Creek in the amount of \$867,769, which was disallowed by the Receiver on or about March 28, 2023. Mr. Furtado’s claim arose from guarantee fees, pursuant to Guarantee Fee Agreements between Stoney Creek LP, by its general partner, Stoney Creek GP, and Mr. Furtado, as guarantor (dated Feb. 27, 2018, Nov. 19, 2019, and Dec. 18, 2020).
- [6] On or about April 11, 2023, Mr. Furtado delivered a notice of dispute in respect of the Receiver’s disallowance of his claim.
- [7] On or about June 6, 2023, the Receiver advised Mr. Furtado and the other stakeholders that “[i]f the Stoney Creek [disputed claim] is not withdrawn in the following weeks, the Receiver intends to bring a motion to Court to have the Receiver’s disallowance of the claim upheld.” Mr. Furtado subsequently confirmed that he would not withdraw the disputed claim.

Analysis

Was the Receiver correct in having disallowed Mr. Furtado’s claim against Stoney Creek?

- [8] The Receiver was correct in disallowing Mr. Furtado’s claim against Stoney Creek.

- [9] The Receiver reviewed the three Guarantee Fee Agreements. The Receiver noted that the Guarantee Fee Agreements were only signed by Mr. Furtado (in his personal capacity as the guarantor, and as the corporate signing officer for Stoney Creek). The Guarantee Fee Agreements provide that Go-To Stoney Creek LP “agrees to pay to the Guarantor [Furtado] an annual guarantee fee equal to 5% of the total principal amount guaranteed by the Guarantor from time-to-time under the Guarantees.” The Receiver submits that this is another example of self-dealing by Mr. Furtado, which was not disclosed to the investors.
- [10] The Receiver does not dispute the existence of the Guarantee Fee Agreements or that they provide for a guarantee fee payable to Mr. Furtado from Stoney Creek. The Receiver disallowed Mr. Furtado’s claim against Stoney Creek for the following reasons, set out in the Notice of Disallowance of Claim:
- a. It constitutes undisclosed, related-party agreements made by a fiduciary in breach of the fiduciary’s contractual and/or common law duties. Without limiting the generality of the foregoing, neither Go-To Stoney Creek LP’s Limited Partnership Agreement dated October 20, 2017 (the “LP Agreement”) nor Go-To Stoney Creek LP’s “Investment Opportunity” brochure to investors dated March 2019 (the “IO Brochure”) discloses your entitlement to any guarantee fees. The IO Brochure goes even further, in that it specifically references that “*The General Partner and the Builder will sign for all third party financing and provide the Banks with all personal guarantees when required,*” and your name is not specifically referenced. Additionally, the IO Brochure does not reference that any guarantor would be entitled to a fee for providing a guarantee. If the intention was that you personally would be entitled to a guarantee fee, such entitlement should have been explicitly disclosed in the IO Brochure and the LP Agreement. ...;
 - b. In the alternative, if disclosure of the related-party fees can somehow be inferred from the LP Agreement (which the Receiver does not believe to be the case), the fees would still breach section 5.12 of the LP Agreement, which requires such fees to be “*reasonable and competitive with the cost of similar goods or services provided by an independent third party.*” You have provided no evidence to the Receiver that the purported guarantee fees are reasonable and competitive with what could have been obtained from an independent third party. In fact, the purported guarantee fees are five times higher than a similar purported guarantee fee between yourself and Go-To Niagara Chippawa LP (which is an Affiliate, as defined in the LP Agreement, of Go-To Stoney Creek LP); and

c. In the further alternative, you have not provided any evidence to the Receiver that you had the financial wherewithal to pay the subject guarantees if called upon (in other words, that Go-To Stoney Creek LP received anything in exchange for purportedly agreeing to the guarantee fees). This is particularly noteworthy, as the subject guarantees increased from \$2.4 million as of February 27, 2018, to \$6 million as of November 19, 2019 to \$10.65 million as of December 18, 2020.

- [11] In Mr. Furtado's notice of dispute, he disagreed with the Receiver's position regarding the obligation to disclose the guarantee fees. He stated: "Mr. Furtado disagrees entirely with the assertion that there was any requirement or obligation on his part to disclose the entitlement to guarantee fees." Mr. Furtado now argues that the guarantee fee obligation was disclosed in any event in Stoney Creek LP's 2019 financial statements.
- [12] Mr. Furtado, as a fiduciary of both Stoney Creek GP and Stoney Creek LP, was obliged to disclose his personal contractual entitlement to guarantee fees tied to bank loans to Stoney Creek LP. The Guarantee Fee Agreement is between Stoney Creek LP and Oscar Furtado. It is executed by Mr. Furtado personally and by Mr. Furtado, as the President & CEO of Stoney Creek GP. In making this agreement, Mr. Furtado was contracting that Stoney Creek LP would pay him an annual guarantee fee equal to 5% of the total principal amount from time to time guaranteed by him under the guarantees.
- [13] As noted above, Mr. Furtado was the sole director and president of Stoney Creek GP. As such, he owed fiduciary duties to Stoney Creek GP: s. 134 of the *Business Corporations Act*, R.S.O. 1990, c. B.16 (Ontario). Mr. Furtado, as the sole director of the general partner, also owes a fiduciary duty at the limited partnership level: *Extreme Venture Partners Fund I LP v. Varma*, 2021 ONCA 853, at para. 96, where the Court of Appeal stated:
- [I]t would be an anomalous result if the law offered no remedy for the breach of a directors' fiduciary duty in circumstances where the limited partnership suffered the resulting loss. If that were the case, directors could act with impunity to damage the interests of the limited partnership, including by engaging in self-dealing, and there would be no remedy for such a breach of fiduciary duty. The law of fiduciary duties, which is based in equity, should not brook such a lacuna in its remedies.
- [14] Stoney Creek's limited partnership agreement provides that: "The General Partner shall exercise its powers and discharge its duties honestly, in good faith and in the best interests of the Partnership."
- [15] Mr. Furtado, in executing the Guarantee Fee Agreements as an officer of Stoney Creek GP, was doing so as an agent of the corporation. Directors and officers of a corporation act as agents of the corporation, particularly when developing company business: *Blue Line Hockey Acquisition Co., Inc. v. Orca Bay Hockey Limited Partnership*, 2008 BCSC 27, at para. 133.

[16] Fiduciaries are subject to certain duties, including the duty of full disclosure. As noted by the Court of Appeal in *Advanced Funding Corp. v. Bannick* (1979), 1979 CanLII 1681 (ON CA), 27 O.R. (2d) 193, at 196:

One of the prime fiduciary duties of an agent is that of full disclosure. Wherever it appears that the agent is going to profit from the agency over and above the remuneration agreed to be paid by the principal, the duty of disclosure must be rigorously enforced by the Court, and it must be shown that after full disclosure, the principal has expressly or by necessary implication consented to the agent making a profit. The principle has been stated in many cases [citations omitted].

[17] Mr. Furtado argues that if he was required to disclose the guarantee fees, he did so because they were referenced in the 2019 financial statements. The 2019 financial statements have been withdrawn by the auditor.

[18] The notes to Stoney Creek LP's 2019 financial statements include the following statements:

- The Partnership has an agreement with Oscar Furtado (Guarantor), ultimate beneficial owner of the Class B unitholders, to guarantee the repayment of the indebtedness amounts outstanding. The Guarantor is entitled to an annual guarantee fee equal to 5% of the total principal amount guaranteed by the Guarantor. During the year ended December 31, 2019, \$nil (2018 - \$60,143) in guarantee fees was paid and is included in land inventory.
- During the year ended December 31, 2019, \$34,521 (2018 - \$nil) in guarantee fees was payable to the Guarantor and is included in accounts payable and accrued liabilities and land inventory.

[19] In determining whether there was disclosure of the guarantee fee agreement with Mr. Furtado, the Receiver relied upon the Limited Partnership Agreement and the investment marketing brochure for the Stoney Creek project. Mr. Furtado pointed to the fact that the Receiver had not relied upon the 2019 financial statements in suggesting that the Receiver had not fully investigated his claim. The 2019 audit opinions were withdrawn by PwC, the auditor. In a letter from PwC to the Receiver, copy to Mr. Furtado, dated March 7, 2022, the auditor stated:

PwC has determined that the auditor's reports to the Shareholder of GTDH and Partners of the Go-To Group for financial year 2019 as well as the auditor's report to the Partners of Go-To Spadina for financial year 2020 should not be relied upon by any party and as such, we are withdrawing these opinions.

This letter is to notify management, and those charged with governance – in this case Mr. Furtado and the Receiver – that PwC, as previous auditors of the Go-To Group and GTDH, seeks to prevent any reliance on the Auditor’s Reports for the periods in question. Please take the necessary steps to ensure that anyone in receipt of the Audited Financial Statements, including that our Auditor’s Reports thereon, are informed of this situation and advised not to rely on same.

- [20] The Receiver notes that section 5.12 of the Limited Partnership Agreement (between Stoney Creek GP, Go-To Development Holdings Inc. and each party who executes the agreement and agrees to be bound as a limited partner) could potentially be an applicable provision if there was evidence that the guarantee fees were reasonable and competitive with what would be provided to a third party. However, that provision would not obviate the need for disclosure. Section 5.12 of the Limited Partnership Agreement provides:

The General Partner may employ or retain an Affiliate of the General Partner (which for greater certainty includes Go-To Holdings) on behalf of the partnership to provide goods or services to the Partnership, provided that the cost of such goods or services are reasonable and competitive with the cost of similar goods or services provided by an independent third party.

- [21] There was no evidence that the guarantee fee claimed by Mr. Furtado is “reasonable and competitive with the cost of similar goods or services provided by an independent third party” such that it could fall within section 5.12. I note that Mr. Furtado did not swear an affidavit on this motion.
- [22] The Go-To marketing brochure for the Stoney Creek project, entitled “Investment Opportunity”, does not disclose that limited partner investor funds will be used to pay guarantee fees to the related party, Mr. Furtado. The “Summary of Key Considerations” in the brochure discloses the following with regard to the structure of the deal and the bank financing:

Deal Structure/Liability

- The Limited Partners have limited liability on their investment.
- The General Partner, Go-To Developments, has unlimited liability. The General Partner and Builder will sign for all third party financing and provide the Banks with all personal guarantees when required.
- The Limited Partners only fund the original purchase of the land, related closing costs and initial soft costs. The Investor will not be required to provide any additional funding to complete the project.

Bank Financing

- Financing for development and construction is obtained from the Bank.

- The Banks will not provide construction financing until the following is achieved:
 - a. The land is properly zoned.

 - b. The City has approved the plans for development.

 - c. The project has pre-sold a minimum of 70% of the homes in a given phase.

- When the Bank does provide financing, this is done using the appraised value of the land. The appraised value of the land continues to increase at each stage of the development process. As an example, upon completion of zoning the appraised value of the land increases. There is a further increase in the appraised value when City approvals are obtained and again when pre-sales occur.

[Emphasis added.]

[23] The marketing brochure distributed to potential investors in the Stoney Creek project describes which costs investors are responsible for and does not mention guarantee fees. The brochure mentions that the General Partner and Builder will sign for third party financing and provide personal guarantees where required, but does not state that Mr. Furtado may provide personal guarantees, nor does it specify that any guarantee fees will be paid if a personal guarantee is provided.

[24] Mr. Furtado points to section 5.13 of the Limited Partnership Agreement, which provides:

The validity of a transaction, agreement or payment involving the Partnership and an Affiliate of the General Partner is not affected by reason of the relationship between the General Partner and such Affiliate or by reason of the approval or lack thereof of the transaction, agreement or payment by the directors of the General Partner, all of whom may be officers or directors of or otherwise interested in or related to such Affiliate.

The parties hereto acknowledge that: (i) the General Partner and Go-To Holdings may have the same directors, officers, direct or indirect shareholders, employees and affiliates; and (ii) that Go-To Holdings and the directors, officers, shareholders, employees and affiliates of each of Go-To Holdings and the General Partner are engaged in a wide range of investing and other business activities, which may include, direct and/or indirect, ownership and development of real property. Consequently, the directors, officers or employees of the General Partner will only devote as much time as is necessary (but not all of his or her full time) to supervise the management of the business and affairs of the Partnership.

[25] Mr. Furtado submits that any disclosure obligation is eliminated by the inclusion of section 5.13 in the LPA. The Receiver agrees that section 5.13 permits the entering into of an agreement such as the Guarantee Fee Agreements. However, the Receiver submits that section 5.13 does not obviate the need to disclose the fee agreements and fees. I agree.

[26] The only disclosure of the guarantee fees is in the notes to the financial statements, which have been withdrawn. The notes do not disclose the total quantum of guarantee fees potentially payable to Mr. Furtado (over \$860,000), nor do they disclose the means of calculating them. While the 2019 balance sheet discloses loans payable by Stoney Creek LP in the amount of \$6,350,000, the notes do not specify the quantum of guarantee fees. The guarantee fee amount payable to the guarantor (Mr. Furtado) in 2019 (\$34,521) would not suggest to someone reading the statements that the fees potentially payable to Mr. Furtado would be of the magnitude claimed. Mr. Furtado points to the guarantee fee agreement, which contemplated additional guarantees being provided. The 2020 iteration of the guarantee fee agreement contained the total indebtedness that was guaranteed in the amount of \$10,650,000. However, as noted, the guarantee fee agreement, signed by Mr. Furtado for Stoney Creek and Mr. Furtado personally, was not disclosed. In any event, considering that this was a lucrative related party transaction, one would expect full disclosure, including to investors in the limited partnership. As noted by this Court in *Klana v. Jones* (2003), 2003 CanLII 42363 (ON SC), 35 B.L.R. (3d) 236 (Ont. S.C.J.), at para. 44:

The duty owed by an agent to its principal requires the agent to make full disclosure of material facts which place or may place the agent in a conflict of interest. The duty of full disclosure extends to every material fact regarding the subject matter of the agency, which clearly would contemplate financial disclosure. The onus of providing that there was adequate disclosure lies with the agent. It is not sufficient for the agent merely to disclose that he or she has an interest or to make a statement that would signal the principal should inquire. “Material information means

information that a reasonable person would consider likely to operate on the principal's judgment." The test for whether information is material is objective. [Citations omitted.]

[27] I am satisfied that Mr. Furtado had a duty to provide full disclosure of the guarantee fee arrangement, which he failed to do.

Disposition and Costs

[28] The Receiver's request for the Court to uphold the Disallowance Order is granted.

[29] Mr. Furtado shall pay the Receiver's costs fixed in the amount of \$14,500 (including taxes and disbursements) forthwith.

Steele,
J.

Date: November 9, 2023

TAB 11

Advanced Realty Funding Corp. v. Bannink, 1979 CanLII 1681 (ON CA)

Date: 1979-12-19

Other citations: 27 OR (2d) 193 — 106 DLR (3d) 137 — 9 BLR 161 — [1979] OJ No 4483 (QL)
— 12 RPR 17

Citation: **Advanced Realty Funding Corp. v. Bannink, 1979 CanLII 1681 (ON CA)**, <<https://canlii.ca/t/g1hnl>>, retrieved on 2024-05-06

Advanced Realty Funding Corp. v. Bannink

27 O.R. (2d) 193

106 D.L.R. (3d) 137

ONTARIO

COURT OF APPEAL

JESSUP, ARNUP AND THORSON, J.J.A.

19TH DECEMBER 1979.

Agency -- Fiduciary duty -- Secret commissions -- Mortgage broker intending to accept finder's fee from lender -- Whether sufficient to include standard form of acknowledgment in signed document.

Where a mortgage broker intends to accept a finder's fee from a mortgage lender he must make full disclosure of all the details to his client so as to make sure that the latter understands and agrees. It is not sufficient simply to include in a document signed by the client a standard form of acknowledgment that the broker may receive a fee. Failure to make full disclosure deprives the broker of any right to the agreed commission.

APPEAL from a judgment in favour of the plaintiff in an action for a commission.

[Regal (Hastings), Ltd. v. Gulliver et al., [1942] 1 All E.R. 378; Boardman et al. v. Phipps, [1967] 2 A.C. 46; Aberdeen R. Co. v. Blaikie Brothers (1854), 1 MacQ. 461; Oliver v. Kemp, 1929 CanLII 252 (MB CA), [1929] 4 D.L.R. 1045, 38 Man. R. 310, [1929] 3 W.W.R. 369; S.E. Lyons Ltd. v. Arthur J. Lennox Contractors Ltd. et al., [1956] O.W.N. 624; Boston Deep Sea Fishing & Ice Co. v. Ansell (1888), 39 Ch. D. 339; Charles Baker Ltd. v. Baker et al., 1954 CanLII 92 (ON CA), [1954] O.R. 418, [1954] 3 D.L.R. 432; Fullwood v. Hurley, [1928] 1 K.B. 498; Anglo-African Merchants Ltd. et al. v. Bayley et al., [1970] 1 Q.B. 311, refd to]

G. W. Corby, for appellant, defendant.

G. C. Magwood, for respondent, plaintiff.

The judgment of the Court was delivered by

ARNUP, J.A.:-- The plaintiff is a mortgage broker. It sued its client, the defendant, for breach of the agreement entered into by him when he engaged the plaintiff. The breach alleged was the refusal of the defendant to go through with a mortgage transaction which the plaintiff had arranged and which the defendant accepted. The plaintiff obtained judgment for \$3,175 at trial. The defendant now appeals.

The defendant is a dairy farmer on a substantial scale. He needed funds and wanted to obtain a second mortgage loan for \$70,000, repayable over a period of 20 years. Paul Kueneman, an employee of the plaintiff, learned of the desire of the defendant to borrow money. Kueneman telephoned the defendant and arranged to see him at the farm. An application for a loan was completed, with information as to the defendant's financial position, including assets and liabilities. The application indicated that the defendant expected to pay a rate of interest from 15 1/2% to 16 1/2%.

On the same occasion, a document described as a "commission and fee contract" was signed by the plaintiff and by Kueneman on behalf of the defendant. That document was headed in blackface type:

Before you sign, remember this is a binding contract. Take the time to read it carefully, refuse to be hurried and don't be reluctant to ask for a full explanation. If you don't understand, or are unsatisfied with explanations, don't sign. Consult your lawyer and our head office.

You must be given a copy of everything you sign.

By para. 3 of the contract, the defendant agreed to pay the plaintiff commission and fees of \$250 plus \$2,800, and "all reasonable legal fees and disbursements incurred in so doing". A key clause followed which I now quote:

4. I/we agree that you shall be entitled to the said compensation notwithstanding that you may advance your own funds, temporarily or for the full term of the loan and receive a finder's fee or a placement fee from any lender.

Paragraph 5 of the contract is also material; omitting the irrelevant portions, it reads:

5. If the loan transaction cannot be concluded because ... I/ we should decline or omit to accept the loan funds so arranged in accordance with the application ... then I/we agree to forthwith pay Advanced Realty Funding Corporation in consideration of your efforts and services on my/our behalf the aforementioned compensation plus any solicitor's fees and disbursements as liquidated damages and not as a penalty.

Paragraph 6 of the contract provided that the defendant should pay to the plaintiff "all and every appraisal fee and or application fee paid by the Corporation on my/or our behalf".

At the trial, Kueneman testified that he could not recall whether he explained the two documents to the defendant but said he was prepared to answer any questions that the defendant might have. He testified that the defendant was given an opportunity to read over the document and that, in all, Kueneman spent over two hours with the defendant and his wife going over the two documents. On cross-examination, Kueneman stated that he could not recall whether the defendant had read over the mortgage application or the fee agreement nor did he recall explaining "in any detail" the meaning of the placement fee or the 4% commission shown in the contract.

From the whole of the evidence it is quite clear that Kueneman did not make any attempt to explain to the defendant or the defendant's wife the nature or amount or method of calculating a "finder's fee" referred to in cl. 4. He testified that some mortgage lenders were prepared to pay a finder's fee and some were not. It was known to him that Avco Financial Services Realty Limited ("Avco") did pay a finder's fee of 1% on the first \$20,000 of a loan and thereafter, one-half of 1%; in this transaction that would amount to \$450.

Avco agreed to accept the loan with some modifications which were satisfactory to the defendant. An appraiser was hired, did an appraisal and charged a fee of \$125, originally paid by Avco, which was then reimbursed by the plaintiff.

On September 9, 1976, the defendant and his wife signed a Form 3, statement of mortgage, as required by the Regulations [O. Reg. 461/71; am. O. Regs. 686/75, s. 5; 884/79, s. 2] under the Mortgage Brokers Act, R.S.O. 1970, c. 278, setting out the complete details of a second mortgage to Avco of \$70,000, and showing the deductions to be made from that gross amount. This document was signed in the office of the plaintiff, with its representative present (not Kueneman) and a representative of Avco. No explanation was given concerning any finder's fee; the subject was not mentioned.

The following day the defendant went to his own lawyer who indicated to him that it might be possible to get a second mortgage at a somewhat lower interest rate. In fact, the defendant did get a loan of \$70,000 at 15 1/2%, but it was really borrowed on a promissory note, with a mortgage as collateral security, and is a quite different "deal" from that which he had accepted with Avco.

The trial Judge described the defendant as "an intelligent, shrewd individual with ample experience in dealing with property". He also said that it was his "impression that the defendant knew very well what was being done and carefully examined the documents presented to him for signature before he signed them". When he summarized his findings, the trial Judge said he was satisfied the defendant "well knew what he was signing when he completed exs. 2, 3, and 6" (the application for loan, the commission and fee contract, and the first and second statements of mortgage). He further made the finding that the defendant knew, when he signed exs. 2 and 3, that if the plaintiff were to obtain and arrange a mortgage for him, he would have to pay a fee for their services. He made no express finding that the defendant knew that if the Avco transaction went through, Avco would pay the plaintiff a finder's fee. On the evidence, the trial Judge could not have found that the plaintiff explained to the defendant the nature of a finder's fee, what amount was to be paid in this case, or how it was to be calculated.

In the result, the trial Judge gave judgment for the fees set out in the contract of \$2,800 and \$250 respectively, and the appraisal fee of \$125, making a total of \$3,175.

On this appeal, a point was argued by counsel for the defendant which was not dealt with in the reasons for judgment, and having regard to the careful way in which the trial Judge has set out his findings, I can only assume that the point was either not made at all at trial, or was not argued in depth. The submission is that the plaintiff was the agent of the defendant, that it had an express or implied arrangement with Avco that if the mortgage transaction went through, the plaintiff would be paid a finder's fee in the amount of \$450, that this amounted to a secret commission or remuneration, and that the plaintiff thereby disentitled itself to any remuneration whatever from the defendant. It was primarily because of this point that we reserved judgment on the appeal.

There is no doubt that an agent owes fiduciary duties to his principal. The plaintiff was the agent of the defendant for the purposes of the transaction for which it was engaged. One of the prime fiduciary duties of an agent is that of full disclosure. Wherever it appears that the agent is going to profit from the agency over and above the remuneration agreed to be paid by the principal, the duty of disclosure must be rigorously enforced by the Court, and it must be shown that after full disclosure, the principal has expressly or by necessary implication consented to the agent making a profit. The principle has been stated in many cases, and was dealt with by the House of Lords in *Regal (Hastings), Ltd. v. Gulliver et al.*, [1942] 1 All E.R. 378, republished as a note to *Boardman et al. v. Phipps*, [1967] 2 A.C. 46 at pp. 134-59. I refer particularly to the statement of Lord Sankey in *Regal (Hastings)* at p. 381 All E.R., followed in *Boardman v. Phipps* at p. 85. See also the statement of Lord Cranworth in *Aberdeen R. Co. v. Blaikie Brothers (1854)*, 1 MacQ. 461 at p. 471, quoted in *Boardman v. Phipps* at pp. 106 and 124.

It was held by the Manitoba Court of Appeal in *Oliver v. Kemp*, 1929 CanLII 252 (MB CA), [1929] 4 D.L.R. 1045, 38 Man. R. 310, [1929] 3 W.W.R. 369, that an agent for the sale of land who receives a commission from the purchaser without the knowledge of his principal cannot recover commission from the latter. This case was quoted with approval in *S.E. Lyons Ltd. v. Arthur J. Lennox Contractors Ltd. et al.*, [1956] O.W.N. 624 at p. 627. The latter case also makes clear that "the important matter" is that the agent agreed to receive the secret commission, not that he in fact received it. This is long established law: see *Boston Deep Sea Fishing & Ice Co. v. Ansell (1888)*, 39 Ch. D. 339.

It has also been held that the onus of proving full disclosure is on the agent: see *Charles Baker Ltd. v. Baker et al.*, 1954 CanLII 92 (ON CA), [1954] O.R. 418 at p. 432, [1954] 3 D.L.R. 432 at p. 440. In that case, Mackay, J.A., said at p. 431 O.R., p. 439 D.L.R.:

It is settled law that in equity full and fair disclosure implies that consent has been given with full knowledge of all the material facts and circumstances which rebuts any presumption of undue influence or favouritism, and that the principal with such knowledge and under such circumstances ratifies and confirms the transaction.

See also *Dunne v. English (1874)*, L.R. 18 Eq. 524 at pp. 533-4.

So strict is the duty of disclosure that it has been said it is not enough to give notice to the principal that there is another commission, leaving the principal to inquire what it is and how much: *Fullwood v. Hurley*, [1928] 1 K.B. 498, per Scrutton, L.J., at pp. 503-4. There must be the "fullest disclosure" and an informed consent by the principal: *Anglo- African Merchants Ltd. et al. v. Bayley et al.*, [1970] 1 Q.B. 311 at p. 322.

Applying these principles to the present case, I am of the view that the plaintiff has not satisfied the onus upon it of showing full and complete disclosure to the defendant of the fact that it was going to be paid a finder's fee and how much that fee was. The plaintiff is, therefore, disentitled from receiving any remuneration from acting in the transaction of finding the defendant an acceptable mortgage. On the authorities, the Court does not engage in speculation as to what the principal might have done if disclosure had been made, nor is it an essential part of the relevant principle that there must have been detriment to the principal as a result of the non-disclosure.

This judgment does not mean that a mortgage broker is never entitled to collect a finder's fee. It does mean that it is not sufficient to bury a reference to a finder's fee in a rather ambiguous sentence in the midst of its contract for fees and commission. If the broker expects or intends to receive a finder's fee, he has a positive obligation to explain this to his client, indicate the amount of it or how it is to be calculated (if this is then known), make sure that his client understands, and receive his express consent to the broker receiving the fee. If the broker expects to receive a finder's fee, but does not yet know its amount or how it is to be calculated, he should explain this to his client, receive the client's express consent to the broker's accepting the fee, and should undertake to tell the client the amount of or method of calculating the fee, and to receive the client's consent before accepting it.

I do not think that the application of the principle requires that the plaintiff should be deprived of the right to recover the disbursement it made, quite properly, on behalf of the defendant, for the appraisal fee in connection with the mortgage which the defendant eventually refused to accept. Even apart from the express contract, the agent would be entitled to be indemnified for this expenditure on behalf of its principal. It is not part of its remuneration or commission.

The appeal should, therefore, be allowed, paras. 1 and 2 of the judgment of the Court below should be set aside and in lieu thereof, there should be judgment for the plaintiff for \$125, without costs.

The defendant is entitled to the costs of the appeal.

Appeal allowed.

TAB 12

At para(s) 63-64, 71, 75

Naramalta Development Corporation v. Therapy General Partner Ltd., 2012 BCSC 191 (CanLII)

Date: 2012-02-10

File number: M082425

Citation: **Naramalta Development Corporation v. Therapy General Partner Ltd., 2012 BCSC 191 (CanLII), <<https://canlii.ca/t/fq2bm>>, retrieved on 2024-04-25**

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Naramalta Development Corporation v. Therapy General Partner Ltd.*,

2012 BCSC 191

Date: 20120210

Docket: M082425

Registry: Vancouver

Between:

**Naramalta Development Corporation and
Omnex International Corporation**

Plaintiffs

And

**Therapy General Partner Ltd.
as Trustee of Naramalta Estate Winery Limited Partnership,
Rick Connors,
Trilliant Ventures Inc., Richard C. Roberts,
Marcus Ansems and Rachel Ansems**

Defendants

And

John C. McBean

Defendant by Counterclaim

Before: The Honourable Mr. Justice Kelleher

Reasons for Judgment

Representative of Plaintiffs and on his own behalf as Defendant by Counterclaim: J.C. McBean

Counsel for Defendants: G. Plottel and S.D. Hansen

Place and Date of Trial: Vancouver, B.C.
August 29-31, and
September 1-2,
2011

Place and Date of Judgment: Vancouver, B.C.
February 10, 2012

[1] John McBean, the defendant by counterclaim, conceptualized and developed a winery project. In 2004, he founded the Naramalta Estate Winery Limited Partnership (the “Limited Partnership”) which operates Therapy Vineyards (the “Winery”) in the Okanagan Valley of British Columbia.

[2] This action arises over a dispute regarding the operation of the Limited Partnership. The dispute led to the replacement of the general partner, the commencement of this action, the appointment of a receiver, and a decision of Rice J. which resolved some of the issues. The remaining issues are addressed in this judgment.

[3] The plaintiff and defendant by counterclaim, Naramalta Development Corporation (“NDC”) was originally the general partner of the Limited Partnership. It is an Alberta company registered extraprovincially in British Columbia. Its sole business was to act as general partner of the Limited Partnership.

[4] The plaintiff and defendant by counterclaim, Omnex International Corporation (“Omnex”) is also an Alberta company, registered extraprovincially. Omnex owns the majority of shares of NDC.

[5] The defendant by counterclaim, John McBean, is the sole director and officer of NDC and of Omnex. He is the operating mind for both companies. His family trust owns the shares of Omnex.

[6] The defendant Therapy General Partner Ltd. (“Therapy”) was incorporated in Alberta in May 2008. It was registered extraprovincially in British Columbia in June 2008. It replaced NDC as the general partner of the Limited Partnership. Mr. Justice Rice held in April 2010 that Therapy became the general partner in May 2008 pursuant to a vote of the limited partners: *Naramalta Development Corp. v. Therapy General Partner Ltd.*, 2010 BCSC 590 (“*Naramalta 1*”).

[7] A number of defendants are now redundant to this action: Rick Connors, Trilliant Ventures Inc., Richard C. Roberts, Marcus Ansems and Rachel Ansems. The plaintiffs originally sought relief against them in trespass. No such relief was ever awarded or is sought now. None of them seeks relief in the counterclaim.

[8] The issues to be addressed are:

- (1) Omnex claims to be owed more than \$335,000;
- (2) Therapy counterclaims that Omnex, NDC and Mr. McBean are indebted to it;
- (3) The Winery was put in the hands of a receiver appointed by the Court in 2008. Therapy claims that the costs of the receivership should be borne by the plaintiffs and Mr. McBean;
- (4) Therapy claims as well: (a) Omnex should disgorge payments it received as management fees; (b) Omnex and/or NDC should repay funds received as redemption of purported Limited Partnership units; (c) NDC and McBean are liable for issuing certain Limited Partnership units for less than the full subscription price; (d) Omnex is not entitled to remain registered as a limited partner; and (e) Mr. McBean should be found jointly and severally liable with Omnex.

BACKGROUND

[9] Mr. McBean learned in June 2004 that the Winery, then known as the Red Rooster Winery, was for sale. He decided to purchase it.

[10] The Winery is located between Naramata and Penticton, British Columbia. It comprises ten acres of vineyard, a winemaking facility, a retail store and a guesthouse.

[11] In October 2005, Mr. McBean formed a limited partnership and set up NDC as the general partner. He then went about marketing units of ownership. That is, he solicited investors to become limited partners.

[12] The relationship between the Limited Partnership and NDC, the general partner, was governed by the Partnership Agreement. This was drafted by Mr. McBean or his counsel. It provides that it is governed by the laws of Alberta.

[13] The pertinent terms of the Partnership Agreement were accurately summarized and paraphrased by Rice J. in an earlier decision: *Naramalta 1*. I adopt his paraphrasing of the Partnership Agreement, at para. 16 of that decision:

Article 3.1.6 An extraordinary resolution of the Limited Partners is one passed by a vote of at least 75% of votes cast by those present or by proxy in favour at a meeting called for the purpose of such resolution.

Article 10.1 the General Partner has full and exclusive power and authority to carry on the Partnership business and to do such things as it deems necessary and appropriate, or incidental to the Partnership business.

Article 11.1 the General Partner is to manage, control and operate the business in a prudent and reasonable manner, and honestly, in good faith and in the best interests of the Limited Partners.

Article 11.6 the General Partner may enter into a transaction with an affiliate if the fees for the services provided under the transaction are consistent with the fees that would be paid to an arms-length party providing similar services.

Article 12.1 the General Partner may be removed as the General Partner at any time by extra-ordinary resolution in the event of default by the General Partner under this agreement, which default remains unremedied for a period of sixty (60) days from the date that notice of default is given to the General Partner by any Limited Partner.

Article 14.1 the General Partner shall be reimbursed for all costs and expenses incurred as General Partner.

Article 15.10.1 the profits of the Partnership are to be distributed only among the Limited Partners until a total of the profit distributions to them reached 130% of their aggregate capital contributions to the Partnership. After that the Limited Partners total share of the profits was to be reduced to 75% and the General Partner was to receive 25% of the total profit

Article 18.1 the General Partner must call an annual meeting of the Partners each year to review the Limited Partnership business.

Article 18.2 the General Partner may at any time call a meeting [and] must do so upon a request from 10% of the outstanding units, and if he fails to do so within 15 days of a demand in writing, any Limited Partner may call the meeting.

Article 18.3 notice of any Partner's meeting shall be given to each Limited Partner to the General Partner and to the auditor with notice to be mailed by pre-paid post at least 14 days and not less than 30 days prior to the meeting and shall specify the time and place of the meeting and the nature of the business to be transacted.

Article 18.7 at any meeting of Partners, any Limited Partner entitled to vote may vote by proxy in the prescribed form, provided that the proxy shall have been received by the General Partner for verification prior to the meeting.

Article 18.10 no person shall solicit proxies unless such person delivers a notice and information circular to each partner whose proxy is solicited. The information circular shall confirm insofar as is applicable to the form and content prescribed by the Securities Act ... Any proxy solicited in contravention shall be invalid.

Article 21.1 The agreement may only be amended with the consent of Limited Partners by extraordinary resolution.

[14] Mr. McBean hired the defendant Marcus Ansems as the general manager of the operation. He also hired Mr. Ansems's wife, Rachel Ansems, as a bookkeeper. He then retained Ms. Ansems's father, Bob Leadley, to provide accounting services. Although Mr. Leadley lives and practises in St. Catherines, Ontario, he testified he took the position because he has experience with wineries in the southwestern Ontario area, and he could thereby visit his daughter and provide accounting services at a good price.

[15] Rick Connors is one of the investors. In late 2006, he purchased eight units in the Limited Partnership at \$25,000 each for a total of \$200,000. The purchase was in the name of Trilliant Ventures Inc., a company jointly owned by his wife and him.

[16] At the time, Mr. Connors's initial dealings were with Glenn Fawcett. Mr. Fawcett worked for the Winery raising equity capital. In late 2007, Mr. Connors took over Mr. Fawcett's job.

[17] Mr. Connors understood that, pursuant to Article 15.10.1 of the Partnership Agreement, the limited partners were entitled to a return of 130% on their investment. When that had been paid, subsequent profits would be split 75% to the limited partners and 25% to the general partner.

[18] The difficulties began in early 2008. Mr. Connors had become acquainted with Richard Roberts, another investor. They shared a concern about the lack of financial information they were receiving from Mr. McBean. They contacted two other investors, Doug Foster and René Massenon. They arranged a meeting with Mr. McBean to discuss their concerns.

[19] By the time of the meeting, other financial problems had come to their attention. Mr. Ansems contacted Mr. Connors. He told him he was worried that there were unpaid creditors and that cash flow was a source of concern.

[20] The investors' meeting with Mr. McBean was scheduled for May 7, 2008. Mr. Connors came to Kelowna a day earlier and met with Mr. and Ms. Ansems on May 6, 2008. He learned that "key suppliers" were not being paid. He also learned that money that he was raising from new investors, which was supposedly for a new winery, was going to NDC or Omnex. It also appeared that the company was in default of its obligation to the contractor building the new winery.

[21] The four investors met with Mr. McBean the following day. The investors had learned that Omnex was charging managements fees to the Limited Partnership. They raised this with Mr. McBean. Mr. Connors referred to information in the draft financial statements for the fiscal year ended December 31, 2007. Mr. McBean's response to these concerns was to assert that Mr. Connors had no right to this information. He also sought to blame the accountants for the delay in producing financial statements. It was clear to Mr. Connors that the fault did not in fact lie with the accountants.

[22] In the course of this meeting, Mr. Foster asked Mr. McBean to have NDC step aside as general partner until all the information was obtained. Mr. McBean said that if he did so, it would cost them \$1,800,000: \$900,000 for him and \$900,000 for Mr. Ansems.

[23] Mr. McBean had already scheduled a general meeting of all of the limited partners for May 29, 2008 (the "General Meeting"). He told the persons at the May 7, 2008 meeting to get their "proxies ready" for the upcoming meeting as that was what he intended to do.

[24] The May 29, 2008 General Meeting had been scheduled in March. Notice had been circulated on March 31, 2008.

[25] On May 23, 2008 the group of investors that Mr. Connors represented notified the other limited partners of their concerns. They circulated a form of proxy which purported to be in accordance with the rules. They proposed amending the Partnership Agreement to remove NDC as general partner and to substitute Therapy General Partner Ltd. (this corporation had been incorporated in Alberta on May 28, 2008, the day before the General Meeting).

[26] On May 27, 2008, Mr. McBean took a number of steps: first, he terminated the employment of Marcus and Rachel Ansems; second, he ended the relationship with Mr. Leadley's accounting firm; and third, he purported to cancel the May 29, 2008 General Meeting in light of what he called a "palace revolt".

[27] The dissidents led by Mr. Connors insisted that the General Meeting go ahead. The attendance in person and by proxy was sufficient that a quorum was declared. Mr. McBean was present at the General Meeting but chose not to speak or take issue with the propriety of the meeting. He left before it ended.

[28] The limited partners voted to replace NDC as general partner.

[29] Mr. McBean learned of this decision, but did not accept it. Instead, he changed the locks on the Winery lands and hired security guards. He and his wife moved into the guest house. He tried to transfer the Limited Partnership's liquor licence to himself. He also forced Mr. Ansems to leave the premises. This left no one to attend to the processing of the wine.

[30] The resulting dysfunction had to be addressed. The defendant Therapy applied to this Court for the appointment of a receiver. On June 12, 2008, the Court appointed a receiver.

[31] The receiver exercised his authority to call a meeting of the limited partners for July 21, 2008 (the “Ratification Meeting”). At the Ratification Meeting, the limited partners were to be called upon to ratify the resolutions passed on May 29, 2008. That was necessary due to several defects in what happened on May 29, 2008. The Connors investors did not give proper notice for bringing resolutions before a meeting of the limited partners; they omitted information which should have been disclosed; the circular did not disclose the total number of units and voting rights. It was also alleged that the subject matter of the resolution was not sufficiently described to permit a voter to form a reasoned judgment of the matter.

[32] Both sides campaigned by distributing written materials. At the Ratification Meeting, Mr. McBean and his legal counsel were in attendance. He proposed a motion to retain NDC as general partner. This motion was defeated. The limited partners voted to ratify the resolutions passed in May 2008.

[33] The defendants brought a summary trial application in 2009. The defendants sought a determination of three issues:

- (1) the defendants asserted that the costs of the receiver should be borne by the plaintiffs and/or Mr. McBean;
- (2) the defendants took issue with payments made by NDC to Omnex;
- (3) the defendants sought a declaration that resolutions at the General Meeting of May 29, 2008, and ratified on July 21, 2008 were valid.

[34] Mr. Justice Rice gave judgment on April 29, 2010 (*Naramalta 1*). He found that the first two issues should not be determined on a summary basis but left for a full trial. The issue of the receiver’s costs, he said, should be left to trial because the trial judge would have the “advantage of perspective” from which to view things (para. 57). With respect to the second issue, conflicts in the evidence dictated that it was unsuitable for a determination under the then Rule 18A.

[35] In *Naramalta 1*, Mr. Justice Rice concluded that Therapy was the general partner of the Partnership. He found, at paras. 116-117, as follows:

Having weighed the evidence, I find it appropriate to exercise my discretion to declare approved the resolutions submitted at the Meeting of Limited Partners May 29, 2008 and effective to remove NDC and establish Therapy as General Partner of the Partnership.

I find further that the motions purportedly passed at the meeting of May 29, 2008 were duly ratified at the subsequent meeting of July 21, 2008. I also find, although it is unnecessary for me to do so, that Mr. McBean waived the irregularities of the defendants by his personal attendance at both meetings of the Limited Partners on May 29, 2008 and July 21, 2008 and ratified by his personal attendance at both meetings without complaint as to the legitimacy of the proceedings.

ACCOUNT RECONCILIATION

[36] Omnex seeks payment of \$335,297.02 from Therapy. Therapy claims that Omnex owes the Limited Partnership \$205,929 pursuant to its counterclaim. This amount includes a claim for the return of management fees and for payments credited to Omnex for unauthorized redemption of limited partnership units.

[37] Mr. McBean's evidence in support of the claim for money owed to Omnex is based on a number of documents which are incomplete and contradictory. On the other hand, the defendants rely on the audited financial statements of the Limited Partnership.

[38] Much of the difficulty with Mr. McBean's evidence arises from the fact that he often treated NDC, Omnex and a third corporation, Benpro Technologies Inc. ("Benpro"), as one entity. Funds were carelessly commingled.

[39] I have the benefit of the evidence of Mr. Leadley, the former accountant. His testimony establishes Therapy's claim: it is based on the audited financial statements for the fiscal years ending in 2005, 2006, 2007 and 2008.

[40] Mr. Leadley testified that he reviewed the general ledger on a monthly basis and that Mr. McBean never complained to him that the figures in the general ledger or the financial statements were incorrect.

[41] In fact, Mr. McBean admitted in cross-examination that the 2006 audited financial statements were correct and that he could not disagree with the calculation in early 2007.

[42] I am satisfied the claim of Omnex against Therapy is without merit. It is dismissed.

[43] Therapy's counterclaim against Omnex is consistent with, and verified by, several years of audited statements, based on complete general ledger information. Therapy is entitled to judgment in the amount of \$205,929.

COST OF THE RECEIVER

[44] Generally speaking, court ordered receivers are officers of the court and as such are entitled to be paid out of the property they are managing. However, as between the parties involved, one may be entitled to indemnity for the costs of the receiver if the other's conduct interferes with the receiver or otherwise causes a depletion of the assets of the enterprise.

[45] Here, the resolutions passed on May 29, 2008 brought the appointment of NDC as general partner to an end. Mr. Justice Rice found that Mr. McBean by his conduct at the meetings in May and July 2008 waived any invalidity of both meetings. There was no appeal of Rice J.'s decision in *Naramalta 1*.

[46] Therapy argues that despite the overwhelming vote at the May 29, 2008 General Meeting, Mr. McBean took unilateral action entirely inconsistent with the decisions at the meeting. Instead of trying to call a new meeting of the limited partners, or discussing the issues with Mr. Connors, he changed the locks, hired security guards, brought in family, and sought to ignore the overwhelming majority of the limited partners.

[47] The defendants contend that but for the conduct of NDC, Therapy would not have been put to the expense of a receivership. They say that in such circumstances it is appropriate to hold the at fault party to account for the costs of the receiver: see *MacPherson (Trustee of) v. Ritz Management Inc.*, [1992] O.J. No. 506 (Ct J Gen Div).

[48] I disagree. In *MacPherson*, the respondent found to be at fault actively interfered with the receiver carrying out its duties. That is what caused higher receivership costs and depleted the assets of the enterprise from which the receiver's fees would normally come.

[49] Thus, *MacPherson* stands for the principle that a party who exacerbates receivership costs by disputatious proceedings and interference with the receiver should indemnify the innocent parties in the enterprise.

[50] In retrospect, Mr. McBean should not have disputed the results of the May 29, 2008 General Meeting. But there was some merit to his position: Rice J. found there were procedural irregularities.

[51] Therapy's case is not based on Mr. McBean's actions after the receiver was appointed.

[52] In all the circumstances, there is no basis for a finding that NDC or Mr. McBean should be liable for the costs of the receiver.

MANAGEMENT FEES

[53] In January 2005, NDC and Omnex entered into a "Management Fee Agreement" whereby Omnex would provide certain services to the Limited Partnership. It was prepared by Mr. McBean, the operating mind of both companies. Under the terms of the Management Fee Agreement, Omnex's services include:

Executive management of the business;

Acquisition, mergers, joint ventures, partnerships, divestitures;

Capital expenditures;

Financing;

Employee and contractor recruitment, dismissal;

Organization planning;

Policies, procedures guidelines;

Budgeting, forecasting, business planning;

Reporting to stakeholders;

Marketing strategy, promotion, advertising;

Trade, customer, agent, distributor, supplier contracts and relationships.

[54] Compensation was not specified. It was to be agreed between the “parties”.

[55] The “parties” – NDC and Omnex – then agreed in a written agreement effective April 1, 2007, that compensation would be \$8,333.33 per month. Mr. McBean signed the agreement on behalf of both “parties”. That agreement provided, then, for a credit of \$75,000 for the nine months of service from April to December 2007.

[56] In 2008, Mr. McBean apparently decided that the amount of the compensation should be increased. It went up by 20%, to \$120,000 per year, retroactive to January 2007. This was evidenced by a written agreement signed by Mr. McBean on behalf of both “parties”.

[57] Mr. McBean withdrew funds for Omnex, pursuant to the terms of the Management Fee Agreement, at various times and for various amounts.

[58] This Management Fee Agreement raises several difficulties.

[59] First, Mr. Ansems was hired in 2005 as general manager. He was paid \$80,000 per year. His duties were essentially the same as Mr. McBean’s contracted services. The Limited Partnership paid Mr. Ansems for: “... management of all aspects of the current and future operations of Therapy Vineyard and Guesthouses, including full responsibility for profitability and growth”.

[60] Second, Mr. McBean did not disclose the existence of the Management Fee Agreement to the limited partners, or his use of it to justify Omnex withdrawals, until after this action commenced.

[61] Third, the payments are not consistent with the *pro forma* financial statements that were provided to potential investors. The offering memorandum made no reference to management fees paid to the general partner. Rather, the September 2004 financial projections state “Annual General Partner Expenses” to be \$12,000 a year, or \$1,000 per month.

[62] Fourth, the Partnership Agreement (article 15.10.1) does not contemplate any profit participation by the general partner until there has been 130% return to the limited partners on their original investment. At that point (which had not been reached at the time of these events), the general partner is entitled to 25% of profits. The only compensation contemplated for the general partner before that time is reimbursement of expenses.

[63] I conclude that these payments to Omnex under the Management Fee Agreement were no more than a device to compensate Mr. McBean in a manner in which NDC could not be compensated.

[64] NDC, as a general partner, has a fiduciary duty to the limited partners. In *Rochweg v. Truster* (2002), 2002 CanLII 41715 (ON CA), 58 O.R. (3d) 687 (C.A.), a unanimous panel of the Ontario Court of Appeal described the nature of the duty. At para. 22, Cronk J.A. wrote:

Equitable principles recognized by the courts during the last 100 years impose on partners duties of loyalty, utmost good faith and avoidance of conflict and self-interest. In Ontario, the principles which inform these duties are partially reflected in the *Act*. At all times while Rochweg was a partner of RTZ, he owed these duties to his partners.

[65] And at para. 36, he wrote:

It has long been established that partners owe a fiduciary duty to each other, and that equitable principles hold fiduciaries to a strict standard of conduct, encompassing duties of loyalty, utmost good faith and avoidance of conflict of duty and self-interest. These are well recognized, core principles of the law of partnership.

[66] These principles are entirely applicable to a limited partnership. It is clear from *Molchan v. Omega Oil and Gas Ltd.*, 1988 CanLII 103 (SCC), [1988] 1 S.C.R. 348, that a general partner is a trustee and owes a fiduciary duty to its limited partners (para. 34).

[67] The reasoning in *Molchan* was applied by Mr. Justice Shaw of this court in *King v. On-Stream Natural Gas Management Inc.*, [1993] B.C.J. No. 1302 (S.C.). I adopt his conclusion, from para. 28:

On reviewing the provisions in the *Partnership Act* relating to limited partnerships, I can find nothing which either expressly or by necessary implication says that a general partner in a limited partnership is under any lesser duty than a partner in an ordinary partnership with respect to partnership property. Considering the fact that a general partner in a limited partnership has the sole right to manage the business of the partnership and the limited partners are precluded from taking part in management, this, in my opinion, is a compelling reason why a general partner should be under at least the same duty as a partner in an ordinary partnership holding partnership property.

[68] Shaw J. went on to elaborate on the nature of the fiduciary duty owed by a general partner (at para. 29, quoting from *Molchan*):

For these purposes I assume the highest status of the general partner, namely, that of a trustee holding the properties of the partnership on behalf of all other partners.

[69] Even apart from the general law, the terms of the Partnership Agreement make specific reference to the kind of duty owed by the general partner to the limited partners. Article 9.1.3 provides that the general partner “shall act with the utmost fairness and good faith toward the other Partners in the conduct of the Partnership business”. Article 11.1 provides that the general partner will manage, control and operate the business of the partnership “honestly, in good faith and in best interests of the limited partners”.

[70] I conclude that the Management Fee Agreement is entirely inconsistent with NDC's duty to the limited partners.

[71] Mr. McBean understood that a management fee could not be charged by NDC. However he managed to accomplish the same thing through this circuitous contractual relationship with Omnex and did so without disclosing it.

[72] This is simply not in the best interests of the limited partners.

[73] Omnex has received a total of \$126,748.08. The Limited Partnership is entitled to be reimbursed this amount from NDC.

[74] Although NDC is the party in breach of its fiduciary obligations, Omnex is just as liable for the breach under the doctrine of knowing assistance.

[75] Omnex knew of NDC's breach of the Partnership Agreement by the Management Fee Agreement. That is because it has the same principal as NDC. Under the doctrine of knowing assistance, when a person knowingly participates in a breach of trust, that person can be personally liable for the breach, even if he or she is a stranger to the trust: see *Air Canada v. M & L Travel Ltd.*, 1993 CanLII 33 (SCC), [1993] 3 S.C.R. 787.

[76] As I outlined above, the Management Fee Agreement was contrary to the provisions of the Partnership Agreement and was contrary to the best interest of the limited partners. As such, it constitutes a breach of the trust relationship between NDC and the limited partners.

[77] I agree with the defendant Therapy that the audited claim against Omnex to the extent that it takes into account the wrongful payment of the management fees, is correct.

DISCOUNTED UNITS IN THE LIMITED PARTNERSHIP

[78] Article 8.5 of the Partnership Agreement reads as follows: "For each unit subscribed for, a person shall pay TWENTY-FIVE THOUSAND (\$25,000) DOLLARS cash, or by certified cheque at the time of the subscription." The Partnership Agreement was later amended to increase the unit price to \$30,000.

[79] Mr. McBean admitted that on three occasions, partnership units were transferred for no or less monetary consideration than required by the Partnership Agreement. First, Mr. Fawcett's company, Vinequest, was granted one partnership unit for no consideration; second, Mr. McBean granted a limited partnership unit to Mr. Ansem's company for \$10 and "future consideration". Finally,

Mr. McBean admitted that he sold a limited partnership unit to a Mr. Kintzl, a director of Benpro, for \$27,000. His rationale for the \$3,000 discount was that there was no commission payable on the sale and Mr. Kintzl could have the benefit of that.

[80] There is no dispute that the partnership lost \$58,000 which it would have received if full payment had been received for these subscriptions.

[81] These actions were contrary to the Partnership Agreement. NDC is liable to Therapy in the amount of \$58,000.

IS OMNEX A LIMITED PARTNER?

[82] Therapy is seeking a declaration that Omnex is not a limited partner.

[83] Mr. McBean testified that certain funds were advanced to the Limited Partnership, which funds were earmarked to purchase three units for NDC and three units for Omnex. This was made up, he testified, of a cheque for \$90,000 paid by Omnex to Re/Max. Benpro allegedly gave a cheque for \$60,000 to Mr. McLean, counsel for NDC.

[84] Doug Foster also testified. He is a limited partner. He provided seed capital for the initial purchase of the Winery. His evidence is that the company he controls, 338164 Alberta Ltd., purchased 16 units of the Limited Partnership for a total investment of \$400,000. A portion, \$90,000, was paid to Omnex on August 30, 2004. A further \$310,000 was paid directly to Mr. McLean on October 21, 2004.

[85] A copy of Mr. Foster's cheque payable to Omnex for \$90,000 was put to Mr. McBean in cross-examination. He was asked to explain how NDC could rely on Mr. Foster's money to purchase NDC units when the money had already been counted to purchase his 14 units of the Limited Partnership.

[86] Mr. McBean was unable to explain this.

[87] Moreover, Mr. McBean was unable to produce the \$60,000 cheque from Benpro which he relied upon. He agreed that there was no evidence that Omnex ever paid any money to the Limited Partnership for units.

[88] The bank statements of NDC and Mr. McLean could have been produced by Mr. McBean to support the assertion of Omnex with respect to the purchase of the units.

[89] The defendants demanded production of these documents, and an order of the Court was made. In light of the failure to produce the documents, it is appropriate for the Court to draw an adverse inference from this failure.

[90] The adverse inference principle is most frequently applied in the context of the failure to call a witness. However an adverse inference may also be drawn for the failure to produce relevant records in the parties' control even where there is no court order: see *Shafiee v. Jooyandehdel*, 2009 BCSC 1124; and *Walek v. Guardian Storage Inc.*, 2010 BCSC 365.

[91] An order was made by the Court on October 17, 2008, requiring the plaintiffs and the defendants by counterclaim to produce bank statements for accounts used in connection with the Limited Partnership's business, including records held by Mr. McLean.

[92] Despite the court order, despite questions both at his examination for discovery and in cross examination, Mr. McBean has been unable or unwilling to point to any evidence that would show that Omnex ever paid for units in the Limited Partnership. This is an appropriate case to draw an adverse inference and conclude that the bank statements would have confirmed Therapy's claim.

[93] It is declared that Omnex is not a limited partner.

WRONGFUL REDEMPTION

[94] On December 15, 2007, Mr. McBean arranged the "purchase" by NDC of three limited partnership units from Omnex. By a written agreement dated December 31, 2007, NDC purported to "sell" these units to the Limited Partnership for a total of \$75,000 or \$25,000 each.

[95] Mr. McBean admitted that this amounted to a redemption of units; that NDC received \$75,000 for the redemption, and then passed the money to Omnex.

[96] Redemption of these units is inconsistent with the Partnership Agreement. Article 8.15 provides as follows:

No limited partner shall have any right to withdraw, or make a demand for withdrawal, of partnership capital or receive any other distribution from the partnership except as expressly provided for in this agreement.

[97] Article 15.15 provides:

No partner shall have any right to withdraw or make a demand for withdrawal of any amount or receive any distribution from the partnership except as expressly provided for in this agreement, and unless such withdrawal satisfies the requirements of the *Partnership Act* of Alberta.

[98] In the offering memorandum for investors prepared by Mr. McBean, the full range of liquidity options are set out. Partnership units can be redeemed or withdrawn in the case of death, bankruptcy or "other accidental occurrence requiring liquidation of the asset for cash consideration".

[99] There is no evidence that any of these scenarios was met when NDC redeemed these units.

[100] I have found above that Omnex did not purchase any units in the Limited Partnership. As Therapy argues, and Mr. McBean admitted, NDC never held any partnership units either. It follows that the redemption, while contrary to the Partnership Agreement, is also illusory.

[101] What is the appropriate remedy? The evidence is that NDC received \$75,000 from the Limited Partnership and passed the funds on to Omnex.

[102] NDC is plainly liable to the Limited Partnership for the funds it wrongfully received. The issue is whether Omnex is also liable. I conclude that it is. My conclusion is based on the doctrine of knowing receipt.

[103] A party cannot, with knowledge of a trust, receive trust property in breach of that trust: see *Citadel General Assurance Co. v. Lloyds Bank Canada*, 1997 CanLII 334 (SCC), [1997] 3 S.C.R. 805.

[104] NDC, in receiving funds from the Limited Partnership to which it was not entitled, held those funds in trust for the Limited Partnership. A constructive trust is created by operation of law in these circumstances: see *Waters' Law of Trusts in Canada*, 3d ed. (Toronto: Thomson Carswell, 2005), at p. 22:

The constructive trust arises when the court imposes trust machinery in order to describe A's obligation to transfer property to B. There are many examples of this type of trust; perhaps the most familiar is the vendor's liability towards the purchase of land between contract and conveyance, and the obligation of a fiduciary to give up propriety advantage acquired through the employment of his office. The trust is "constructive" because, regardless of anyone's intent, the law constructs a trust in order to enforce the obligation. In Canada that obligation is now recognized as arising out of unjust enrichment. ...

[105] NDC breached its trust obligation to the limited partners when it acquired the proceeds of the "redemption".

[106] Omnex had actual knowledge of the redemption transaction. That is because Mr. McBean was the only natural person in the transaction. He was the sole director and the operating mind behind both Omnex and NDC.

[107] In these circumstances Omnex is jointly and severally liable with NDC to Therapy in the amount of the \$75,000 redemption.

PERSONAL LIABILITY

[108] Therapy argues that Mr. McBean should be personally liable for the claims against Omnex. That is, Mr. McBean and Omnex should be jointly and severally liable for Therapy's claims against Omnex for the account reconciliation, the cost of the receivership, and the discounted units.

[109] Thus, Therapy argues this is a case where the Court should pierce the corporate veil. It is common ground that courts are reluctant to pierce the corporate veil in the absence of exceptional circumstances. One of the grounds for doing so is “fraud and improper conduct”: see Gower, *Modern Company Law*, 4th ed. (London: Stevens, 1979), at p. 126.

[110] The ground was explained this way by McGuinness in *Canadian Business Corporations Law*, 2nd ed. (Markham: LexisNexis, 2007), at p. 49:

... [T]he separate personality of a corporation will be disregarded where the corporation has been used as a cover for deliberate wrongdoing. So, for instance, the courts are prepared to lift the veil:

- where the company has been used as a cloak for fraud or manifestly improper conduct – although in such cases there is no need to lift the corporate veil in order to affix liability on the shareholder who perpetrated the fraud, as the shareholder will be personally liable for the fraud as a co-party;
- where there is a trust relationship, especially where the target who will be attached by lifting the veil has benefitted from a breach of that trust;
- where the company is involved in criminal activity directed by its shareholders.

Absent such abuse, the instances in which the courts are prepared to ignore the separate personality of the corporate entity are very rare, and are for the most part limited to cases where the corporation has carried on business as an agent for its shareholders.

[111] Therapy relies on the British Columbia Court of Appeal’s decision in *B.G. Preeco 1 (Pacific Coast) Ltd. v. Bon Street Holdings Ltd.* (1989), 1989 CanLII 230 (BC CA), 37 B.C.L.R. (2d) 258 (C.A.). In that case, Mr. Justice Seaton, speaking for a unanimous court, stated, at p. 268:

The cases in which the corporate veil is pierced on the ground of “fraud or improper conduct” deal with instances where a corporation is used to effect a purpose or commit an act which the shareholder could not effect or commit.

In *Gilford Motor Co. v. Horne*, [1933] Ch. 935, [1933] All E.R. Rep 109 (C.A.), the plaintiff sought an injunction to prevent the defendant, through a newly-incorporated company, from breaching a restrictive covenant. The injunction was granted against both the individual and the company on the basis that the company was merely a device by which the individual defendant breached his restrictive covenant.

Similarly, in *Jones v. Lipman*, [1962] 1 All E.R. 442, [1962] 1 W.L.R. 832 (Ch. D.), the plaintiff was granted specific performance of a contract entered into with the first defendant. In an attempt to avoid the contract, the first defendant sold the property in question to the second defendant, a company in which the first defendant and a clerk of his solicitor were sole shareholders. ...

The group enterprise theory has also been extended to other types of cases. This version of piercing the corporate veil was used in *Manley Inc. v. Fallis* (1977), 2 B.L.R. 277, 38 C.P.R. (2d) 74 (Ont. C.A.) to find an employee of one company liable for breach of fiduciary duty by setting up a business in competition with his employer's parent company.

[112] Therapy argues:

188. McBean used Omnex and NDC as corporate vehicles to siphon money out of the partnership. He did so by breach of contract and breach of fiduciary duty. He was very much the controlling mind of both companies and deployed them to a purpose he could not accomplish himself.

189. Specifically, the limited Partnership Agreement does not permit the payment of management fees. He could not have presented to NDC an invoice in his personal capacity for services rendered; clearly that would breach the agreement. NDC, similarly, could not pay McBean directly – it would be a breach of fiduciary duty.

190. McBean knew this. He admitted knowing it in his examination for discovery. He instead chose to effect his wrongful purpose by having NDC contract with Omnex for his personal engagement. That he was using them simply to impose his will to commit a wrongful act is plainly evidenced by the fact that he signed the contract on behalf of both companies.

[113] As the B.C. Court of Appeal points out in *Preeco*, lifting or piercing the corporate veil is not permitted simply to achieve fairness (at p. 266). The conduct must fit specifically within the criteria to permit the court to look behind a corporate form.

[114] The defendants do not allege fraud. Moreover, this is not “improper conduct” by Mr. McBean within the meaning of the cases. This is not, for example, a case where Mr. McBean is under a personal duty or obligation which he sought to avoid through the use of a corporation. The limited partners all entered into contracts with the general partner, NDC.

[115] This is not a case where a corporation was created for the purpose of shielding the directors from personal liability. The circumstances here are unlike those in *Tracy (Representative ad litem of) v. Instaloans Financial Solution Centres (B.C.) Ltd.*, 2008 BCSC 669, cited by Therapy. There is no evidence that Omnex was created for the purpose of allowing Mr. McBean to receive the proceeds from breaches of trust. Omnex existed before the Limited Partnership was created.

[116] For these reasons, I conclude this is not a case for piercing the corporate veil.

SPECIAL COSTS

[117] Special costs are awarded where there is some form of reprehensible conduct, where such costs are desirable as a form of chastisement: see *Stiles v. British Columbia (Workers' Compensation Board)*, [1988] B.C.J. No. 1565 (C.A.).

[118] In *Garcia v. Crestbrook Forest Industries Ltd.* (1994), 1994 CanLII 2570 (BC CA), 9 B.C.L.R. (3d) 242 (C.A.), Mr. Justice Lambert put it this way, at para. 17:

... it is my opinion that the single standard for the awarding of special costs is that the conduct in question properly be categorized as “reprehensible”. As Chief Justice Esson said in *Leung v. Leung* [(1993), 77 B.C.L.R. (2d) 314], the word reprehensible is a word of wide meaning. It encompasses scandalous or outrageous conduct but it also encompasses milder forms of misconduct deserving of reproof or rebuke.

[119] The defendants claim special costs are justified based on Mr. McBean’s conduct before and after the action commenced.

[120] Before the action commenced, Mr. McBean knew that NDC had been voted out as general partner and replaced by the defendant Therapy. Yet he chose to ignore this and changed the locks, moved into the premises of the Winery, hired security guards and took various other actions entirely inconsistent with the decision of the majority of the partners.

[121] These were extreme actions and, with the benefit of hindsight, were ill advised. But from Mr. McBean’s perspective, he contested the lawfulness of the General Meeting and the resolution.

[122] He sought injunctive relief as well. On June 13, 2008, that relief was refused. An award of costs in favour of the defendants in respect of that application is appropriate.

[123] But I am not persuaded this conduct justifies an award of special costs. Mr. McBean believed Therapy was in the wrong. He was mistaken. His actions were high handed but that is not the same as reprehensible.

[124] Mr. McBean was uncooperative before and after the June 2008 decision. On June 11, 2008, the Court had to make an order allowing Mr. Ansems and another employee to enter the Winery to preserve and treat the wine. It was necessary to make another transitional order on October 2, 2008, requiring execution of documents transferring title in real and personal property from NDC to Therapy, and requiring that the books and accounts be delivered. Then, on October 17, 2008, Mr. Justice Rice ordered production of several specific documents.

[125] Finally, on April 2, 2009, Mr. Justice Rice ordered NDC and Mr. McBean to execute a “notice to amend the certificate of limited partnership”.

[126] Article 12.5 of the Partnership Agreement provides:

On the admission of a new General Partner to the Partnership, the General Partner will transfer the management and operation of the Partnership business and the books, records and accounts of the Partners to the new General Partner, and will execute and deliver all documents necessary to effect such transfer.

[127] Therapy argues that Mr. McBean's conduct throughout has been "obstructionist, uncooperative, combative and vengeful". It argues there has been noncompliance with court orders.

[128] The allegation by Therapy of "breach of court order" appears to refer to Mr. McBean's failure to produce the NDC bank statements.

[129] Mr. McBean has been difficult. But there here has been no finding of contempt and there is no allegation of fraud.

[130] Counsel for Therapy relied on *Howard v. Madill*, 2010 BCSC 525. In that case, there was conduct bearing some similarity. Mr. Madill changed the locks on the company premises and sought to remove the plaintiff as the corporate signing authority. But Madam Justice Bruce had no trouble finding that there was reprehensible conduct. The defendant in that case fraudulently assumed beneficial ownership of the shares and was aware that he had no legal right to retain them but did so anyway.

[131] I do not find Mr. McBean's conduct reprehensible within the meaning of the authorities. An award of costs against NDC and Omnex at Scale B is appropriate.

CONCLUSION

[132] The plaintiffs' action is dismissed.

[133] Therapy's claims against Mr. McBean are dismissed.

[134] Therapy is entitled to judgment against Omnex and NDC in the amount of \$201,748.08.

[135] Therapy is entitled to judgment against NDC in the amount of \$58,000 in respect of the discounted units.

[136] It is declared that Omnex is not a limited partner.

[137] Therapy is entitled to costs against Omnex and NDC at Scale B.

"Kelleher J."

TAB 13

At para(s) 104-106

Merklinger v. Jantree No. 3 Limited Partnership & Snapdragon Ltd., 2004 CanLII 54553 (ON SC)

Date: 2004-12-02

File number: 96-CU-114241

Other citation: 10 BLR (4th) 273

Citation: **Merklinger v. Jantree No. 3 Limited Partnership & Snapdragon Ltd., 2004 CanLII 54553 (ON SC), <<https://canlii.ca/t/1lmv5>>, retrieved on 2024-04-25**

COURT FILE NO.: 96-CU-114241

DATE: 2004/10/12

ONTARIO OF SUPERIOR COURT OF JUSTICE

BETWEEN:

JANET MERKLINGER

Plaintiff/Applicant

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William G. Dingwall Q.C., for the Plaintiff/
Applicant

[2] In 2002, the plaintiff brought a motion in Superior Court to break the barrier to registering her interest in the limited partnership. The Court ruled the registration could take effect without the need to satisfy the specified condition. The general partner and the limited partnership appealed the decision to the Divisional Court. Although the Divisional Court upheld the decision of the learned motion court judge, the general partner did not register the plaintiff's interest.

[3] On August 20, 2003, the plaintiff filed a notice of motion requesting the following: a motion for summary judgment on the statement of claim; an order for production of the books and records of the limited partnership from 1993 onwards; an order for an accounting of any distributions; an order for recalculation and redistribution of the proceeds of any distribution; and an order for removal of the general partner.

[4] During the course of cross-examining the general partner on the motion in the fall of 2003, the plaintiff learned the following information: the partnership's property had been refinanced in the spring of 2003; a corporation owned by the partnership's accountant had recently purchased the other limited partners' units; and the general partner had recently distributed surplus proceeds from the refinancing to the general partner and the accountant's corporation. The general partner set aside monies from the refinancing proceeds representing the partnership units claimed by the plaintiff.

[5] The major points of dispute in this case are as follows:

1. whether the general partner stood in a fiduciary position in relation to the plaintiff and if so, whether it breached its fiduciary duty;
2. whether the general partner distributed monies to itself in accordance with the terms of the partnership agreement; and
3. whether the court has the authority to remove a general partner and if so, whether the general partner in this case should be removed.

[6] It is necessary to set out the events, which occurred, during the protracted litigation in order to determine these and other contested issues.

II: THE FACTS

A. 1989 to 1997: Creation of the Limited Partnership and the Commencement of Litigation

[7] Paul Merklinger ("PM") proposed to develop a real estate property and market it to investors through a tax sheltered limited partnership. On December 2, 1986, Jantree No. 3 Limited Partnership ("Limited Partnership") was created to develop, own, and operate a single tenant industrial building on lands to be acquired in Oakville, Ontario. PM or a corporation controlled by him would be the general

partner while investors would be limited partners along with PM or one of his controlled corporations. PM conceived the development and found the investors. Jantree Growth Properties Inc. (“Growth”), a corporation controlled by PM was the initial general partner from 1986 until January 11, 1993.

[8] As of January 31, 1987, 80 units of the Limited Partnership were issued at a value of \$10,000 a unit with a minimum subscription requirement of 10 units. The total value of all 80 units was \$800,000. PM owned 20 units through a controlled corporation called Jantree Development Corporation (“Development”). Six individual investors were issued the remaining 60 units in blocks of 10 units each. PM’s interest eventually devolved upon his spouse Janet Merklinger (“Janet M”).

[9] A Partnership Agreement dated December 2 1986, set out the respective rights and obligations of the general partner Growth and the limited partners. It also set out the scope of the business and other matters concerning the Limited Partnership.

[10] The following transactions occurred on December 31, 1989: Growth, a corporation controlled by PM, executed a promissory note in the amount of \$400,000 in favour the plaintiff Janet M; Development transferred 20 units of the Limited Partnership to Growth; and Growth transferred those 20 units to the plaintiff Janet M. The assignment of these 20 units from Growth to Janet M was not recorded on the register of the Limited Partnership as was required by Article 3.11 of the Partnership Agreement.

[11] As of December 31, 1989, Janet M owned 20 units of the Limited Partnership constituting a 25% interest in the Partnership. The original six investors collectively owned 60 units constituting 75% interest in the Partnership. Growth remained the general partner and Development, PM’s other controlled corporation, was no longer a limited partner.

[12] In late 1991, the Ontario Securities Commission (“OSC”) was conducting an investigation of PM and Growth for alleged violations of the *Securities Act*, R.S.O. 1990, c. s.5. PM disappeared around 1993; to this day his whereabouts remain a mystery. PM’s disappearance became significant because the assignment of 20 units of the Limited Partnership from Development to Growth and from Growth to Janet M was never recorded in the Limited Partnership’s register.

[13] On January 11, 1993, Snapdragon Ltd. (“Snapdragon”) became the Limited Partnership’s general partner and assumed all of the rights and obligations of that position under the Partnership Agreement. David Cale is an officer and director of Snapdragon, its sole shareholder, and was at all times its directing mind. Snapdragon did not own any units in the Limited Partnership and was not a limited partner. There was no evidence in the record concerning the circumstances surrounding the removal of Growth as the general partner and the appointment of Snapdragon in its place.

[14] Janet M notified Snapdragon that Growth had assigned 20 units of the Limited Partnership to her and requested that it amend the partnership records to reflect her ownership. Snapdragon would not recognize the assignment of the 20 units and refused to record Janet M’s ownership of the assigned units in the register of the Limited Partnership.

[15] On or about February 15, 1993, Mr. Cale wrote to Janet M informing her that a capital call was required of all limited partners. Janet M was advised that she was required to make a capital payment of \$4,065 representing either her or Development's interest. Snapdragon also advised Janet M that she was required to pay a monetary judgment registered against the original limited partner Development.

[16] The Ontario Ministry of Consumer and Commercial Relations (Companies Branch) dissolved Growth on March 29, 1993 and Development on July 26, 1993. Snapdragon was aware of the dissolution of PM's controlled corporations and the disappearance and unknown whereabouts of PM.

[17] In August 1993, Mr. Cale reminded Janet M/Development of the need to make a capital payment. In October 1993, Snapdragon informed Development that its interest in the partnership had been reduced by 90% for its failure to meet the capital call by September 30, 1993.

[18] Between 1993 and 1996, Janet M and Snapdragon were unable to reach an agreement concerning registration of Janet M's ownership of 20 units of the Limited Partnership. As of the early fall of 1996, Janet M was the assignee of 20 units of the Limited Partnership. The general partner Snapdragon made a capital call on Janet M with respect to the 20 units assigned to her through PM's controlled corporations. These corporations were now dissolved and Snapdragon would not recognize Janet M as a limited partner. The question of registration became very important and turned into a significant issue of dispute between the parties.

[19] An accountant named Mr. Posner purchased a 10-unit interest from one of the original limited partners. The record was not clear as to the precise date Mr. Posner purchased his interest in the Limited Partnership but the evidence is that the transaction took place in the early 1990's. Mr. Posner also became the Limited Partnership's accountant sometime in 1995 or 1996. Mr. Posner's position as both the accountant and a limited partner and his role in distributing the proceeds of refinancing the Limited Partnership's assets in 2003 become important in relation to the disputed issues in this proceeding.

[20] Janet M issued a statement of claim, dated November 14, 1996, against the Limited Partnership and Snapdragon. Mr. C. Stephen White represented Janet M and Mr. LoFaso represented the Limited Partnership and Snapdragon.

[21] The plaintiff Janet M requested the following relief in her statement of claim:

- a declaration that Janet M is and has been the owner of 20 units of the Limited Partnership since December 31, 1989;
- alternatively, Janet M is an assignee of 20 units of the Limited Partnership since December 31, 1989;
- an order requiring Jantree and Snapdragon to revise their corporate records to reflect Janet M's interest in the Limited Partnership;

- an accounting of the Limited Partnership's distributions and allocations;
- an order requiring payment of funds owing pursuant to the accounting, or alternatively damages; and
- costs on a solicitor and own client scale.

[22] Snapdragon and the Limited Partnership filed a statement of defence dated January 7, 1997 disputing the transfer of the 20 Limited Partnership units to Janet M. It was the defendants' position that Janet M and her assignor had forfeited their right, title, and interest in the Limited Partnership.

[23] The litigation has dragged on for 7½ years. The reasons for this delay will emerge from the following narrative. The conduct of the parties and their respective positions are relevant to whether or not Snapdragon acted in good faith in its dealings with the plaintiff and whether the court should grant the plaintiff's request for an order removing Snapdragon as the general partner.

B. 1997 to 2003: Purported Settlement Agreement, Fruitless Negotiations, and Failed Resolution

[24] The parties attended a mediation session on May 30, 1997. While both parties believed they had reached an agreement, the settlement completely unravelled over the next 5½ years. Between May 30, 1997 and February 13, 2003, the parties engaged in fruitless negotiations. Motions were brought and there was an appeal to the Divisional Court from an interlocutory order of a motions judge. Neither the negotiations nor the litigation produced a settlement of the lawsuit.

[25] The post-settlement correspondence began in June 1997, a few days after the purported settlement. In a letter dated June 4, 1997, Mr. LoFaso sent Mr. White proposed terms of the negotiated settlement. The proposed settlement required Janet M to comply with Article 3.11 of the Partnership agreement, pay outstanding judgments against the Jantree group of companies, give full indemnity with respect to any claims that could be made by PM regarding title to his interest in the Limited Partnership, dismiss the civil suit except for the requirement for an accounting, and pay costs in the amount of \$2,500. It was agreed that Janet M's solicitors would draft the minutes of settlement ("MOS") and provide evidence of compliance with paragraph 3.11 of the Partnership Agreement.

[26] Between June 4 and August 27, 1997, Mr. LoFaso wrote Mr. White on several occasions requesting a copy of draft MOS and inquiring whether Janet M wished to settle the matter or proceed with the action. Although Mr. White missed several promised deadlines, he produced a draft settlement agreement on August 28, 1997. Mr. White advised that he was in possession of the funds to satisfy the settlement's monetary condition and confirmed that his client wished to complete the settlement.

[27] The draft settlement agreement of August 28, 1997 included the term that "Janet Marie Merklinger will provide evidence of full compliance with Article 3.11 of the Limited Partnership Agreement." Article 3.11 of the Partnership Agreement provides in part as follows:

Assignment of Units by Limited Partners

Subject to relevant securities regulations, a Unit may be assigned by a person or his agent duly authorized in writing to any person but such last mentioned person shall not be recorded on the Register as the holder of a Unit nor if such person is not a Limited Partner, be entitled to become a Limited Partner unless such person:

[completes declaration forms ...]

... and no such person will become a Limited Partner until all filings and recordings required by law have been duly made.

The interpretation and application of Article 3.11 of the Partnership Agreement became the focus of protracted negotiations and litigation that commenced on May 30, 1997 and continued throughout the proceedings.

[28] On September 11, 1997, Mr. LoFaso proposed an amended version of the MOS. In a letter dated October 14, 1997, Mr. White accepted the amended MOS except for a new clause inserted by Mr. LoFaso that Janet M's ownership rights to the 20 units were "subject to the rights of PM or Jantree [the Limited Partnership]." This additional term was neither discussed at the mediation session nor referred to in Mr. LoFaso's letter of June 4, 1997. The proposed term raised a fresh subject of dispute.

[29] In a letter to Mr. White dated November 10, 1997, Mr. LoFaso maintained that the clause was necessary. Mr. LoFaso wrote that "[t]he defendants have always taken the position that Paul Merklinger and/or his companies have an interest in the property and not Janet Merklinger." In this letter, Mr. LoFaso raised the issue that Snapdragon required a certificate from the Ontario Securities Commission ("OSC") consenting to the transfer of the partnership interest. This certificate had not been mentioned in the draft MOS or the amended draft MOS.

[30] The parties held further discussions to resolve the dispute. In a letter to Mr. White, dated December 18, 1997, Mr. LoFaso confirmed the terms discussed in a telephone conference with him to finalize settlement of the lawsuit. Mr. LoFaso confirmed that Snapdragon required that a Form 2 be completed and filed with the OSC by the transferor (PM or Development) of the Limited Partnership units to Janet M. He advised that he was unable to provide the regulations relating to Form 2. The letter also confirmed that Janet M would complete and file the Form 2 or obtain a court order dispensing with its filing. Upon receipt of the Form 2 filing or an order dispensing with filing, Snapdragon would agree to delete the contested clause from the MOS. On January 5, 1998, Mr. White confirmed that he would take "the necessary steps to obtain and file the Form 2, as required by the Ontario Securities Commission."

[31] On February 3, 1998, Mr. White advised Mr. LoFaso by letter that he was encountering difficulty determining the procedure for obtaining a Form 2. He requested further information to assist him with respect to the Form 2. In a letter of response dated February 25, 1998, Mr. LoFaso advised that the

required document in question was a Form 21 under the *Securities Act*, not a Form 2. On March 17, April 1 and May 20, 1998, Mr. LoFaso wrote Mr. White requesting the documentation to settle the dispute.

[32] On June 15, 1998, Mr. White advised Mr. LoFaso that the required Form 2 was a Form 2 under the *Limited Partnerships Act* and was not a requirement under the *Securities Act*. Mr. White stated that it was no longer necessary to file a Form 2 because O.Reg. 11/91 revoked the need for it. He proposed that the settlement be completed per his August 28, 1997 draft MOS.

[33] On July 22, 1998, Mr. LoFaso advised that his client required Janet M to file a Form 20 with the OSC with respect to a trade in a security. He advised that the vendor of the security, namely Growth, must file the Form 20. On September 14, 1998, Mr. LoFaso wrote Mr. White requesting information concerning the status of the execution and filing of the Form 20 with the OSC. On September 30, 1998, Mr. White, after obtaining advice from the securities department at his law firm, advised Mr. LoFaso that the relevant provision of the *Securities Act* did not apply to secondary market trades. He further advised that since the Form 20 was only a disclosure requirement, the trade was valid and the OSC did not require Janet M, Snapdragon, or the Limited Partnership to file a Form 20.

[34] On November 17, 1998, Mr. LoFaso informed Mr. White that in his opinion the Form 20 requirement applied to secondary trades. He agreed that a completed Form 20 was only a disclosure requirement and its completion was not a prerequisite to a valid trade. He also agreed that the obligation to complete a Form 20 rested with Development and Growth for their respective transfer of the units and that Janet M, in her capacity as transferee, was not required to complete a Form 20. However, the defendants asserted that Article 3.11 restricted the general partner's authority to recognize Janet M as a limited partner so Janet M's interest would not be recognized until she complied with Article 3.11. Mr. LoFaso's position was that Janet M was required to apply to a court or the OSC to waive the statutory filing requirement.

[35] Between November 1998 and January 13, 1999, Mr. LoFaso wrote Mr. White on five occasions requesting information with respect to the steps Mr. White had taken to complete the Form 20 requirement. On January 19, 1999, Mr. White notified Mr. LoFaso that he would be bringing an application to waive the *Securities Act* filing requirements. Between January 21, 1999 and May 13, 1999, Mr. LoFaso wrote Mr. White on four occasions requesting particulars of the proposed application but he received no response to his inquiries.

[36] On February 14, 2000, Mr. White served a Notice of Motion returnable on February 21, 2000. The motion was adjourned to March 9, 2000 for argument. In Mr. Cale's affidavit dated November 12, 2003, he refers to a letter from Mr. LoFaso to Mr. White dated February 24, 2000. In the letter, Mr. LoFaso advised that the defendants would not oppose the motion to obtain a waiver to comply with the OSC but that counsel would attend to inform the court of the general partner's limited authority under the Partnership Agreement. On March 9, 2000, Mr. White requested an adjournment to review his

position and the motion was re-scheduled to May 4, 2000. On March 28, 2000, Mr. White advised Mr. LoFaso that he did not intend to proceed with the motion but was considering alternative courses of action to address the defendants' concerns with respect to the OSC filing.

[37] On April 10, 2000, Snapdragon brought a motion for summary judgment returnable on May 4, 2000. On May 2, 2000, Mr. White informed Mr. LoFaso that he would seek to adjourn the motion in order to allow Janet M to contact the OSC to determine if it was possible to comply with the disclosure obligation in PM's absence and without having to revive the dissolved corporations. Jennings J. adjourned the summary judgment motion to June 2, 2000 and ordered that Snapdragon and the Limited Partnership could return the motion on 3 days notice if the plaintiff's solicitors failed to make the inquiry/application to the OSC on or before May 12, 2000. The motion was never returned.

[38] In a letter to Mr. LoFaso dated May 12, 2000, Mr. White provided an opinion interpreting the applicable provisions of the *Securities Act* governing the transfer of units from Growth to Janet M. He opined that a Form 20 was not required for the transfer. Janet M brought a fresh summary judgment motion that was returnable on May 31, 2000. On the eve of this motion, Mr. White adjourned it *sine die*.

[39] In a letter dated September 6, 2000, Mr. LoFaso informed Mr. White that the settlement negotiations were concluded and that no agreement had been reached. The plaintiff in a supplementary factum on this motion, dated December 15, 2003, agreed that there was no settlement agreement.

[40] On January 19, 2001, Ms. W.A. McLauchlin of Glaholt & Associates served a notice of change of solicitors on behalf of Janet M. Mr. White took no further part in these proceedings.

[41] In a letter dated August 9, 2001, Mr. LoFaso informed Ms. J. Becker of Glaholt & Associates that Snapdragon did not have authority under the Partnership Agreement to recognize Janet M. as a limited partner unless she complied with Article 3.11 of the Partnership Agreement. Mr. LoFaso further advised that Janet M's entitlement to the 20 units "has not been the topic of discussion since" the ADR meeting in May 1997. The focus of the matter had been whether Janet M would be able to comply with Article 3.11 of the Partnership Agreement. Mr. LoFaso advised the new solicitors that Snapdragon and the Limited Partnership were prepared to recognize Janet M as the owner of 20 units in accordance with the terms set out in the draft MOS. In addition, Janet M had to satisfy the following conditions: (1) Janet M must pay the Limited Partnership for its legal costs from 1996 to the conclusion of the litigation; (2) Janet M must dismiss the claim against Snapdragon and the Limited Partnership; and (3) Janet M must execute a full and final release in favour of Snapdragon, the Limited Partnership and the limited partners.

[42] There is no evidence that Glaholt & Associates participated in any negotiations or took any steps to resolve matters or advance the litigation. On May 30, 2002, Mr. William Dingwall Q.C. filed a notice of change of solicitors on behalf of Janet M. Glaholt & Associates took no further part in the proceedings.

[43] In summary, Janet M. was assigned 20 units of the Limited Partnership in 1989 and issued a statement of claim in November 1996. As of May 30, 2002, Snapdragon would not unconditionally recognize Janet M. as a limited partner notwithstanding there were no competing claims from her ex-spouse or any other person. More than five years after the purported settlement agreement, Janet M.'s application to be recorded as a limited partner was at a standstill.

C. Motion to Waive the Requirement to File a Form 20

[44] On October 8, 2002, Mr. Dingwall brought a motion before the Superior Court in Toronto for an order that the defendants comply with the settlement agreement, a declaration that Article 3.11 of the Partnership Agreement did not require a Form 20 to be filed under the *Securities Act* and an order that Snapdragon be removed as general partner. The defendants objected to the motion being heard in Toronto. Somers J. dismissed the motion on this ground and reserved costs to the judge ultimately hearing the motion.

[45] The motion was brought on again in Newmarket and Salmers J. heard the motion on November 21, 2002. Snapdragon and the Limited Partnership argued that the disputed 20 Limited Partnership units escheated to the Crown. Therefore, Janet M was required to give notice to the public trustee in order to allow it to appear and inform the court of its position on the motion. The defendants submitted that the Superior Court lacked the authority and/or jurisdiction to order that the 20 units could be transferred without filing a Form 20 under the *Securities Act*; however, they also agreed that they would not object to such an order if the court determined that the *Securities Act* requirements could be waived. Counsel for the defendants also argued that the parties never completed the terms of the 1997 settlement agreement so the defendants were not bound by the terms of the draft MOS.

[46] On November 21, 2002, Salmers J. held that the ownership of the 20 units should not be rendered insolvent due to the dissolution of Development and Growth and their consequent inability to file the Form 20. Without ruling on the validity of the defendants' position that the plaintiff must satisfy the *Securities Act* requirement, Salmers J. ordered that "the transfers may take effect without the filing of the Form 20 and therefore the lack of Form 20's with respect to the transfers does not contravene s. 3.11 of the Limited Partnership Agreement."

[47] Salmers J. did not rule on the plaintiff's request for an order that the defendants must comply with the purported settlement agreement because there was insufficient evidence to grant such relief. Costs of the motion and the earlier appearance before Somers J. were reserved to the ultimate disposition of the matter.

D. Appeal From Salmers J.'s Order

[48] On November 28, 2002, Snapdragon and the Limited Partnership appealed Salmers J.'s ruling to the Court of Appeal. Their notice of appeal requested an order to set aside the ruling of Salmers J. on the following grounds: (1) the motions judge lacked authority to dispense with the need to file a Form 20 as required under the *Securities Act*; (2) the motions judge lacked authority to amend Article 3.11 of the

Limited Partnership Agreement by dispensing with the requirement to file a Form 20; and, (3) the motions judge failed to find that Article 3.11 of the Partnership Agreement was subject to the relevant securities regulations (a Form 20 filing). The defendants sought costs on a substantial indemnity basis. On December 18, 2002, the defendants filed a second notice of appeal to the Court of Appeal based on the same grounds of appeal and for the same relief as contained in the November 28, 2002 notice of appeal.

[49] On December 6, 2002, Snapdragon and the Limited Partnership appealed to the Divisional Court. They sought a declaration that Salmers J.'s order was a final order from which leave is not required under s. 19(a) of the *Courts of Justice Act*. In the alternative, they sought leave to appeal to the Divisional Court from the interlocutory order of Salmers J. pursuant to s. 19(b) of the *Courts of Justice Act*.

[50] On January 13, 2003, on the return of the motion, C. Campbell J. ruled that Salmers J.'s order was interlocutory and was not a final order. In the course of his reasons, C. Campbell J. set out the defendants' grounds for the leave to appeal application: (1) the learned motions judge erred because he did not comply with the mandatory requirements of the *Securities Act*; and (2) the motions judge lacked jurisdiction to make the order. C. Campbell J. rejected these submissions and ruled that a Superior Court judge has inherent jurisdiction to grant the relief sought in order to achieve justice. Therefore Salmers J. had the authority to alleviate any impediments to transferring Janet M's interest arising from the dissolution of the transferor corporations. The motion for leave to appeal was dismissed and costs were awarded against the defendants.

[51] On February 13, 2003, the Court of Appeal dismissed the defendants' appeal for delay.

[52] Mr. Cale, at paragraphs 85-86 of his affidavit sworn on November 12, 2003, justified the decision to appeal the order of Salmers J. on two bases: (1) to ensure that Snapdragon was protected from a claim by the limited partners that the general partner had not fully complied with the requirements of the Partnership Agreement; and (2) to avoid any potential claim that Snapdragon failed to fulfill its duties under Article 7.07 of the Partnership Agreement by not appealing the decision to the Divisional Court.

III: THE EVIDENCE OF MR. CALE

A. Assignment of Units of the Limited Partnership to Mr. Posner (October 2, 2003 Cross-Examination of Mr. Cale

[53] Mr. Cale provided the sole evidence relating to the activities of the general partner and Limited Partnership for the 1993-2003 period. Janet M was unable to provide any evidence with respect to this period because Snapdragon had refused to recognize her as a limited partner or provide her with any financial or other information related to the Limited Partnership. The General Partner's knowledge and

conduct during this period provides part of the factual basis for determining the related issues of distributing the proceeds from the refinancing and whether Snapdragon should be removed as the general partner.

[54] Mr. Cale was cross-examined on October 2, 2003. He stated that he is the sole shareholder, officer and director of Snapdragon. He was called to the bar of Ontario in 1972 and has a Masters degree in Business Administration. He practiced commercial law with a focus on financing and real estate and retired from the practice of law in 1991.

[55] Mr. Cale's evidence was that Brian Syvert was the accountant for the Limited Partnership for a few years after 1993, after which Mr. Gary Posner took over. The accountants were responsible for preparing the Limited Partnership's financial statements. Prior to 2003, a numbered company that Mr. Posner owned and controlled had purchased 10 units. Barter Alliance & Exchange Ltd. ("Barter Alliance"), another company Mr. Posner owned and controlled, acquired 50 units of the Limited Partnership in May 2003. The change of ownership in the 50 units was first disclosed to Janet M's solicitors during this cross-examination, even though Mr. Dingwall had previously requested this information after the May 2003 transfers had been made. As of October 2, 2003, Mr. Cale had not received any documentation from Barter Alliance in relation to the 50-unit transfer.[1]⁶

[56] Snapdragon did not register Janet M as the owner of the 20 units notwithstanding Salmers J.'s order and C. Campbell J.'s refusal to grant leave to appeal. The 2002 financial statements listed six limited partners and set up an unallocated capital account equivalent to 20 Limited Partnership units. During cross-examination of Mr. Cale in relation to the Limited Partnership's 1996 financial statements, Mr. Dingwall referred to the 20 units as "Janet M's interest." It was the defendants' position that ownership of the 20 units was in dispute and that they should be referred to as disputed units and not as "Janet M's units." [2]⁷

[57] Mr. Cale's evidence was that a payment was made to the limited partners in 1989, a payment representing a return on capital was made in 1992, and a distribution of \$12,195 was made in 1996. The latter payment was a return on capital for the 1993 capital call of the same amount. Mr. Cale acknowledged that the profits and losses recorded in the financial statements were attributed only to six partners and did not reflect Janet M's interest in the 20 units.[3]⁸ The financial statements for the years 1996 and 2000 were calculated on the basis of six unit holders except that the capital cost allowance for the year 2000 was based on 6 unit holders and 2 unallocated units. Mr. Posner, in his capacity as an accountant for the Limited Partnership, handled the calculations and prepared the financial statements for 1996 and the following years.[4]⁹

[58] Mr. Cale stated that one formal partnership meeting was held in 1993 when he became the general partner. After 1993, there were two informal meetings at unspecified dates.[5]¹⁰ Mr. Cale produced no minutes of these meetings.

6. Q.35-Q.85- transcript of cross-examination of David Cale, October 2, 2003

7. Q.248-Q.259; Q.273-Q.274.

8. Q.139-Q.140; Q.220-Q.222.

9. Q.276.

[59] In Mr. Cale's reply evidence, he stated that after 1993 the 20 units were treated as unallocated capital. The unallocated 20-unit interest had received a recent distribution from the refinancing and Mr. Cale had invested those funds in banker's acceptances at the Toronto-Dominion Bank. He stated that the other 6 unit holders paid income tax on money they did not receive because 25% of the units were not allocated to an individual or a corporation.[6]¹¹

[60] Mr. Cale brought 3 boxes of records with him to the examination. At the conclusion of the cross-examination, Mr. Cale informed Mr. Dingwall that the assets had been re-mortgaged for \$550,000 and that the original mortgage had been discharged.

B. Distribution of Funds from the Refinancing (November 26, 2003 Cross-Examination of Mr. Cale)

[61] On the return of a motion on September 2, 2003, Perkins J. ordered the defendants to produce the books and records of the Limited Partnership from 1993 to September 26, 2003 and scheduled cross-examination of Mr. Cale on his affidavits dated April 10, 2000 and November 13, 2002. Costs were reserved to the judge hearing the motion.

[62] On September 17, 2003, the defendants forwarded copies of the financial statements for the years 1989 to 2002, except for those from 1990 and 1998, which they were unable to locate. In a letter dated September 19, 2003, Mr. Dingwall advised that he required Mr. Cale to bring with him for inspection and cross-examination the minutes of partnership meetings from 1996 onwards, any partnership agreements, and all records in relation to any transfer of units since January 1, 1989.

[63] The motion was spoken to in motions court on November 18, 2003. DiTomaso J. scheduled the continued cross-examination of Mr. Cale and set out timelines for the production of documents, etc. He made the following orders: (1) that Mr. Cale re-attend for his continued cross-examination and bring with him all minutes of partnership meetings since commencement of the litigation; (2) that the defendants produce for inspection all records and supporting materials for any transfers of any kind in respect of the units that have occurred since January 1, 1989; (3) that the defendants comply with Perkins J.'s order for production; (4) that the defendants pay Mr. Dingwall, in trust, all monies held or controlled by them on behalf of the plaintiff, subject to an accounting; and (5) that the costs of expedited transcripts, continued cross-examination, and attendance before DiTomaso J. be reserved to the judge hearing the motion.

[64] Cross-examination of Mr. Cale continued on November 26, 2003. For the period of 1993 to September 26, 2003 (the effective date of Perkins J.'s order requiring the defendants to produce the Limited Partnership's books and records), the only financial information provided to Janet M occurred shortly after Snapdragon became general partner in 1993. Mr. Dingwall referred Mr. Cale to his letter to Mr. LoFaso dated May 30, 2002, in which he requested financial information about the Limited Partnership. Mr. Cale refused to answer whether he had ever supplied any of the listed information. Mr.

10. Q.310-Q.311.

11. Q.317-Q.322.

LoFaso stated on behalf of his clients that the information was not provided because until Janet M obtained an order dispensing with the requirements of the *Securities Act*, Mr. Cale refused to recognize Janet M as a limited partner.[7]¹² I note that Salmers J.'s decision of November 21, 2002 did not alter the defendant's position on the issue of disclosure.

[65] Prior to February 13, 2003, Mr. Cale, in his capacity as general partner, applied to Empire Life for a new mortgage. In a letter dated February 13, 2003, Empire Life committed to provide new mortgage financing to the Limited Partnership.

[66] A property appraisal, dated February 20, 2003, valued the property as a vacant building at \$875,000. Using an income approach, the property was valued at \$825,000. In April 2003, the original mortgage had been paid down to approximately \$179,000. On April 22, 2003, Empire Life advanced a mortgage loan to the Limited Partnership in the amount of \$550,000 for a term of 10 years at 6.75% interest.

[67] Mr. Cale did not provide Janet M or the original limited partners with a copy of the appraisal.[8]¹³ On the advice of counsel, Mr. Cale refused to explain why he did not do so before or after they transferred their interests to Mr. Posner's corporation.[9]¹⁴ Snapdragon did not inform Janet M or the original limited partners that it intended to re-mortgage the property prior to April 22, 2003, nor did it advise them that the property had been re-mortgaged for \$550,000. Mr. Cale stated that he did not consult with Janet M or the other original limited partners because it was not necessary and he was not required to do so under the Partnership Agreement.[10]¹⁵

[68] Mr. Cale's evidence was that Mr. Posner would have known about the refinancing "once the mortgage had been finalized." [11]¹⁶ The Empire Life commitment letter was dated February 13, 2003 and Mr. Cale's evidence was that Mr. Posner would have known of the mortgage commitment in that time period.[12]¹⁷

[69] Mr. Cale was aware that a corporation controlled by Mr. Posner had purchased units from the original partners. The acquisition and assignment of the five original partners' interests in the Limited Partnership to Barter Alliance were dated April 30, 2003, except for one original partner's interest, which was transferred in May 2003. The limited partners each received \$65,000 for their respective 10 unit interests.[13]¹⁸ Mr. Cale was unable to recall when he received a copy of the transfers from the original limited partners to Mr. Posner's corporation. Mr. Cale's evidence was that he was unaware that Mr. Posner had offered to purchase Janet M's 20-unit interest in the Limited Partnership for \$60,000.[14]¹⁹

12. Q.50 –transcript of the cross-examination of David Cale, November 26, 2003.

13. Q.164.

14. Q.138-Q.139.

15. Q.104-Q.106; Q.165-Q.167; Q.140.

16. Q.378.

17. Q.378-Q.384.

18. Q.38.

19. Q.83 & Q.96.

[70] Mr. Cale's evidence was that Snapdragon was not in a position of trust in relation to the limited partners. It was his position that the general partner's duty was contractual. He agreed that Snapdragon received funds on behalf of the Limited Partnership and that the general partner was responsible for reporting to the limited partners. He agreed that "in theory" he had a duty to report to all the limited partners.[15]²⁰

[71] Mr. Posner's controlled corporations received a capital distribution of \$195,941. Snapdragon received a payment of \$111,966.83 from the refinancing. Mr. Cale's evidence was that Snapdragon was entitled to the payment pursuant to Article 5.10 of the Partnership Agreement. Snapdragon also received a mortgage fee in the amount of \$5,885.

[72] Snapdragon received an additional sum of \$11,694. Mr. Cale's evidence was that Snapdragon was entitled to this payment pursuant to Article 5.03 of the Partnership Agreement. It was Mr. Cale's position that he was entitled to 30% of the cash receipts of the Limited Partnership. Mr. Cale calculated that the general partner was entitled to 30% of the Limited Partnership's net income (\$23,400) plus 30% of the non-cash amortization expense (\$15,559). Mr. Cale's evidence was that "we added back the amortization expense of \$15,559." [16]²¹ Snapdragon distributed 30% of the total cash (\$11,694) to itself as the general partner. Mr. Cale did not tell any of the original limited partners that he received these payments.[17]²²

[73] Mr. Cale agreed that Snapdragon received approximately \$130,000 in 2003 as the general partner. Mr. Cale did not inform the original limited partners that Snapdragon had received any payments from the proceeds of the refinancing.[18]²³ Mr. Cale did not inform Janet M or any of the original partners of the payments to Snapdragon totalling \$129,491.83.[19]²⁴ Mr. Cale stated that he would have informed Mr. Posner of the payment to Snapdragon around the time that the mortgage had been finalized. The mortgage advance was made on April 22, 2003.[20]²⁵

[74] Mr. Cale agreed that the total subscription price was \$800,000 for all the subscribed units. PM or his corporations' share of the subscription price was \$200,000. Mr. Cale did not know whether PM or his corporations advanced \$200,000. The other limited partners' subscription price totalled \$600,000. Mr. Cale's evidence was that the initial mortgage of \$400,000 reduced the subscription price for the original limited partners.[21]²⁶

[75] Mr. Cale presumed that the subscription price for Janet M's units and the other limited partners was nil on the basis that at the time of the distribution in 2003, none of the limited partners were original partners who had contributed capital. Mr. Cale conceded that he calculated his fee of

20. Q.155-Q163.

21. Q.328.

22. Q.355, Q.360.

23. Q.349-Q.360.

24. Q.356.

25. Q.362-Q.378.

26. Q.225-Q.254.

approximately \$111,000 based on attributing no value to the limited partners' interests.[22]²⁷ Mr. Cale did not make any calculations in the event that the net subscription price of the substituted limited partners was greater than zero.

[76] The five original limited partners who sold their units did not receive any distribution from refinancing the property.[23]²⁸ The distribution to Snapdragon occurred at the same time as the distribution to Mr. Posner's corporations. Mr. Cale responded that it was done "the same way that we did the transfer units at all the same time." [24]²⁹ In reference to the time period of Mr. Posner's knowledge of the payment to Snapdragon, his evidence was "[i]t certainly would have been on or around the time that we knew that the cheques were coming." [25]³⁰

[77] Mr. Cale arrived at a figure of \$73,010.82 for the unallocated 25% interest. He explained his calculations as follows. The net proceeds for the refinancing were \$373,222.77. He multiplied that amount by .7 (\$261,255 - representing 70% of the distribution), divided by 8 (representing the total number of units broken down into lots of 10 units each), and multiplied by 2 (\$65,313.96 - representing Janet M's 20 units). The original limited partners did not receive any distribution from the mortgage refinancing because they had sold their units to Mr. Posner's corporations.[26]³¹

[78] Mr. Cale acknowledged that there was no record that a Form 20 had been filed for the pre-2003 transfer from one of the original limited partners to Mr. Posner's numbered company. Mr. Cale undertook to produce a copy of a Form 20 filed for that transfer if he found one in the corporate records. Snapdragon issued a unit certificate dated October 15, 2003 on behalf of the Limited Partnership. It recognized the transfers to Barter Alliance on October 15, 2003. No Form 20's were produced for any of these transfers to Mr. Posner's corporations.[27]³²

[79] Snapdragon would not agree to return the funds it had received pending the outcome of the litigation because it was Mr. Cale's position that he had the authority under the Partnership Agreement to receive the various payments.[28]³³ On December 18, 2003, Glass J. ordered Mr. Cale not to remove any funds from Snapdragon or the Limited Partnership and to return \$32,500 to the Limited Partnership as possible unallocated funds belonging to the plaintiff. Costs were reserved to the judge hearing the motion.

[80] At the completion of the cross-examination in respect of the August 20, 2003 motion, none of the original investors were limited partners. As a result of the cross-examination of Mr. Cale in October and November 2003, the plaintiff first learned that Mr. Posner had purchased the interests of the remaining original partners through a controlled corporation (Barter Alliance). Thus, Mr. Posner's controlled corporations owned 60 units of the Limited Partnership. Mr. Cale also revealed that

27. Q.255-Q.263; Q.432-Q.439.

28. Q.268.

29. Q.347.

30. Q.367.

31. Q.389-Q.401.

32. Q.410-Q.423, Q.430.

33. Q.443.

Snapdragon refinanced the Limited Partnership's sole asset, made a distribution to Mr. Posner's corporations, and reserved approximately \$72,000 as unallocated capital representing the 20 unit interest claimed by Janet M. Snapdragon paid itself a mortgage fee, a percentage of the refinancing proceeds, and a percentage of the 2003 cash receipts. Snapdragon did not register Janet M. as a limited partner on the Limited Partnership register.

IV: THE SUMMARY JUDGMENT MOTION

A. The Statement of Claim

[81] The statement of claim dated November 14, 1996 requests the following relief:

1. a declaration that Janet M is and has been a substituted limited partner in respect of 20 units of the Limited Partnership since December 31, 1989 [paragraph 1(a)];
2. in the alternative, a declaration that Janet M is and has been an assignee of 20 units of the Limited Partnership since December 31, 1989 [paragraph 1(b)];
3. an order requiring Snapdragon and the Limited Partnership to revise their records to reflect Janet M's interest [paragraph 1(c)];
4. an accounting of the distributions and allocations of the Limited Partnership since December 1989, together with an order requiring payment of any funds owing pursuant to such an accounting [paragraph 1(d)]; and,
5. in the alternative, damages in the amount of \$500,000 [paragraph 1(e)].

B. The Notice of Motion

[82] The notice of motion dated August 20, 2003 sought the following relief:

1. an order for judgment on the terms outlined in the statement of claim (summary judgment motion);
2. an order requiring the defendants to produce the books and records of the Limited Partnership from 1993 onwards;
3. an order requiring the defendants to account for all distributions made to the limited partners;
4. an order requiring the recalculation and distribution to Janet M of her share of any distributions plus interest; and,
5. an order removing Snapdragon as general partner and appointing a new general partner, as nominated by Janet M.

[83] As noted above, on September 2, 2003, Perkins J. ordered the defendants to produce the books and records of the Limited Partnership from 1993 to September 26, 2003. On November 18, 2003, DiTomaso J. ordered the defendants to produce for inspection all records and supporting materials for the transfers of partnership units after January 31, 1989. These interlocutory orders were not appealed.

C. The Defendant's Admissions

[84] In their factum dated November 25, 2003, Snapdragon and the Limited Partnership responded to the relief claimed in the plaintiff's statement of claim. It was the defendants' position, subject to qualifications concerning the effective dates, that they did not dispute the relief claimed in sub-paragraphs 1(b), 1(c) and 1(d) of the statement of claim. The defendants agreed to the following:

1. the plaintiff is an assignee of 20 units of the Limited Partnership as of January 11, 1993, as requested in paragraph 1(b) of the statement of claim;
2. the defendants consent to an order to revise the records of the general partner to reflect the plaintiff Janet M's interest in the Limited Partnership as of January 11, 1993, as requested in paragraph 1(c) of the statement of claim; and
3. the defendants shall conduct an accounting of the distributions and allocations of the Limited Partnership since January 11, 1993, as requested in paragraph 1(d) of the statement of claim.

[85] Snapdragon submitted that the effective date of the assignment etc. should be January 11, 1993 because it did not know of the activities of the former general partner or the Limited Partnership prior to becoming the general partner in 1993.

[86] During the course of the oral argument, Snapdragon and the Limited Partnership made the following admissions:

1. Janet M is the owner of 20 units of the Limited Partnership;
2. Janet M was assigned the 20 units on or about December 31, 1989;
3. Janet M has been and continues to be a substituted partner of the Limited Partner since December 31, 1989; and
4. Snapdragon and the Limited Partnership will revise their corporate records to reflect Janet M's 20-unit interest in the Limited Partnership as of December 31, 1989.

V: THE ISSUES

A. Ruling on the Summary Judgment Motion

[87] As a result of the concessions and admissions set out in paragraphs 84 and 86, I grant summary judgment with respect to paragraphs 1(a), 1(b) and 1(c) of the statement of claim. Paragraph 1(d) is satisfied to the extent that the defendants will conduct an accounting of the distributions and allocations of the Limited Partnership for the period commencing January 11, 1993. I so order.

B. The Outstanding Issues

[88] The outstanding issues are:

1. should Snapdragon produce the books and records of the Limited Partnership from 1993 onwards?
2. are Snapdragon's obligations contractual or does it owe a fiduciary duty to the limited partners?
3. if Snapdragon is a fiduciary, did it breach its fiduciary duty to Janet M? Should Snapdragon be required to repay some, or all, of the monies received from the Limited Partnership? and
4. should Snapdragon be removed as the general partner?

[89] The summary judgment decision granted the relief sought in the statement of claim and an order was made that the defendants shall conduct an accounting of the distributions and allocations of the Limited Partnership since January 11, 1993, as set out in sub-paragraph 84(3). The notice of motion requested additional orders, as specified in paragraphs 82(2)-82(5). These issues are distinct from the relief sought in the statement of claim.

[90] I raised the issue of the court's jurisdiction to hear and determine these related issues with counsel. They submitted that the court had jurisdiction to hear the additional issues. Neither counsel filed any case law or authorities with respect to the court's jurisdiction to hear and determine the remaining issues set out in the notice of motion. Counsel submitted that there was a long history of litigation and that both parties wished all outstanding issues to be resolved in this proceeding. Counsel further submitted that the litigation had become a financial drain on all parties and that their clients did not wish to further deplete their resources litigating this case. The parties agreed and consented that all issues raised in the motion and oral argument should be determined on the basis of the evidence filed by the parties, and that no additional evidence was required to decide the outstanding issues. Counsel for the applicant/plaintiff and counsel for the respondents/defendants addressed these issues in their facta and oral arguments.

C. The Positions of the Parties

a. Plaintiff Janet Merklinger

[91] The plaintiff seeks an order removing Snapdragon as the general partner. It is the plaintiff's position that Snapdragon breached its fiduciary duty when it prevented Janet M from becoming a substituted limited partner. The plaintiff submits that the defendants negotiated in bad faith by

requiring her to file a Form 20, especially when other transferees were not required to do so. The plaintiff argues that the defendants' appeal of Salmers J.'s order is further evidence of the defendants' bad faith.

[92] Janet M submits that Snapdragon failed to disclose financial information in a timely manner. Snapdragon did not inform Janet M or the other original unit holders of the refinancing or related information. Snapdragon paid itself monies and fees from the proceeds of the refinancing and only disclosed this information after the fact during cross-examination of Mr. Cale. Counsel for the plaintiff argues that Snapdragon received funds contrary to the provisions of the Agreement and thereby deprived the Limited Partnership and the plaintiff of monies. Counsel further alleges that Mr. Cale and the accountant Mr. Posner conspired to benefit themselves in contravention of their fiduciary duties.

[93] The plaintiff also seeks an order requiring Snapdragon to repay the Limited Partnership monies it received in 2003. The plaintiff's position is that Snapdragon incorrectly assumed that the subscription price of her 20 units and the other limited partners' units were nil and therefore, incorrectly calculated the amount of its entitlement from the refinancing proceeds. The plaintiff submits that Snapdragon breached its fiduciary duty by taking funds from the Limited Partnership without legal entitlement.

b. Defendant Snapdragon

[94] Snapdragon's position was that its duties under the Partnership Agreement were strictly contractual. Snapdragon was not required to inform the limited partners about the refinancing. Snapdragon submits that Article 3.11 of the Partnership Agreement incorporated by reference provisions of the *Securities Act* that required the transferor to file a Form 20 with the OSC; therefore, Snapdragon's authority to recognize the transfer of Janet M's interest was restricted. Counsel argues that from 1993 to the present, they did not dispute the transfer of ownership of the 20 units.

[95] Snapdragon denies it acted in bad faith towards the plaintiff and submits that it acted only in the best interests of the Limited Partnership and limited partners. It is the defendants' position that Snapdragon attended a mediation session in an attempt to reach a settlement. Janet M's failure to fulfill the terms of the settlement agreement caused delays and precluded her registration as a limited partner. Counsel argues that Snapdragon carried out its duties in accordance with the terms of the Partnership Agreement.

[96] Snapdragon submits that it was entitled to receive a percentage of the income of the Limited Partnership pursuant to the terms of the Partnership Agreement. Snapdragon further submits that it was entitled to receive a distribution from the proceeds of the refinancing pursuant to the terms of the Agreement. The basis for its distribution calculation was that the limited partners net adjusted subscription price was nil because they were not original investors. Snapdragon created a reserve for the unallocated 20-unit interest. In the alternative, if Snapdragon made an error calculating monies payable under the Agreement, counsel for Snapdragon argues that monies owing to Snapdragon should be calculated on the basis of the unaudited 2003 financial records.

D. Issue 1: Production of Records

a. Should Snapdragon produce the Limited Partnership's Books and Records for the years 1993-2004?

[97] The plaintiff seeks an order requiring Snapdragon to produce the Limited Partnership's books and records from 1993 to the date of the court's decision. Janet M's position is that she requested these records without success and that she is entitled to review them in her capacity as a substituted limited partner.

[98] The defendant's position, as set out in its factum and in oral argument, is that it has provided Janet M or her counsel with all the accounting records, including financial records, in its power. In mid-November 2003, Mr. LoFaso offered the plaintiff's counsel an opportunity to inspect the Limited Partnership's records at his office.[29]³⁴ Snapdragon is prepared to consent to an order that Janet M may inspect the books and records, including financial statements, and that Snapdragon must co-operate and assist Janet M in conducting such an inspection.

[99] The defendant Snapdragon's offer mirrors the statutory requirements of the *Limited Partnerships Act*. Section 10 of the *Act* states that "[a] limited partner has the same right as a general partner to inspect and make copies of or take extracts from the limited partnership books at all times." [30]³⁵ Section 34 of the *Act* provides that where a person who is required to permit inspection of a document refuses to do so, the Superior Court may direct the custodian of the record to permit inspection of the records upon application of the aggrieved person.

[100] On September 2, 2003, Perkins J. ordered the defendants to produce the Limited Partnership's books and records from 1993 to the date of the hearing of the motion. The defendants have not complied with this order. The order was not appealed and there was no motion to set aside the order. The defendants did not suggest that the Limited Partnership, the general partner, or the limited partners (past or present) would suffer prejudice if an order for production were granted. I also find that the defendants failed to produce or disclose important information to the plaintiff in a timely manner (see also paragraphs 165-175 herein).

b. Conclusion

[101] Given the history of the litigation and for the reasons set out in paragraphs 97-100, I order the defendants to produce forthwith a copy of all books and records of the Limited Partnership from January 11, 1993 to the date of the release of this judgment.

E. Issue 2: Existence of a Fiduciary Duty

a. Is Snapdragon a Fiduciary?

34. November 26, 2003 transcript of cross-examination of David Cale, pp. 2-4.

35. *Limited Partnerships Act*, R.S.O. 1990, c. L.16, s.10 (a).

[102] Counsel for the plaintiff filed a copy of the headnote of *International Corona Resources Ltd. v. Lac Minerals Ltd*[31]³⁶ and a two-page excerpt of the case (pp. 543-44) in support of its position that Snapdragon owed Janet M a fiduciary duty. Counsel for the defendants filed no case law in support of Snapdragon's position that its obligations to Janet M were solely contractual. Neither counsel referred the court to authoritative texts or other legal publications to support their respective positions.

[103] In *Molchan v. Omega Oil and Gas*,[32]³⁷ the Supreme Court of Canada held that the corporate general partner owed a fiduciary duty to the sole limited partner.[33]³⁸ The Court found, however, that the general partner did not breach its duty to the sole limited partner.

[104] More recently in *Rochweg et al v. Truster et al.*,[34]³⁹ the Ontario Court of Appeal considered the duty of an individual partner to disclose financial information to other partners in a professional partnership. The Court examined the principles underlying the duties of a partner:

Equitable principles recognized by the courts during the last 100 years impose on partners duties of loyalty, utmost good faith and avoidance of conflict and self-interest. In Ontario, the principles which inform these duties are partially reflected in the [*Partnership*] Act.

...

It has long been established that partners owe a fiduciary duty to each other, and that equitable principles hold fiduciaries to a strict standard of conduct, encompassing duties of loyalty, utmost good faith and avoidance of conflict of duty and self-interest. These are well recognized, core principles of the law of partnership.[36]⁴⁰

[105] The Court analyzed the basis for a fiduciary duty amongst partners:

The fiduciary duty between partners thus arises not only from the reciprocal agency relationship between them but, also, from the duty of utmost good faith which each partner owes to the other. Fundamental to this overarching fiduciary duty is the requirement that each partner place the interests of the partnership, and the avoidance of situations which create, or could create, a conflict between fiduciary duty and the interests of the partnership, ahead of a partner's private interests. Accordingly, partners are required to prefer the interests of the partnership over their own personal interests. The scope of the fiduciary duty in partnerships is of the broadest nature.[37]⁴¹

The Court suggested that in the context of modern partnerships, fiduciary concepts should be applied in a flexible manner.[38]⁴²

36. (1986), 1986 CanLII 2839 (ON SC), 25 D.L.R. (4) 504 (H.C.J.).

37. 1988 CanLII 103 (SCC), [1988] 1 S.C.R. 348.

38. *Ibid.*, at 371.

39. (2002), 2002 CanLII 41715 (ON CA), 58 O.R. (3d) 687.

40. *Ibid.*, at para. 36.

41. *Ibid.*, at para. 62

42. *Ibid.*, at para. 63

[106] Thus the case law is clear that the equitable principles of a fiduciary apply to a general partner in a limited partnership. There are no practical or policy reasons for excluding limited partnerships from the application of the core principles of the law of partnership. A flexible approach allows courts to apply these principles in the context of the structure of limited partnerships.

[107] In the chapter entitled “The Consequences of Being a Partner: Fiduciary Obligations” in *A Practical Guide to Canadian Partnership Law*,^[39]⁴³ M. Ellis & A. Manzer stated that the duty which arises in a fiduciary relationship is often described as one of “utmost good faith” (*uberrimae fides*). This imports a requirement that the fiduciary act toward the beneficiary with an absolute sense of loyalty and fidelity. The result is that the fiduciary is required to act in a manner consistent with the best interests of the beneficiary in all matters related to the undertaking of the matters done in confidence. The fiduciary is required to favour the interests of the beneficiary over his own. The fiduciary is unable to profit or gain from any matter which comes to the knowledge of the fiduciary, as to the beneficiary or matters undertaken for the beneficiary, while acting in, or arising out of, the fiduciary role.

[108] As stated by LaForest J. for the Supreme Court of Canada in *Frame v. Smith*,^[40]⁴⁴ the characteristic elements of a fiduciary relationship are:

1. the fiduciary has scope for the exercise of some discretion or power;
2. the fiduciary can unilaterally exercise that discretion or power so as to affect the beneficiary’s legal or practical interests; and,
3. The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

These three elements are present in the relationship between Snapdragon and Janet M in the context of this commercial venture.^[41]⁴⁵

[109] Accordingly, I find that Snapdragon stood in a fiduciary position in relation to Janet M, who was a substituted limited partner since December 1989. The bases of the common law fiduciary duties are the principles of equity and agency. I find that the minimum fiduciary obligations Snapdragon owed to the limited partners are as follows: the duties of loyalty and good faith; the duty to act in the best interests of the fiduciary; the duty to avoid creating a conflict between the best interests of the fiduciary and those of the partnership; and the duty to not put its own interest ahead of those of the limited partners.

[110] A narrow construction of the fiduciary duties of a general partner is that their fiduciary duties are circumscribed by the terms of the Partnership Agreement. Article 7.07 of the Partnership Agreement states as follows:

43. Aurora, On., Canada Law Book, loose-leaf ed., at 5-1.

44. 1987 CanLII 74 (SCC), [1987] 2 S.C.R. 99 at para. 60.

45. See for example Articles 2.07, 2.08, 3.10, 3.11, 5.03, 5.10, 7.01-7.04, 7.06, 7.08, 8.02 and 9.01 of the Partnership Agreement.

The General Partner will exercise its powers and discharge its duties under this Agreement honestly, in good faith and in the best interest of the Limited Partners and in connection therewith shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

[111] The language of Article 7.07 adopts the core principles of fiduciary duties at common law for a general partnership. Even if I accepted Snapdragon's submission that its duties to the limited partners are strictly contractual, which I do not, Article 7.07 incorporates the common law principles that Snapdragon, in its capacity as general partner, stands in a fiduciary position in relation to the limited partners. Thus, Article 7.07 requires Snapdragon to carry out its powers and authority under the Partnership Agreement honestly, in good faith, and in the best interest of the Limited Partnership and the limited partners.

[112] I find that Snapdragon's obligations for the Limited Partnership's day-to-day activities were of a commercial nature. The general partner owed a general duty to exercise the care, diligence and skill of a reasonably prudent manager with respect to running the Partnership's business affairs. For example, a general partner is responsible for administrative matters, such as paying the municipal realty taxes, and has managerial responsibilities, such as negotiating the terms of the lease with the tenant. The general partner was required to exercise reasonable skill in performing these tasks in a reasonable and prudent fashion similar to a manager of any business enterprise.

[113] Snapdragon holds a position of trust arising out of the performance of other aspects of its duties. For example, Snapdragon owes a fiduciary duty to the limited partners when it receives monies from the Limited Partnership's business activities to distribute the monies amongst the limited partners and itself in accordance with the Partnership Agreement. In the performance of this function, the general partner's responsibility to the limited partner is similar to that of a traditional trustee.

[114] Article 2.05 of the Partnership Agreement provides:

The General Partner represents and warrants to and covenants with each Limited Partner that the General Partner ... shall act with the utmost fairness and good faith towards the other Partners in the business of the Partnership.

[115] Thus, in addition to its fiduciary duties under the common law and Article 7.07 of the Partnership Agreement, Snapdragon represents, covenants, and warrants that it shall act with utmost fairness and good faith towards each limited partner. This provision of the Agreement reinforces my finding that Snapdragon stands as a fiduciary with respect to Janet M.

[116] Mr. Cale is a retired member of the bar who practiced commercial law with a focus on financing and real estate. Mr. Posner is the Limited Partnership's accountant and his duties included preparing the financial statements and reporting to the Limited Partnership on financial matters. As legal and accounting professionals, they knew or ought to have known the responsibilities of a person holding a

fiduciary position and the obligation to comply with their fiduciary duties in a commercial venture. I find that Snapdragon stood in the position of a professional fiduciary in its relationship to each of the limited partners.

b. Conclusion

[117] I find that Snapdragon stood in a fiduciary position in relation to the limited partner Janet M.

F. Issue 3: Breach of Fiduciary Duty

a. The Test for Breach of Fiduciary Duty

[118] The duties owed by a fiduciary to a beneficiary can vary depending on the nature of the partnership and the duties and responsibilities of the partners. In the case at bar, the Limited Partnership is a commercial venture, the general partner is responsible for managing the single asset of the partnership and the limited partners are investors. Therefore, the principles of equity and agency governing a fiduciary relationship are determined in the context of the following factors: the commercial nature of the limited partnership; the relationship between the general partner and limited partner(s); the terms of the partnership agreement and the particular function performed by the general partner that allegedly gives rise to a breach. I examine the plaintiff's allegation of a breach of a fiduciary duty in this context.

[119] The test to determine if a fiduciary has breached its fiduciary duty is an objective one. Assuming Mr. Cale believed Snapdragon's duties were contractual, that it did not have an obligation to inform investors that the property had been refinanced, or that a distribution to the limited partners was properly made, is not determinative of this issue. A fiduciary's subjective mental state is simply one of the circumstances the court considers in analyzing whether the fiduciary breached a particular duty.

b. Did Snapdragon Breach its Fiduciary Duty by Refusing to Recognize Janet M as a Substituted Limited Partner?

i. Snapdragon's Conduct toward Janet M

[120] Counsel for the plaintiff alleges that Snapdragon acted in bad faith commencing in 1993 and continuing into 2004. I will review the ongoing relationship between Snapdragon and Janet M in two distinct periods (1989-1997 and 1997-2003) for reasons that become apparent later in my decision.

1989 - 1997:

[121] I find that paragraphs 7 to 23 of this judgment accurately set out the relevant facts for the period commencing with the formation of the Limited Partnership in 1986 and ending with the issuance of the statement of defence in early 1997. Neither party disputed this evidence. The documentary evidence for the 1989-1993 periods is sparse. The only significant documents from this period are the

Partnership Agreement and the two assignments (Development to Growth and Growth to Janet M). There is no evidence that Growth, in its capacity as the general partner, recorded the transfer of the 20 units to Janet M.

[122] As of January 11, 1993, Snapdragon replaced Growth as the new general partner. Mr. Cale's affidavit dated November 12, 2003, refers to a letter concerning PM's background dated December 10, 1991 from Cassels Brock to the Limited Partnership's former accountant Mr. Syvert. Mr. Cale's affidavit does not state when he became aware of that letter's contents. On the undisputed evidence, I find that Mr. Cale was aware of Development's business problems and PM's financial and other difficulties; however, the extent of his knowledge in the period 1993-1997 is not set out in the record.

[123] Counsel for the defendants submitted that the 20 units were never assigned to Janet M; rather, they were security for a loan because PM was in financial trouble. I do not accept this submission. The documentary evidence and the uncontradicted evidence of Janet M is that Development assigned 20 units of the Limited Partnership to Growth and that Growth in turn transferred these units to Janet M on December 31, 1989.

[124] On the undisputed evidence, I make the following factual findings: (1) Janet M was assigned 20 units of the Limited Partnership on December 31, 1989; (2) Snapdragon refused to recognize the transfer of the units from Development to Growth and subsequently from Growth to Janet M; (3) Snapdragon made a capital call on the other limited partners and Janet M/Development and demanded that Janet M pay Development's judgment debt(s); and (4) Janet M did not make a capital payment or pay the outstanding judgment against Development.

[125] I am not satisfied that Snapdragon acted in bad faith when it was concerned about the transfer of units from 1993-95. However, Snapdragon and the Limited Partnership both acted in an oppressive manner by demanding that Janet M satisfy the capital call and pay the outstanding judgment(s) against Development, while disputing her ownership of the 20 units and refusing to record her interest in the Limited Partnership's register. In these circumstances, Janet M. was not obligated to make a capital payment or pay Development's outstanding judgment(s) because Snapdragon refused to register her 20-unit interest and recognize her as a substituted limited partner.

1997 – 2003:

[126] I have reviewed the evidence in the record to determine whether Snapdragon acted in the best interest of the Limited Partnership or in utmost good faith during the years 1997-2003. The relevant evidence for the period commencing January 7, 1997 (the issuance of the statement of defence) and ending December 31, 2003 is set out in paragraphs 24-43 above. This undisputed evidence chronicles the events and respective positions of the parties during this period.

[127] The parties thought they had reached a settlement at the mediation session held on May 30, 1997. After the mediation session, Mr. LoFaso wrote Mr. White on several occasions requesting a copy of the draft MOS. The plaintiff's solicitor did not provide the draft MOS until the end of August 1997,

resulting in a 3-month delay. The next delay was caused when Mr. LoFaso inserted a new term in his amended version of the draft MOS. This term was not discussed at the mediation session and was inconsistent with the defendants' professed acknowledgment that Janet M owned 20 units. The insertion of this new term created a fresh controversy and resulted in a further 3½-month delay.

[128] In mid-December 1997, the solicitors attempted to finalize the settlement. Mr. LoFaso advised the plaintiff's solicitors that Mr. Cale required Janet M to either file a form with the OSC or obtain a court order dispensing with the need to file the form. The form was erroneously identified as a Form 2 under the *Securities Act*. It was not a relevant document and the plaintiff's solicitor asked Mr. LoFaso for assistance and information regarding the form. After a two-month delay, Mr. LoFaso advised Mr. White by letter dated February 25th 1998 that pursuant to the Regulations under the *Securities Act*, the required form was a Form 21 and not a Form 2. This information was erroneous because the form that supposedly needed to be filed was a Form 20. Although Mr. LoFaso requested that Mr. White proceed with the filing, Mr. White caused another 3½-month delay by delaying his response until mid-June 1998.

[129] The inability of either solicitor to identify the correct form, and their lack of knowledge of its scope and purpose, demonstrates their lack of familiarity with this area of the law. I find that neither solicitor appreciated the full implications of the Form 20 requirement when they attended the mediation session in May 1997. Also, the solicitors did not understand the purported relationship between Article 3.11 of the Partnership Agreement and the provisions of the *Securities Act* in the months following the mediation session.

[130] The plaintiff submits that the defendants acted in bad faith in their negotiations with the plaintiff commencing in 1997 when they insisted that a Form 20 be filed with the OSC as a pre-condition to recognizing Janet M as a substituted limited partner. Counsel argues that I can use the evidence of events that occurred in 2003 to infer that the general partner was acting in bad faith in prior years.

[131] As stated, the test whether Snapdragon acted in bad faith is determined objectively in the context of the actor's position in performing a particular activity or duty. After reviewing the record for the 1996 to November 1998 period, I find that during the initial stages of the negotiations, the solicitors for both parties were unaware of the significance of the terms of the purported settlement agreement and the purpose of a Form 20 filing. The plaintiff retained a large full-service law firm with expertise in corporate and securities law. Janet M's solicitors agreed to terms of settlement and drafted minutes of settlement that they should have known were impossible to satisfy. The plaintiff's solicitors caused unnecessary delays by failing to respond to correspondence in a timely manner. In light of these circumstances, I do not find that the defendants acted in bad faith in relation to Janet M in the period 1997-1998.

[132] In the period from September 1998 to mid-November 1998, the undisputed evidence is that Snapdragon and its counsel were aware that filing a Form 20 was the transferor's disclosure obligation and was not the transferee's responsibility. The defendants' solicitor also knew that the lack of a Form

20 filing did not affect the validity of the transfers from Development to Growth or from Growth to Janet M. Almost 1½ years after the mediation session, the parties were no closer to resolving the dispute.

[133] In January 1999, Mr. White brought a motion to seek relief from the requirements of the *Securities Act* in order to resolve the impasse. In early April 2000, the defendants served a motion for summary judgment. On May 4 2000, the plaintiff withdrew the motion and requested an adjournment of the defendants' motion in order to allow the plaintiff an opportunity to apply to the OSC to waive the Form 20 requirement. On May 31st 2000, the defendants' summary judgment motion was adjourned *sine die* and was never revived. The parties were no closer to a resolution of the dispute after the passage of another four months.

[134] In early September 2000, the defendants informed the plaintiff that the settlement negotiations were at an end and that the parties should proceed to trial. The plaintiff changed solicitors and retained Glaholt and Associates in January 2001. There is no evidence that Glaholt entered into any negotiations or took any steps to advance the litigation. On May 30, 2002, the plaintiff retained Mr. Dingwall who brought a motion in October 2002 to waive the requirement for filing a Form 20 with the OSC.

[135] I make factual findings in this and the following paragraphs. In November 1998, Mr. LoFaso, on behalf of the defendants, acknowledged that the completion of a Form 20 was a disclosure obligation of the transferor and was not the transferee's responsibility. The defendants knew that the lack of a completed Form 20 did not affect the validity of the transfers from Development to Growth or from Growth to Janet M. The defendants were aware that Development and Growth had been dissolved and that PM's whereabouts were unknown. The defendants also knew that the dissolved corporations could not execute the Form 20 and that it was most unlikely that PM, their directing mind and signing officer, would return to the jurisdiction. It would be extremely unlikely that the dissolved corporations would be revived or could, if revived, make any claim of ownership in the 20 units. In their submissions before Salmers J. in 2002, the defendants continued to argue that there was a possibility PM could return. Salmers J. summarily rejected this submission.[42]⁴⁶

[136] Recognition of Janet M as a substituted limited partner with a 20-unit interest would not have jeopardized the other limited partners' interests. Leaving aside the issue of whether or not a Form 20 filing was a mandatory requirement under Article 3.11 of the Partnership Agreement, the *bona fides* of the defendants' position became less tenable with the passage of time. Even assuming that a Form 20 was required to be filed in order to comply with Article 3.11, it was a matter of form and not substance.

[137] The undisputed evidence is that from 1998, and continuing during the subsequent years, the defendants knew that their insistence on a Form 20 filing would preclude recognition of Janet M's partnership interest. Notwithstanding this knowledge, on January 19, 2001, Snapdragon advised Glaholt & Associates that recognition of Janet M's 20-unit interest was conditional upon her filing a Form 20 with the OSC. Paragraphs 13 and 25 of the defendants' factum dated January 9, 2003 and filed

46. Transcript of proceedings on November 21, 2002, p.11, l.26-p.12, l.9.

on the motion before Salmers J., state that because PM is unavailable to either revive the dissolved corporations or execute the Form 20, “it is a legal and factual impossibility to effect the transfer of units requested by the plaintiffs.” Thus, the defendants insisted on a condition that they knew was factually and legally impossible to perform.

[138] I find that Snapdragon’s broad interpretation of the scope of Article 3.11 of the Partnership Agreement and its insistence that the plaintiff file a Form 20 with the OSC created a catch-22 situation. Snapdragon would only recognize the 20 unit transfer if Janet M obtained an executed Form 20 from the corporate transferors and filed it with the OSC. However, the transferors (Development and Growth) did not exist and the whereabouts of their directing mind and signing officer was unknown. Because the plaintiff did not have the power to fulfill the pre-condition, the condition could never be satisfied and Janet M could never be registered as a limited partner in the Limited Partnership’s records.

[139] As of November 1998, the defendant Snapdragon knew that the Form 20 condition could never be satisfied in the subject circumstances, that the lack of Form 20 did not affect the validity of the transfer, and that the registration of Janet M’s 20 unit interest did not prejudice the rights or interests of the general partner or the other limited partners. I find that after November 1998, the defendants did not negotiate in good faith when they insisted that the plaintiff must file a Form 20 with the OSC as a pre-condition for Snapdragon recording the transfer on the Limited Partnership’s register. The sole purpose for imposing the Form 20 precondition was to prevent Janet M from becoming a limited partner.

[140] Snapdragon did not act with utmost fairness and good faith toward Janet M when it refused to recognize her as a limited partner. It acted contrary to Janet M’s best interest without any valid business reason for doing so.

ii. Snapdragon’s Submission that it did Not Dispute the Plaintiff’s Claim to become a Limited Partner

[141] In their factum dated November 25, 2003, and during oral argument, the defendants’ counsel forcefully argued that they did not dispute the plaintiff’s claim with respect to her partnership interest. It was their position that Snapdragon was required to ensure that Janet M complied with Article 3.11 of the Partnership Agreement.

[142] However, the statement of defence dated February 1997 stated that Janet M and her assignor had forfeited their right, title, and interest in the Limited Partnership. Snapdragon’s position in the fall of 1997 was that PM and his controlled corporations had an interest in the corporation whereas Janet M did not. In September 2000, the defendants’ solicitor notified the plaintiff’s solicitor that the settlement negotiations were concluded and that the action should proceed in its normal course. These pleadings were never amended.

[143] Between issuance of the statement of defence in February 1997 and the motion before Salmers J in November 2002, Snapdragon's position concerning Janet M's entitlement to be recognized as a partner was either disputed or conditional. In the proceedings before Salmers J. on November 21, 2002, the defendants' position was that the disputed 20 units of the Limited Partnership escheated to the Crown. During cross-examination of Mr. Cale on October 2, 2003, the defendants disputed the suggestion that Janet M owned 20 units of the Limited Partnership. Snapdragon referred to the 20 units as an unallocated interest in the 2003 financial statements.

[144] At the commencement of oral arguments the defendants recognized the 20 unit transfer to Janet M effective January 15, 1993; however, they would not recognize Janet M as a substituted limited partner as of December 31, 1989. During the course of oral argument, the defendants conceded that the transfer to Janet M was effective December 31, 1989, and near the end of oral argument they acknowledged that Janet M was a substituted limited partner.

[145] I do not accept Snapdragon's submissions that it did not dispute Janet M's claim to be a limited partner. I find that the defendants disputed the transfer of the 20 units to Janet M and refused to register her interest as a substituted limited partner from 1996 until late in the oral argument. I find that it was necessary for the plaintiff to apply to the Superior Court to obtain a waiver of the Form 20 requirement and to continue litigating the matter in order to force Snapdragon to recognize Janet M as a substituted limited partner. Had the plaintiff not persevered, Snapdragon and the Limited Partnership would not have recognized her interest in the Limited Partnership.

[146] The fiduciary Snapdragon did not act toward Janet M. with a sense of loyalty and fidelity, and it clearly did not act in her best interests. Snapdragon and the Limited Partnership affected Janet M's legal and financial interests while she was in a vulnerable position. There was no evidence that registration of Janet M's shares could adversely affect the legal or economic interests of the other limited partners. Indeed, the failure to recognize Janet M's interest meant that the other limited partners had to pay taxes on the income attributed to the unallocated units without receiving the financial benefit.

iii. Janet M's Application to Waive the Requirements of the *Securities Act*

[147] The alternative route to perfect Janet M's registration as a substituted limited partner was to apply to a court of competent jurisdiction for an order waiving the requirement to file a Form 20. On December 18, 1997, Mr. LoFaso confirmed that Janet M's solicitor should file a Form 2 [sic Form 20] or should obtain an order dispensing with the filing. In a letter dated November 17, 1998, Mr. LoFaso advised Janet M's solicitors as follows in relation to the waiver alternative:

... it is my position that your client must make the appropriate application to a court of competent jurisdiction, or to the Ontario Securities Commission, at her own expense, to have the statutory filings waived so that this matter can be finalized. In this regard, I can advise that I have been instructed not to oppose any such application, however, I will require to be kept apprised of the steps taken in furtherance of this objective.

[148] Mr. LoFaso, in a letter to Mr. White dated February 24, 2000, advised that the defendants would not oppose the motion to obtain a waiver to comply with the OSC; however, counsel would attend to inform the court that the general partner's powers were limited under the Partnership Agreement. As noted, Mr. White subsequently abandoned this motion.

[149] In the motion before Salmers J., counsel for the defendants opposed the plaintiff's application. Counsel's primary submission was that the 20-unit interest escheated to the Crown or, in the alternative, PM might return to claim his interest. The defendants further submitted that the court did not have the authority to waive the mandatory requirements of the *Securities Act* as incorporated by Article 3.11 of the Partnership Agreement.

[150] Mr. LoFaso, in his November 17, 1998 letter, advised the plaintiff to bring an application to a court of competent jurisdiction. When the plaintiff made an application to the Superior Court, the defendants objected to the court's jurisdiction to grant relief. In oral argument before me, Snapdragon attempted to maintain its position that the defendants were merely bringing to the court's attention the limitations of the general partner's authority to recognize an assignment of the transfer of units. I do not accept the defendants' submission. I find that the defendants opposed the plaintiff's application to waive the Form 20 requirement. I find that some time after Mr. LoFaso's November 17, 1998 letter, the defendants changed their instructions to Mr. LoFaso and instructed him to oppose Janet M's application to waive the Form 20 requirement.

[151] Snapdragon and the Limited Partnership appealed Salmers J.'s decision and sought to overturn his ruling. The notice of appeal to the Court of Appeal sets out the grounds of appeal. The defendants' position was that Salmers J. lacked jurisdiction or authority to make the order and sought costs against the plaintiff on a substantial indemnity basis. The defendants knew that Janet M was unable to file a Form 20 with the OSC because doing so was legally and factually impossible. When Janet M's solicitors obtained an order from a Superior Court judge waiving the requirement of a Form 20 (as suggested by Mr. LoFaso in his letter of November 17, 1998), the defendants did not accept the decision.

[152] In oral argument, counsel for the defendants attempted to justify their appeals on the basis that they were necessary to protect the general partner from a lawsuit. It is difficult to conceive how the general partner could become liable for recording the interest of a valid transfer in accordance with a Superior Court ruling that a Form 20 was not necessary and that the transfer of the interest did not contravene Article 3.11 of the Partnership Agreement. I find that the ruling by a Superior Court judge should have concluded the litigation; it satisfied the sole barrier that the defendants had erected to deny registration of the 20-unit transfer to Janet M.

[153] Mr. Cale, in his affidavit dated November 12, 2003, attempted to justify the decision to appeal Salmers J.'s decision on the grounds that Snapdragon could incur liability if it failed to fulfill its duties under Article 7.07 of the Partnership Agreement. Article 7.07 provides:

The General Partner will exercise its powers and discharge its duties under this Agreement honestly, in good faith and in the best interest of the Limited Partners and in connection therewith shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

[154] I do not accept Mr. Cale's justification for appealing Salmers J.'s decision. I find that Snapdragon had no exposure to any potential liability from the other limited partners if it failed to prosecute the appeal. The sole purpose of the appeal was to prevent the plaintiff from becoming a substituted limited partner. I find that Snapdragon failed to discharge its fiduciary duties of loyalty and good faith by failing to act in the best interests of Janet M or the other limited partners and by not exercising its powers in a reasonably prudent manner. I find that Snapdragon breached Articles 7.07 and 2.05 of the Partnership Agreement by unnecessarily continuing the litigation.

iv. Steps Taken by Snapdragon to Recognize Janet M's Interest

[155] Section 4 of the *Limited Partnerships Act* provides that the general partner shall maintain a register to record the limited partners. Article 3.11 of the Partnership Agreement incorporates this statutory requirement by requiring the general partner to maintain a register to record the assignment of units by a limited partner. Assuming, for the purpose of argument, that Article 3.11 precluded Janet M's registration as a limited partner as advocated by Snapdragon. Janet M was dependent upon Snapdragon to exercise its authority under Article 3.11 with utmost fairness and good faith. She was in a vulnerable position in the subject circumstances.

[156] In oral argument counsel referred to s. 18(1) of the *Limited Partnerships Act*, which provides that a limited partner's interest is assignable. Neither counsel referred to s. 17 of the *Act* or to Article 12.01 of the Partnership Agreement in their facta or oral argument. Section 17 of the *Act* states:

After the formation of the limited partnership, additional limited partners may be admitted by amendment of the record of the limited partners.

Article 12.01 of the Partnership Agreement provides as follows:

This Agreement may be amended by the General Partner, without notice to or consent of the Limited Partners, to reflect the admission, resignation or withdrawal of any Limited Partner, or the assignment by any Limited Partner of the whole or any part of its interest in the Partnership, under or pursuant to the terms hereof or of the Limited Partnerships or [sic] Act.

[157] Snapdragon had the power and authority to amend the Agreement to record the assignment of the 20-unit interest to Janet M. There is no evidence in the record that Snapdragon took any positive steps to accommodate the plaintiff's request for recognition. For example, Snapdragon did not attempt

to obtain consent from the other limited partners to register Janet M as a substituted limited partner as provided s.18 (4) in the *Limited Partnerships Act*. Snapdragon failed to take any measures to assist Janet M when it knew that the Form 20 precondition was factually and legally impossible to fulfill.

[158] As stated by the Court of Appeal in *Rochwerg v. Truster*,^[43]⁴⁷ the fiduciary duty between partners arises from their reciprocal agency relationship and the duty of utmost fairness that each partner owes to the other. Rather than attempting to assist a partner, Snapdragon and the Limited Partnership blocked Janet M's request to become a substituted limited partner when it knew the precondition was legally and factually impossible to satisfy. The failure to positively act was a breach of Articles 2.05 and 7.07 of the Partnership Agreement and Snapdragon's common law fiduciary duty.

v. The Form 20 requirement for Mr. Posner's Corporations

[159] On September 2, 2003, Perkins J. ordered the defendants to produce the books and records of the Limited Partnership to Janet M from 1993 onwards. On November 18, 2003, DiTomaso J. ordered the defendants to produce for inspection all records and supporting materials for the transfers of partnership units after January 31, 1989.

[160] Mr. Cale acknowledged that there was no record of a Form 20 filing with respect to transferring units in the early 1990s from one of the original limited partners (Gross) to Mr. Posner's numbered company. Mr. Cale undertook to produce a copy of a Form 20 for that transfer if he found one in the corporate records.^[44]⁴⁸ Mr. Cale was also aware that the other original limited partners transferred their units to Barter Alliance in May 2003. On October 15, 2003, Snapdragon issued 5 certificates representing the transfer of 50 units of the Limited Partnership from the remaining original limited partners to Mr. Posner's corporation. Snapdragon did not produce a Form 20 for these transfers^[45]⁴⁹ notwithstanding that Mr. Cale had undertaken to produce a Form 20 if he found one. The record does not contain Form 20 filings for any of the transfers from the original limited partners to the numbered corporation or Barter Alliance.

[161] On the undisputed evidence, I find that Snapdragon and the Limited Partnership recognized transfers of units without requiring the assignees, namely the numbered corporation and Barter Alliance, to file a Form 20 with the OSC.

[162] Snapdragon applied different rules for assigning units to Janet M than for Mr. Posner's controlled corporations. The fiduciary cannot favour the interests of one beneficiary but not another in identical circumstances. This contravenes the duty of loyalty owed by the fiduciary to Janet M. The application of different standards in like situations also contravenes Snapdragons' covenants and warranties under the Agreement.

vi. Conclusion

47. *Supra* note 34 at para. 62.

48. *Supra* note 29.

49. *Ibid.* Q.410-Q.423; Q.430.

[163] I make the following factual findings. After 1998, Snapdragon's sole purpose for insisting on the Form 20 OSC filing was to defeat Janet M's entitlement to be recognized as a limited partner. Snapdragon acted in bad faith and breached its warranty and its fiduciary duty by requiring Janet M to file a Form 20 after it was aware that it was legally and factually impossible to do so. Snapdragon breached its warranty to act with utmost fairness and good faith. It breached its common law fiduciary duty to Janet M when it contested the plaintiff's application to waive the Form 20 filing, refused to accept Salmers J.'s decision, and appealed Salmers J.'s ruling to the Divisional Court and Court of Appeal.

[164] I find that Snapdragon and the Limited Partnership acted unfairly and in bad faith when they required Janet M, but not Mr. Posner's controlled corporations, to file a Form 20 as a condition precedent to recording her 20-unit interest in the Partnership's register. Snapdragon also breached the representations, warranties and covenants set out in Article 2.05 of the Partnership Agreement to act in utmost good faith and fairness. Snapdragon and the Limited Partnership breached their fiduciary duty to Janet M by applying a different and more onerous procedure to record the transfer of units to her than to Mr. Posner's controlled corporations. Finally, Snapdragon and the Limited Partnership's failure to take any steps to accommodate Janet M in becoming a substituted limited partner was a breach of their fiduciary duty.

c. Did Snapdragon Breach its Fiduciary Duty by Failing to Disclose Financial Information?

i. Analysis

[165] Article 9.01 of the Partnership Agreement requires the general partner to call an annual general meeting. Mr. Cale's evidence was that he held one formal partnership meeting in 1993 and reported to the limited partners "in theory" only.

[166] Section 10(b) of the *Limited Partnerships Act* provides that, on demand, a limited partner has to be given true and full information concerning all matters affecting the Limited Partnership and a complete and formal account of the Partnership's affairs. Snapdragon did not provide any financial information to Janet M after 1993. In 2003, Janet M's solicitor requested information about the share transfers, the financial statements, and the Limited Partnership's books and records. Mr. Cale did not produce the requested information and documents in a timely manner.

[167] On September 2, 2003, Perkins J. ordered the defendants to produce the Limited Partnership's books and records from 1993 onwards on or before September 26, 2003. This order was not complied with in a timely manner. Snapdragon produced financial statements for some years (but not others) but did not produce other documents before the deadline. There were other problems as well. For example, the information about the transfers to Barter Alliance was disclosed only after there had been a distribution to Snapdragon and Mr. Posner's controlled corporations from the surplus refinancing proceeds.

[168] Mr. Cale's evidence was that the mortgage transaction would have occurred in any event because the mortgage was coming due and the limited partners were interested in receiving funds. Snapdragon knew that upon the completion of the refinancing, surplus funds would be available for distribution to the limited partners and the general partner. Snapdragon did not inform the limited partners that the sole asset would be re-mortgaged or that there would be a surplus available for distribution. The refinancing and the surplus funds were not routine transactions of the Limited Partnership and information about the transaction was very important to the limited partners. The purpose of the investment was to receive a return on capital and to obtain a tax savings. The refinancing was an opportunity for the limited partners to receive a return on their 1987 capital investment in accordance with the terms of the Partnership Agreement.

[169] Mr. Cale's reason for not reporting the financial information was that he was not required to do so. I do not accept Mr. Cale's excuse for failing to disclose the financial information to the limited partners. I find the mortgage refinancing and the availability of a surplus for distribution was important material information that should have been disclosed to all the limited partners in a timely manner.

[170] In *Tzembelicos v. Tzembelicos*,^[46]⁵⁰ Ground J. discussed the duty of a partner in a general partnership to disclose information to the other partners prior to the sale of partnership interests. He stated:

I am of the view that the provisions of the *Partnership Act* and the common law fiduciary duty among partners requires the disclosure of any transaction, agreement or understanding affecting the partnership, the partnership business or the partnership property and extends to any agreement relating to a partner selling or purchasing a partnership interest within the partnership.

[171] The general partner retains the auditor to review and report to the general and limited partners on the financial statements pursuant to Article 8.02 of the Partnership Agreement. The accountant, Mr. Posner, held a position of trust with respect to the limited partners. Mr. Dingwall attempted to examine Mr. Posner as a witness in mid-January 2004 but the witness did not attend. I was prepared to grant an adjournment of the proceedings on terms to allow Mr. Dingwall an opportunity to examine Mr. Posner. Mr. Dingwall elected to proceed with the hearing.

[172] Mr. Posner possessed information of fundamental importance about the Limited Partnership's financial affairs. This information was critical with respect to the valuation of the limited partners' investment. I find that Mr. Posner, in his capacity as the Limited Partnership's accountant, had a duty to report to the limited partners. He was a fiduciary in that capacity and was obligated to inform Janet M and the other limited partners of the material financial information. Based on the undisputed evidence that Mr. Posner did not inform Janet M of the important financial information before he attempted to purchase her shares, I find Mr. Posner breached his fiduciary duty to Janet M. Mr. Posner did not

50. [2004] O.J. No. 154.

attempt to avoid a conflict of interest; instead he contravened one of the underlying principles of a fiduciary duty when he attempted to advance his own self-interest as purchaser over the interest of the beneficiary Janet M.

[173] Mr. Posner, in his capacities as the accountant and as a unit holder, knew that there was a mortgage commitment, that there would be a surplus from the refinancing, and that these surplus funds would be available for distribution. Mr. Posner received approximately \$195,000 as a capital distribution from the proceeds of the refinancing and received \$20,464.50 as a distribution from the cash receipts. Mr. Cale's evidence was that "we did the transfer units at all the same time" and "we knew the cheques were coming."⁵¹ These statements show that Mr. Cale and Mr. Posner worked together to allocate the surplus. I find that Mr. Posner, as the accountant, was aware how the surplus funds could be distributed and the approximate amount of funds available for distribution. I find that the following events were not coincidental: the timing of the refinancing; the availability of surplus funds; the failure to disclose; the purchase of the other limited partners' interest by Mr. Posner's corporations; Mr. Posner's attempt to purchase Janet M's units; and the distribution of the surplus funds to Mr. Posner and Snapdragon. It is unnecessary for the purposes of these reasons to decide whether or not there was some kind of conspiracy as alleged by Mr. Dingwall.

[174] Mr. LoFaso submitted that the limited partners, as reasonable persons, might or would have sold their shares rather than receiving a distribution because of their individual tax positions. However, because the original partners did not give evidence, there is no evidence of their individual tax positions. I find that the fiduciary cannot claim that the beneficiary would have acted in the same manner in any event where the fiduciary withholds critical information preventing him or her from making an informed decision. Had Snapdragon informed the original limited partners of the financial information in a timely manner, each original investor would have been in a position to elect whether to receive a capital and income distribution and maintain their investment or to sell their units to Mr. Posner's controlled corporation. There was an imbalance of power that resulted in an uneven playing field. The purchaser of the units possessed information gained from a fiduciary position and this information was not shared with the beneficiaries, namely Janet M and the other limited partners. Janet M and the original limited partners were not given the full and complete disclosure they needed to make an informed election. Snapdragon failed to provide the material financial information to the other limited partners and thereby breached its fiduciary duty to them.

[175] Mr. LoFaso alternatively argued that the original limited partners received fair compensation for their units. Counsel submitted two alternative calculations of share valuation. There was, however, no opinion evidence of the value of the shares before and after the refinancing and distribution. The issue before me is not whether a hypothetical unit holder received fair compensation but rather whether the fiduciary made full disclosure in discharge of his or her duty such that the beneficiary made a decision to sell units in the Partnership with full knowledge of all relevant circumstances. I do not accept Mr. LoFaso's alternative submissions for the above reasons.

ii. Conclusion

51. Supra note 29 Q.347, Q.367.

[176] I find Snapdragon had a fiduciary duty pursuant to the Partnership Agreement and at common law to report the important financial information to the limited partners in a timely manner. In any event, this information should have been reported prior to the transfers of units to Barter Alliance in 2003. Snapdragon breached its fiduciary duty to disclose the financial information to the limited partners and breached the representation, covenant, and warranty provision of the Agreement to act with utmost fairness and in good faith.

d. Did Snapdragon Breach its Fiduciary Duty by Paying Itself a Mortgage Fee?

i. Analysis

[177] Snapdragon paid itself a mortgage fee in the amount of \$5,885 from the Limited Partnership's funds. The mortgage fee was first disclosed during the proceedings on this motion. Counsel for Snapdragon did not point to any provision of the Partnership Agreement allowing Snapdragon to charge or collect a mortgage fee. During oral argument, Snapdragon abandoned its entitlement to receive a mortgage fee.

ii. Conclusion

[178] Snapdragon was in a position of trust in relation to the distribution of surplus funds. I find that Snapdragon breached its fiduciary duty to Janet M and the other limited partners by receiving monies it was not entitled to under the Partnership Agreement. Snapdragon put its own self-interest ahead of those of the limited partners. The mortgage fee payment to itself constitutes a breach of Articles 2.05 and 7.07 of the Partnership Agreement and a breach of Snapdragon's common law fiduciary duty to Janet M. The fact that Snapdragon agreed to repay the mortgage fee to the Limited Partnership does not retroactively cure these breaches.

e. Did Snapdragon Breach its Fiduciary Duty by Distributing to itself Proceeds from the Refinancing?

i. Analysis

[179] Article 5.10 of the Partnership Agreement provides:

The General Partner will, to the extent that Refinancing Proceeds are not used for the business of the Partnership, distribute Refinancing Proceeds arising from any Refinancing as follows:

- (1) until the Limited Partners have been allocated Refinancing Proceeds to the extent of the Net Adjusted Subscription Price, 100% to the Limited Partners; and
- (2) then to pay any credit amount, proportionately, in any Partner's Current Account; and

(3) thereafter any balance as follows:

(a) 70% to the Limited Partners; and

(b) the remainder to the General Partner.

The amount of Refinancing Proceeds to be distributed will be distributed within a reasonable time following the date upon which such Refinancing Proceeds are received.

Article 1.01, paragraph 31 of the Agreement defines “Net Adjusted Subscription Price” as follows:

“Net Adjusted Subscription Price”, at any time, means that portion of the Subscription Price that has been paid in respect of the Units at or prior to such time less Refinancing Proceeds and Sale Proceeds distributed at or prior to such time in respect of the Units.

[180] There was no evidence that the refinancing proceeds were used for business purposes other than the payout of the existing mortgage. Mr. Cale decided, for the purposes of determining the net adjusted subscription price of the units, that only the original investors had paid for their units. Mr. Cale’s evidence was that he assumed the net subscription price of each of the limited partners’ units was zero for the purpose of the Article 5.10 calculation because “none of the individual unit holders at this point in time had paid for their subscriptions to the partnership.”

[181] Mr. Cale did not know how much each original investor had paid for their respective units. Although Mr. Cale believed that neither PM nor his controlled corporations paid for the 20 unit interest, he did not know if a payment had in fact been made. Mr. Cale did not perform any alternative calculations based on an assumption that the substituted limited partners had paid an amount greater than zero for their units.

[182] The mortgage was advanced on April 22, 2003 and the distributions were made on June 4, 2003. As noted, Mr. Cale determined that the persons entitled to the refinancing proceeds were the limited partners at the time the cheques were drawn for the distribution. There is no evidence explaining the delay between the date of the receipt of the mortgage funds on April 22, 2003 and the date of the distribution on June 4, 2003. Article 5.10 of the Partnership Agreement sets out the timeline for distributing the refinancing proceeds: “The amount of the refinancing proceeds to be distributed will be distributed within a reasonable time following the date upon which such refinancing proceeds are received.” The Partnership agreement does not, however, specify when the refinancing proceeds become vested. Mr. Cale did not consider whether the transferors (the original unit holders) were entitled to receive a distribution from the refinancing proceeds on the basis that the refinancing proceeds were received while they were limited partners.

[183] The general partner cannot arbitrarily delay the distribution of refinancing proceeds in order to benefit the interest of the transferee of the units. Snapdragon issued unit certificates, dated October 15, 2003, on behalf of the Limited Partnership, to recognize the transfer of units from the original limited partners to Barter Alliance. There is no evidence of the exact date the units were transferred or why Snapdragon distributed the refinancing proceeds to a limited partner prior to recognizing the transfer of units.

[184] Section 18(2) of the *Limited Partnerships Act* states, “[a] substituted limited partner is a person admitted to all the rights and powers of a limited partner who has died or who has assigned the limited partner’s interest in the limited partnership.” Section 18(6) states, “[a] substituted limited partner has all the rights and powers and is subject to all the restrictions and liabilities of the limited partner’s assignor ...”

[185] I find as follows. The assignee (a substituted limited partner) stands in the position of the assignor (original limited partner) for the purpose of calculating the net adjusted subscription price of the units owned by the substituted limited partner. Mr. Cale did not calculate the distribution from the refinancing proceeds in accordance with Article 5.10 of the Partnership Agreement because he wrongly assumed that the net adjusted subscription price was zero for the substituted limited partners. He made this assumption solely on the basis that they were not the original investors at the time the distribution was made. Also, Mr. Cale did not direct his mind to whether the transferor or the transferee was entitled to the distribution of the refinancing proceeds.

[186] I make the following factual findings. There was no basis in the Partnership Agreement for Mr. Cale’s assumption that the net subscription price was zero for the substituted limited partners. Accordingly, Snapdragon did not distribute the refinancing proceeds in accordance with Article 5.10 of the Partnership Agreement and therefore breached this term. Snapdragon arbitrarily assumed the zero value, which had the effect of maximizing the distribution to the general partner at the expense of the original limited partners or the substituted limited partners.

[187] Counsel for Snapdragon made alternative calculations of the net subscription price based on the capital account set out in the financial statements. He acknowledged that Mr. Cale did not know the amount the original investors had invested; however, he submitted that Mr. Dingwall should know because his former firm was the solicitor for PM and the Limited Partnership during the initial years. Mr. LoFaso also submitted that if the court found Mr. Cale’s interpretation and application of Article 5.10 incorrect, the court should decide the amount of the distribution to Janet M on the basis of the financial statements in the Limited Partnership’s records. Mr. Cale did not consider this alternative method of valuation. There is no evidence as to the reliability of the financial statements as a basis for determining the net subscription price since the accountant who prepared the statements declined an opportunity to give evidence. There was no expert evidence to assist the court to determine the validity of Mr. LoFaso’s method for determining the adjusted subscription price of the units.

[188] There is insufficient evidence in the record to determine the net adjusted subscription price paid for the units by the original limited partners. Thus, I am unable to calculate the amount of the distribution payable to the original limited partners or the substituted limited partners and the general partner pursuant to article 5.10 of the Partnership Agreement. I am also unable to determine whether refinancing proceeds should be distributed to the original limited partners or the substituted limited partners due to the insufficient evidence in the record of the dates and other circumstances surrounding the unit transfers to Barter Alliance.

[189] Snapdragon agreed to conduct an accounting of the Limited Partnership's distributions and allocations from January 11, 1993. As well, I ordered Snapdragon to produce copies of the Limited Partnership's books and records for Janet M from 1993 to the release of this decision. Upon the receipt of this information, documents, and some of the original documentation, the parties and the general partner will be in a position to calculate the net adjusted subscription price of the units owned by each limited partner or substituted limited partner. Once this calculation is made so that there is reliable financial information and all the circumstances concerning the transfer of units are known, an independent general partner exercising reasonable skill and acting in utmost good faith will be able to distribute the refinancing proceeds in accordance with Article 5.10 of the Limited Partnership Agreement.

ii. Conclusion

Snapdragon breached its fiduciary duty under Article 7.07 of the Agreement and at common law. It calculated the distribution of the proceeds from the refinancing on a basis that maximized the financial benefits to itself and failed to consider the interests of the original limited partners. Snapdragon acted in its own self-interest and failed to favour the interest of the beneficiary over its own. Snapdragon also breached its covenant to act with utmost good faith towards the limited partners in the business of the Limited Partnership. Snapdragon repaid \$32,500 to the Limited Partnership pursuant to the order of Glass J. I order Snapdragon to repay the Limited Partnership the balance of monies it received from the distribution of the refinancing proceeds pursuant to Article 5.10.

f. Did Snapdragon Breach its Fiduciary Duty by Distributing to Itself a percentage of the 2003 Cash Receipts?

i. Analysis

[190] Article 5.03 of the Partnership Agreement directs the general partner to distribute cash in respect of fiscal periods to the limited partners and the general partners. Article 1.01, paragraph 14 defines the term distributable cash as the amount by which the Limited Partnership's aggregate cash receipts in a fiscal period exceed the defined aggregate expenses. Mr. Cale's evidence is that the Partnership's net income for 2002 was \$23,421. He then added an amortization expense of \$15,559, a non-cash item, to determine the total cash receipts (\$38,980). Pursuant to Article 5.03, the general partner receives 30% of the cash receipts, which was calculated to be \$11,694. Snapdragon paid itself \$11,694 representing a distribution of 30 percent of the cash receipts.

[191] Janet M adduced no evidence to challenge Mr. Cale's interpretation or calculation of cash receipts. There is no evidence that the distribution of the cash receipts was not done in accordance with the Article 5.03 of the Agreement.

ii. Conclusion

[192] I find that Snapdragon did not breach its fiduciary duty in the distribution of cash receipts to itself in respect of the 2003 income. Subject to a confirmatory audit of the 2003 financial statements, I find that Snapdragon is entitled to receive a distribution of cash receipts in the amount of \$11,694.

G. Issue 4: Removal of Snapdragon as the General Partner

a. Should Snapdragon be Removed as the General Partner?

i. Analysis

[193] Janet M seeks to remove Snapdragon as the general partner because it breached its fiduciary duty to her. The Partnership Agreement specified the procedure for removing the general partner. It is Snapdragon's position that its removal should be done in accordance with the terms of the Partnership Agreement. Neither counsel cited case law or authoritative texts with respect to their positions on this issue.

[194] Article 10.04 of the Partnership Agreement provides:

The General Partner may not be removed as the General Partner except for cause and in accordance with Article 10.05.

Article 10.05, titled "Conditions of Removal of General Partner," provides in part as follows:

The right of the Limited Partners to remove the General Partner by Ordinary Resolution and to admit a replacement thereof shall not be effective in any manner unless and until the General Partner has received a written notice from a Limited Partner stating that the General Partner has failed to exercise its powers and carry out its duties as required by this Agreement or by law and describing, in general terms, the event giving rise to such failure and

1. the General Partner has not, within 21 days of the receipt of such notice by the General Partner, delivered a written notice to such Limited Partner denying the existence, or continuance, of the failure described in such notice; or
2. a single arbitrator appointed by the General Partner and such Limited Partner pursuant to the [Arbitration] Act ... has determined that by reason of the failure described in such notice the General Partner has failed to exercise its

powers and carry out its duties as required by this Agreement or by law and by reason thereof, it is reasonable to expect the Limited Partners to have a justifiable lack of confidence in the ability of the General Partner to continue to exercise its powers and carry out its duties as such.

The procedure for the appointment and remuneration of an arbitrator is then set out in Article 10.05. The section continues as follows:

The arbitrator so appointed shall hear submissions from the Limited Partner and the General Partner within fifteen (15) days of his appointment and shall render his decision within thirty (30) days of the conclusion of those submissions. The decision of the arbitrator when rendered shall be final and binding upon both the General Partner and is not subject to appeal.

[195] Article 9 of the Partnership Agreement sets the procedures for meetings, including notice requirements, the quorum requirements, voting rights (one vote for each one unit), the chair, etc. Article 9.21 stipulates that any action to remove the general partner shall not be effective until the Limited Partnership has received the opinion of legal counsel on the effects that such a removal may have on the limited liability of the limited partners.

[196] Mr. LoFaso submitted that pursuant to Article 10.04 of the Partnership Agreement, the removal of the general partner must be for cause and in accordance with Article 10.05. Mr. LoFaso acknowledged during the course of oral argument that the court had jurisdiction to remove the general partner but that the court ought not to do so in the subject circumstances.

[197] Mr. LoFaso addressed the procedure for the removal of the general partner. He submitted that the removal of the general partner by the limited partners must be done by an ordinary resolution, which requires a quorum of not less than 2 persons representing 50% of the units. He further submitted that the combined effect of s. 18(6) of the *Limited Partnerships Act* and Article 3.21 of the Partnership Agreement preclude Janet M from voting to remove Snapdragon as general partner. Leaving aside the correctness of Mr. LoFaso's interpretation of the combined effect of the *Act* and Article 3.21 when neither PM nor a controlled corporation is the general partner, these arguments support the practical need to determine this issue outside the procedural restrictions of the Agreement. In light of the history of this dispute, it is most unlikely that the process to remove the general partner would be completed in a co-operative spirit but, to the contrary, it is likely that there would be endless disputes over the interpretation and application of the procedural requirements. Even if Janet M follows all the procedural requirements of Articles 9 and 10, Mr. Posner's corporations have the controlling vote on an ordinary resolution to remove the general partner. I conclude that the removal of the general partner pursuant to the procedural provisions under the Partnership Agreement would not resolve this issue in a timely, co-operative or fair manner.

[198] The difficult issue is whether the court should order the removal of Snapdragon as the general partner. The jurisprudence on this issue is sparse and divided. In *Bates v. Brownstones East II Properties Ltd.*[48]⁵² the plaintiffs applied to the court to remove the defendant as general partner and to appoint a new one. In that case, the defendants refused to provide information to the limited partners. The limited partners obtained a mandatory order for the general partner to produce the requested information and subsequently obtained an order for the appointment of a receiver. The court found that the general partner and its solicitor continued to stonewall the limited partners. O’Driscoll J. removed the defendant as general partner and appointed a new general partner because he lacked confidence that the incumbents would fulfill their duties.

[199] In *Colville-Reeves v. Canadian Home Publishers*,[49]⁵³ the plaintiff was a limited partner who invested capital and the defendant general partner managed the business. The partnership was formed when the plaintiff and defendant were married. The plaintiff’s application to recover his capital investment and to remove the general partner was made after a breakdown in the matrimonial relationship. There was no written partnership agreement. D. Lane J. found there was no conclusive agreement between the parties as to how the plaintiff was to recover his capital contributions and as such, there was no basis for such a declaration. D. Lane J. also found there were no grounds to remove the general partner.

[200] Because D. Lane J. found that the *Limited Partnerships Act* did not authorize the court to remove the general partner, he found that the remedies open to a disaffected partner are limited to withdrawal, appointment of a receiver or a motion to wind-up. He respectfully declined to follow the decision of O’Driscoll J in *Bates*. I point out that there was no finding of mismanagement or a breach of the partnership agreement in *Colville-Reeves*. Also, there was no suggestion of bad faith or a breach of any fiduciary duty by the general partner. In my view, there was no basis in fact or law to remove the general partner in the *Colville-Reeves* case.

[201] The future relationship of the parties in a continued partnership is a relevant factor. The defendants have resisted recognizing the plaintiff as a limited partner for more than 10 years. The parties were unable to resolve their differences concerning Snapdragon’s demand to satisfy a procedural requirement, namely to file a Form 20 with the OSC. Given the history of the litigation, it is most unlikely that Snapdragon would be co-operative or that Snapdragon and Janet M would be able to resolve future disagreements. The proceedings since 2002 have been acrimonious and marked by uncivil conduct by counsel both prior to and during the course of argument before me. In my view, the antagonistic behaviour of both counsel militated against a proper resolution of this matter and adversely affected the oral advocacy before me. I find that there is no reasonable expectation that the parties or their counsel will co-operate in the future in a mutually beneficial manner to resolve the capital distribution or to whom the monies are owed.

52. [1993] O.J. No. 717 (Gen. Div.).

53. [1993] O.J. No. 3367 (Gen. Div.).

[202] If the court lacks the authority to remove the general partner as found by Lane J. in *obiter*, Janet M would be limited to the remedies set out in the *Limited Partnerships Act*. Alternatively, Janet M could attempt to remove Snapdragon under the Partnership Agreement. Assuming Janet M takes all the necessary steps to comply with the procedural requirements of Articles 9 and 10 of the Partnership Agreement, and she obtains a favourable ruling from the arbitrator, the likely outcome of an ordinary resolution of the limited partners will be determined by Mr. Posner's voting control. Mr. Posner and Mr. Cale decided to pay a mortgage fee to Snapdragon and to distribute the proceeds from the refinancing in contravention of the terms of the Partnership Agreement and Snapdragon's fiduciary duties. It is apparent that Mr. Posner and Mr. Cale have worked together in the past and the former would likely support Snapdragon's continuance as the general partner in the future.

[203] In limited partnerships, it is not uncommon for disputes to arise because of the partnership's commercial nature. In some limited partnership activities, a conflict of interest may arise between the goals of the business enterprise and the desire of a limited partner(s) to receive a return on capital. Such was the case in *Colville-Reeves*. However, this conflict may be part of the normal limited/general partner relationship because of the commercial nature and structure of a particular limited partnership. In other limited partnerships, the venture may contemplate a conflict of interest between the business activity of general partner and limited partners.[50]⁵⁴ The venture's direction and day-to-day operational decisions are part of the general partner's managerial function and in this area the courts would be reluctant to intervene. It is clear that if, as in *Colville-Reeves*, there is no breach of a partnership agreement or a fiduciary duty, and the general partner is performing his or her managerial duties with reasonable skill and in good faith, there is no basis for the removal of the general partner.

[204] The question that arises is whether the court has the power to remove a general partner in the absence of statutory authority where the general partner acted in bad faith toward one limited partner, breached its obligations under the Partnership Agreement, breached its fiduciary duties at common law and under the Agreement, and breached its covenant and warranty to act with utmost fairness. Is the limited partner, who has done nothing wrong, forced to continue in a partnership arrangement with the general partner for whom there is a *bona fide* lack of confidence? I find that the Superior Court has the inherent jurisdiction to remove the general partner in the special circumstances of this case. I rely upon the decision of O'Driscoll J. in *Bates v. Brownstones East II Properties Ltd.* as authority for this conclusion.

[205] Janet M did not demand a voice in management or a change in the partnership's direction; rather, she only sought the rights and responsibilities of a substituted limited partner. She has pressed this claim since 1993. Since 1998, the general partner has engaged in conduct that has prejudicially affected its relationship with Janet M. An aggravating factor is that Snapdragon's misconduct has increased in severity and was most egregious in 2003 during the course of the litigation. I find that Snapdragon's conduct, objectively viewed, would erode the trust and confidence of a limited partner and has unilaterally undermined the continued maintenance of the partnership relationship.

54. See 337965 *B.C.Ltd. et al v. Tackama Forest Products Ltd. et al* (1992), 1992 CanLII 5964 (BC CA), 67 B.C.L.R. (2d) 1 (B.C.C.A.).

[206] Snapdragon was neither the initiator of the project nor did it find the investors. Snapdragon is a professional management company that came on the scene after the financing was in place and the limited partnership was operational. Snapdragon does not possess unique skills that are needed for the continuation of the partnership. A review of Mr. Cale's evidence shows that he was not interested in performing the routine matters of governance, such as calling annual meetings, and his evidence demonstrates a professed lack of knowledge of the activities of the partnership.

[207] The plaintiff Janet M is a limited partner that Snapdragon has mistreated. Snapdragon has continuously engaged in conduct that undermines a future relationship with Janet M. It has breached the Partnership Agreement relating to core partnership principles and it has allowed its own self-interest to take precedence over the interests of the limited partners. I find that Janet M would have a justifiable lack of confidence in Snapdragon's ability to exercise its powers in good faith and in the interests of the limited partners. I find that it is not reasonably practicable for Snapdragon to carry on the business because of its own actions and not Janet M's. When weighing the equities of the case, I find that the general partner should be removed.

[208] Concerning the future of the Limited Partnership, Mr. Posner has a conflict of interest between his role as auditor and controlling limited partner. The Limited Partnership must retain an independent auditor to audit the Partnership's books and records and to calculate the distribution of the cash receipts and the proceeds from the refinancing. This is a necessary step to restore confidence in the Limited Partnership's financial affairs. Since Janet M may have liabilities as a substituted limited partner from 1989, and since the original limited partners' capital accounts must be determined, an independent auditor must conduct a proper audit. I find that the limited partners must appoint a new auditor. In the special circumstances of this case, I order that Janet M and Mr. Posner, the substituted limited partners representing 100% of the units, must jointly agree on the appointment of the new auditor.

ii. Conclusion

[209] I order the removal of Snapdragon as the general partner for all the reasons stated above. A new general partner shall be selected pursuant to the procedure set out in paragraph 208.

VI: COSTS

[210] Parties may address the issue of costs. I received submissions from counsel on this issue during the course of the hearing and I will consider any additional submissions on the issue of costs. The plaintiff shall have 30 days to make its submissions (5 pages plus appendices). The defendant will have 20 days to respond (5 pages plus appendices).

Bryant J.

Released: October 12, 2004

COURT FILE NO.: 96-CU-114241

DATE: 2004/10/12

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

JANET MERKLINGER

Plaintiff/Applicant

- and -

JANTREE NO. 3 LIMITED PARTNERSHIP & SNAPDRAGON LTD.

Defendant/Respondent

REASONS FOR JUDGMENT

BRYANT J.

Released: October 12, 2004

TAB 14

At para(s) 211-217 (dissent)

DBDC Spadina Ltd. v. Walton, 2018 ONCA 60 (CanLII)

Date: 2018-01-25

File number: C62822

Other citations: 419 DLR (4th) 409 – 288 ACWS (3d) 75 – 78 BLR (5th) 183 – 33 ETR (4th) 173 – 56 CBR (6th) 174 – [2018] CarswellOnt 1571 – [2018] OJ No 578 (QL)

Citation: **DBDC Spadina Ltd. v. Walton, 2018 ONCA 60 (CanLII)**, <<https://canlii.ca/t/hq5mc>>, retrieved on 2024-05-06

Most recent unfavourable mention: Wayne Safety Inc. v Gendelman et al, 2024 ONSC 1642 (CanLII)

COURT OF APPEAL FOR ONTARIO

CITATION: DBDC Spadina Ltd. v. Walton, 2018 ONCA 60

DATE: 20180125

DOCKET: C62822

Cronk, Blair and van Rensburg JJ.A.

BETWEEN

DBDC Spadina Ltd., and
Those corporations listed on Schedule A hereto
Applicants (Appellants)
and

Norma Walton, Ronauld Walton, The Rose & Thistle Group Ltd., and Eglinton Castle Inc. and those corporations listed on Schedule C hereto

Respondents (Respondents)

and

Those corporations listed on Schedule B hereto,

to be bound by the

result

and

Such other respondents from time to time as are on notice of these proceedings and are necessary to effect the relief sought

AND BETWEEN

Christine DeJong Medicine Professional Corporation

Applicant (Respondent)

and

Norma Walton, Ronald Walton, and The Rose & Thistle Group Ltd., Prince Edward Properties Ltd., St. Clarens Holdings Ltd., and Emerson Developments Ltd.

Respondents (Respondents)

Peter H. Griffin and Shara N. Roy, for the appellants, DBDC Spadina Ltd. and those corporations listed on Schedule A hereto

Rosemary A. Fisher and B. Sarsh, for the respondents, Christine DeJong Medicine Professional Corporation and Dennis and Peggy Condos

Mark Dunn, for Schonfeld Inc., Inspector/Manager

A. Blumenfeld, for the respondents, Gideon and Irene Levytam

Heard: June 2, 2017

On appeal from the Judgments and Orders of Justice Frank Newbould of the Superior Court of Justice, dated September 23, 2016, with reasons reported at 2016 ONSC 6018, 40 C.B.R. (6th) 230, and the costs order dated November 28, 2016, with reasons reported at 2016 ONSC 7011.

R.A. Blair J.A.:

BACKGROUND

[1] This appeal arises out of a complex multi-million dollar commercial real estate fraud perpetrated by Norma and Ronald Walton over the course of several years.

[2] The appellants and the respondents are all victims of the fraud. Underlying the issues on appeal is a contest between them over who ranks in priority to whom in claiming against the proceeds remaining from the sale of certain properties acquired as part of the fraudulent scheme.

[3] In substance, the fraudulent scheme worked in this fashion: the Waltons convinced the appellants and respondents, and others, to invest “equally” with them in equal-shareholder, specific-project corporations that would acquire, hold, renovate and maintain commercial real estate properties in the Toronto area. Instead of investing any significant funds of their own, however, the Waltons moved their investors’ monies in and out of the numerous corporations, through their own “clearing house” – Rose & Thistle Group Ltd. – in a shell game designed to avoid their obligations and to further their own personal interests.

[4] The appellant corporations, known as the DBDC Applicants, are owned and controlled by Dr. Stanley K. Bernstein. Through them, Dr. Bernstein invested approximately \$111 million with the Waltons, in 31 projects, between September 2010 and June 2013. In each instance, the individual DBDC applicant entered into an equal shareholding agreement with the Waltons with respect to the specific-project corporation that was to acquire and hold the particular property. The corporations into which the DBDC Applicants’ monies were to be invested are known as the “Schedule B Companies”. These investments took the form of equity (approximately \$2.6 million), shareholder loans (\$78.5 million) and mortgages (\$29.5 million).[1]⁵⁵

[5] The respondent, Christine DeJong Medicine Professional Corporation (“DeJong”), is owned and controlled by Dr. Christine DeJong. She and her husband, Michael DeJong, invested approximately \$4 million with the Waltons – Dr. DeJong through DeJong, and Michael through his own corporations. Those investments were made in equal shareholder arrangements in substantially the same form as those entered into between the Waltons and the DBDC Applicants. The specific-project corporations established for the purposes of the DeJong investments are included in the group of companies known in the proceedings as the “Schedule C Companies”. The properties acquired by the Schedule C Companies are collectively known as the “Schedule C Properties”.

[6] The individual respondents, Dennis and Peggy Condos, and Gideon and Irene Levytam, made similar, but smaller investments in the same fashion. Their interests are also in relation to certain of the Schedule C Companies and the Schedule C Properties those companies acquired. The Condos’ claim is in relation to a \$160,000 investment in one company. The Levytams claim a net investment of \$337,000. Prior to the oral hearing of the appeal, the DBDC Applicants and the Levytams settled and the Levytams did not participate further in the appeal.

[7] None of the agreements contemplated third-party investors in the projects. None permitted the investors’ monies to be used for anything other than the purposes of the specific-project investment.

55. The mortgages are not directly at issue in these proceedings.

[8] The decision under appeal involves parts of Judgments and Orders made by Newbould J. on September 23, 2016. It comes at the back end of a lengthy and complex oppression remedy application commenced by the DBDC Applicants against the Waltons and Rose & Thistle, in October 2013, pursuant to Ontario's *Business Corporations Act*, R.S.O. 1990, c. B. 16. Various Schedule C Companies were subsequently added as respondents.

Appointment of the Inspector

[9] In an endorsement dated October 7, 2013, Newbould J. concluded that the Waltons' conduct was oppressive and unfairly prejudicial to the DBDC Applicants' interests in the Schedule B Companies. He appointed Schonfeld Inc. as an Inspector over the Schedule B Companies.

Appointment of the Inspector as Manager

[10] After an initial review by the Inspector of the affairs of the Schedule B Companies and the conduct of the Waltons, Newbould J. confirmed his view that the Waltons' conduct had been oppressive, and on November 5, 2013 appointed Schonfeld Inc. as Manager of the Schedule B Companies (and the Schedule B Properties held by them), thereby taking control of the Schedule B Companies away from the Waltons.

The Proceedings Before D.M. Brown J.

[11] In July, 2014, after further review by the Inspector/Manager – referred to in more detail below – the DBDC Applicants applied to D.M. Brown J. (as he then was), at a hearing in the same proceedings, for various forms of relief. The range of relief claimed evolved over the course of the hearing. As Brown J. noted, this flowed from the clearer, but still incomplete, picture emerging from the expanded scope of the Inspector's role following the October 2013 Order and its subsequent investigations (at paras. 213-217). By the end of the hearing – as outlined by Brown J. in his reasons (at paras. 214 and 240-243) – the relief sought by the DBDC Applicants included the following:

- (a) declarations that the DBDC Applicants were entitled to constructive trusts where their funds could be traced directly into the purchase of, or the discharge of an encumbrance, with respect to a Schedule C Property;
- (b) damages as against the Waltons personally for civil fraud and fraudulent misrepresentation;
- (c) damages against the Schedule C Companies, jointly and severally, for all losses suffered by the DBDC Applicants in respect of funds advanced to the Schedule B Companies; and
- (d) damages in the amount of \$23.6 million against the Schedule C Companies, jointly and severally, for net proceeds diverted from the Schedule B Companies and received by the Schedule C Companies.

[12] The application was opposed by the Waltons.

[13] At the same time, DeJong (and other related companies controlled by the DeJongs) brought a cross-motion asking for the approval of a settlement it had reached with the Waltons, and opposing the DBDC Applicants' constructive trust claim with respect to 3270 American Drive, a Schedule C Property owned by the Schedule C Company, United Empire Lands Ltd., in which DeJong had invested. Numerous Schedule C investors, including Dr. DeJong, Dennis Condos and the Levytams, filed affidavits in support of the Waltons' position and in opposition to the Applicants' claims.

[14] On August 12, 2014, Brown J. released his decision. He gave full and detailed reasons in the course of which he made findings of fact almost universally against the Waltons and in favour of the DBDC Applicants and Dr. Bernstein. In the end, he concluded, at para. 15, that:

[T]he Waltons did not use the funds advanced to them by the [DBDC] Applicants as their contracts required but, instead, the Waltons mis-used and mis-appropriated most of the funds advanced to them, diverting some of the funds to their own personal benefit and the benefit of their Schedule C Companies. [Emphasis added.]

[15] It bears repeating that the Schedule C Companies were the specific-project corporations with respect to which the Waltons and other investors – including DeJong, the Condos and the Levytams – had entered into equal shareholder agreements in substantially the same form as those entered into between the DBDC Applicants and the Waltons with respect to the Schedule B Companies.

[16] The Inspector gave evidence at the hearing. Brown J. accepted the Inspector's evidence with respect to the "net transfer" of funds from Schedule B Companies to Rose & Thistle and from Rose & Thistle to Schedule C Companies, and made the following findings of fact:[2]⁵⁶

- (i) the Waltons directed the transfer of a net \$23.6 million from the Schedule B Companies' accounts to a bank account belonging to Rose & Thistle during the period from October 2010 to October 2013;
- (ii) during the same period, the Waltons directed transfers of a net \$25.4 million from the Rose & Thistle account to the Schedule C Companies;
- (iii) in almost all cases, some of or all the amounts advanced to the Schedule B Companies by the DBDC Applicants were transferred almost immediately to the Rose & Thistle account; and
- (iv) those transfers of funds from the Schedule B Companies to Rose & Thistle constituted breaches of the agreements between the DBDC Applicants and the Waltons. These agreements required that each Schedule B Company, and the funds advanced to it, be used only to purchase, renovate and refinance the specific property owned by the Schedule B Company.

56. Brown J.'s findings remain operative because they were made in the same oppression remedy proceedings involving the same parties and the same issues; he had simply postponed a decision on the matters now under appeal, which were subsequently heard by Newbould J. following Brown J.'s appointment to this Court.

[17] Ms. Walton's expert witness at the hearing had criticized the net transfer analysis as unhelpful on the ground that it presented only a "snapshot" tracing which, while accurate in itself, did not reflect the history of transfers into and out of Rose & Thistle and any Schedule C Company, and therefore lacked precision. Brown J. rejected this evidence. He concluded that condemning the Inspector's tracing analysis on this basis "amounted to nothing more than chipping away at the edges of inter-company transfers which the Waltons should never have made [in the first place]" (at para. 161).

[18] In addition to his findings respecting the "net transfer" analysis, Brown J. also found, at paras. 96 and 186-187, that:

- (i) the pooling or co-mingling of funds, as described above, was a critical breach of the contractual and fiduciary obligations which the Waltons owed to the DBDC Applicants and Dr. Bernstein;
- (ii) the DBDC Applicants were not aware that the Waltons were withdrawing funds from the Schedule B Companies' bank accounts for any purpose other than the costs of the relevant associated properties;
- (iii) the DBDC Applicants did not know that funds from Schedule B Companies were transferred or diverted to the Rose & Thistle "clearing house" bank account because the Waltons, in particular Ms. Walton, deliberately hid those transfers from the Applicants;
- (iv) the Waltons deliberately did not tell the DBDC Applicants that they were using funds advanced by the Applicants for their own personal purposes and benefit and for the benefit of the Schedule C Companies which they owned or controlled; and
- (v) throughout the proceedings, Norma Walton "presented herself to the Court, through her affidavits and through her submissions, as the person who was in charge of the entire enterprise, whether it be the operation of the Schedule B Companies, Rose & Thistle or the Schedule C Companies" (emphasis added).

[19] In the result, Brown J.:

- awarded the DBDC Applicants constructive trusts over eight Schedule C Properties into which the DBDC Applicants could trace Schedule B funds, including the property at 3270 American Drive (which was specifically opposed by DeJong);
- appointed Schonfeld Inc. as Receiver/Manager over the Schedule C Properties and any proceeds of sale thereof, and over the bank accounts of the Schedule C Companies;
- dismissed the DeJong request for approval of the settlement with the Waltons, finding in fact that the proposed settlement constituted an improper and unfair attempt to prefer DeJong over other creditors of the Waltons, including Dr. Bernstein;

- granted the DBDC Applicants a tracing order permitting them to trace their funds into and out of the various Schedule B Companies' accounts, the Rose & Thistle accounts, the Waltons' personal accounts, and others, and into the Schedule C Companies owning the Schedule C Properties;
- deferred the issues of the quantum of the DBDC Applicants' claim for damages as against the Waltons, and the DBDC Applicants' \$22.6 million claim against the Waltons in respect of the Schedule C Companies for unjust enrichment, to be determined at a later time; and
- left undetermined the DBDC Applicants' claims for joint and several damages against the Schedule C Companies.

[20] Appeals by Ms. Walton and DeJong from Brown J.'s Judgment and Orders were dismissed by this Court on September 17, 2015.

[21] This brings us to the proceedings leading to the present appeal.

The Decision Under Appeal

[22] On June 3, 2016 Newbould J. (the "Application Judge")^[3]⁵⁷ heard the motion and application for deferred relief, as well as the claims for joint and several damages against the Listed Schedule C Companies, sought by the DBDC Applicants. The relief requested was framed at this point as: (i) a claim for damages against the Waltons personally, in the amount of \$66,951,021.85, plus interest; and (ii) a claim for damages in the amount of \$22,680,852 as against certain of the Schedule C Companies (the "Listed Schedule C Companies"), on a joint and several basis, based on the concepts of "knowing assistance" and "knowing receipt" in relation to a breach of fiduciary duty.

[23] At the same time, the Application Judge heard: (i) a counter-application by the Waltons claiming damages as against Dr. Bernstein personally for diminishing the value of their equity in the Schedule B and C Companies by bringing the Inspector and Manager/Receiver motion; (ii) an application by DeJong for constructive trust claims in relation to certain Schedule C Companies and Properties (or the proceeds of sale of those properties) respecting which DeJong had made investments in the form of equity or shareholder loans; and (iii) an application by the Condos and Levytams for entitlement to sale proceeds as investors in one of the Schedule C Companies (Cecil Lighthouse Ltd.).

[24] On September 23, 2016, the Application Judge released the decision under appeal. He:

- awarded the DBDC Applicants damages in the amount of \$66,951,021.85, plus interest, as against the Waltons personally, for fraudulent misrepresentation, deceit (civil fraud), and breach of fiduciary duty, and declared that the damage award would survive bankruptcy;

57. Brown J. had been appointed to this Court in the interim.

- dismissed the DBDC Applicants' claim for joint and several damages against the Listed Schedule C Companies, concluding that Norma Walton was not the controlling mind of the Listed Schedule C Companies and therefore, that they could not be liable for knowing assistance or knowing receipt arising out of her breach of fiduciary duty;
- granted DeJong constructive trusts in the aggregate amount of \$2,176,045.57 against four properties owned by four of the Listed Schedule C Companies into which the DeJongs had invested;
- awarded costs against the DBDC Applicants in favour of DeJong, the Condos and the Levytams, further particularized in a Costs Endorsement dated November 28, 2016; and
- dismissed the Waltons' counter-application for damages.[4]⁵⁸

[25] The Application Judge did not determine the claims of the Condos or the Levytams, and he did not deal with the DBDC Applicants' claim for unjust enrichment as such.

[26] I have read the thorough dissenting reasons of my colleague, van Rensburg J.A., and will address her concerns from time to time throughout these reasons. I pause here, however, to touch briefly on one aspect of her reasons.

[27] My colleague devotes considerable time to developing what she characterizes as the DBDC Applicants' "late-breaking claims for damages against the Listed Schedule C Companies". As I understand it, she does so to emphasize that the record on which liability for damages is sought to be established was created in the context of oppression remedy proceedings in which the Listed Schedule C Companies were not parties and that there are no new or additional facts to support their participation in Ms. Walton's breach of fiduciary duty.

[28] Respectfully, for purposes of resolving the appeal, I do not think much turns on when or how the knowing receipt and knowing assistance claims arrived to be dealt with by the Application Judge, and I do not propose to examine the record on this point in any more detail than I have done above. Suffice it to say, I take a different view of it than my colleague does, not only with regard to the extent of DeJong's participation in the proceedings prior to the hearing before the Application Judge, but also with respect to what issues were before Brown J. and either deferred or not dealt with by him and with respect to the need for the Listed Schedule C Companies to have been made parties (which Brown J. rejected) before they were.

[29] These differences have little significance for the outcome of the appeal, in my opinion. No one took the position before the Application Judge, or before this Court, that the DBDC Applicants' claim for joint and several damages against the Listed Schedule C Companies, based on knowing assistance and

58. The Waltons filed a Notice of Appeal from the orders of the Application Judge. Their appeal was dismissed for delay on March 20, 2017.

knowing receipt, was not properly raised at the hearing before him.[5]⁵⁹ Nor has it been asserted that the evidence adduced before Brown J. and the findings of fact made by him could not be relied upon at the hearing. Indeed, the Application Judge himself relied upon them to a great extent.

[30] More importantly, much of what underlies our disagreement with respect to the outcome of the appeal are the differing approaches we take to the utility and sufficiency of what the net transfer analysis demonstrates and does not demonstrate, not the context in which it was developed.

[31] The net transfer analysis remains evidence for what it is. No one disputes it established a net transfer of \$23.5 million out of the Schedule B Companies (both Brown J. and the Application Judge made that finding). I conclude this evidence is valuable in assessing the Listed Schedule C Companies' knowing assistance in Ms. Walton's breach of fiduciary duty and in establishing damages. My colleague takes a different view. I agree that the net transfer analysis was not intended to, and does not, establish the flow of Schedule B Companies' funds into any particular Listed Schedule C Company account.[6]⁶⁰ My colleague concludes this is fatal to the knowing assistance claim. For the reasons set out below, I disagree.

[32] As I see it, the resolution of these differences does not depend on the history of the evolution of the DBDC Applicants' claims.

The Schedule C Companies at Issue on Appeal

[33] In referring to the "Listed Schedule C Companies" above, I am referring to a remaining subset of the Schedule C Companies against which the DBDC Applicants continue to pursue their claim for joint and several damages. The list includes some of, but not all, the Schedule C Companies that own Schedule C Properties against which Brown J. awarded constructive trusts in favour of the DBDC Applicants. It also includes the Schedule C Companies that acquired the four Schedule C Properties over which the Application Judge granted constructive trusts in favour of DeJong. For ease of reference, I will refer to those four Schedule C Companies collectively, where appropriate, as "the DeJong Companies".

[34] The Listed Schedule C Companies, and the Schedule C Properties they hold, are set out on Annexe A to these reasons.

THE ISSUES ON APPEAL

[35] The issues to be determined on the appeal are whether the Application Judge erred:

59. These same observations apply with respect to the counter-application of DeJong for constructive trusts, which was asserted for the first time before the Application Judge.

60. Other than those relating to Schedule C Properties against which constructive trusts were ordered.

- (a) in holding that the Listed Schedule C Companies are not jointly and severally liable to the DBDC Applicants on the basis of knowing assistance and/or knowing receipt;
- (b) in granting DeJong constructive trusts over the Listed Schedule C Properties in question; and
- (c) in awarding costs against the DBDC Applicants.

[36] For the reasons that follow, I would allow the appeal.

ANALYSIS

A. KNOWING RECEIPT

[37] A stranger to a trust or fiduciary relationship may be liable under the doctrine of “knowing receipt” if the stranger receives trust property in his or her own personal capacity with constructive knowledge of the breach of trust or fiduciary duty. It is a recipient-based claim arising under the law of restitution: see *Citadel General Assurance Co. v. Lloyds Bank Canada*, 1997 CanLII 334 (SCC), [1997] 3 S.C.R. 805, at para. 48.

[38] I agree with the Application Judge that a claim for knowing receipt cannot be made out here. The DBDC Applicants chose not to pursue their rights under the tracing order granted by Brown J. They are not able to – nor do they seek to – demonstrate the receipt of any particular funds by any particular Schedule C Company other than the funds with respect to which Brown J. previously granted constructive trusts.

[39] Accordingly, I will not conduct a separate analysis of the knowing receipt claim, but will refer to it, where appropriate, in the discussion about the claim for “knowing assistance”.

B. KNOWING ASSISTANCE

(1) General Considerations

[40] A stranger to a trust or fiduciary obligation may also be liable in equity on the basis of “knowing assistance” where the stranger, with actual knowledge, participates in or assists a defaulting trustee or fiduciary in a fraudulent and dishonest scheme. The rationale underlying this category of liability is that actual knowledge of and assistance in the fraudulent conduct is sufficient to “bind the stranger’s conscience so as to give rise to personal liability”: see *Air Canada v. M & L Travel Ltd.*, 1993 CanLII 33 (SCC), [1993] 3 S.C.R. 787, at p. 812. Fraudulent and dishonest conduct for these purposes means the taking of a risk by the trustee or fiduciary to the prejudice of the beneficiary where the risk is known to be one which there is no right to take: see *Air Canada*, at pp. 815, 826.[7]⁶¹

[41] Knowing assistance and knowing receipt are both doctrines arising in equity. However, there is a fundamental difference between the two types of liability. Knowing receipt liability is restitution-based and falls within the law of restitution; its essence is unjust enrichment. Knowing assistance, however – sometimes referred to as “accessory liability” – is fault-based and is concerned about correcting matters related to the furtherance of fraud: see *Gold v. Rosenberg*, at para. 41; *Citadel General*, at paras. 46-48. I shall return to this distinction later in these reasons.

[42] The criteria for establishing a claim for knowing assistance in the breach of a fiduciary duty were summarized by this Court in *Harris v. Leikin Group Inc.*, 2011 ONCA 790, at para. 8, and again in *Enbridge Gas Distribution Inc. v. Marinaccio*, 2012 ONCA 650, 355 D.L.R. (4th) 333, at para. 23. They are the following:

- (i) there must be a fiduciary duty;
- (ii) the fiduciary – in this case, Ms. Walton – must have breached that duty fraudulently and dishonestly;
- (iii) the stranger to the fiduciary relationship – in this case, the Listed Schedule C Companies – must have had actual knowledge of both the fiduciary relationship and the fiduciary’s fraudulent and dishonest conduct; and
- (iv) the stranger must have participated in or assisted the fiduciary’s fraudulent and dishonest conduct.

(2) The Issues In Applying The Criteria

[43] In determining whether the foregoing criteria have been met and whether the Listed Schedule C Companies are to be held jointly and severally liable for damages arising from knowing assistance in the breach by Ms. Walton of her fiduciary duties to the DBDC Applicants, there are three overarching questions to be answered:

- (i) Was Norma Walton the directing and controlling mind of the Listed Schedule C Companies for purposes of the transactions through which her fraud was perpetrated, such that her knowledge and conduct in that regard may be attributed to the Companies as their knowledge and conduct?
- (ii) If the answer to that question is “yes”, does it follow that the knowledge and participation requirements for knowing assistance have been met with respect to those Listed Schedule C Companies utilized by Ms. Walton in the course of perpetrating her scheme?

61. Other Canadian and British authorities in which the principles relating to “knowing assistance” and “knowing receipt” are outlined and developed include the following: *Gold v. Rosenberg*, 1997 CanLII 333 (SCC), [1997] 3 S.C.R. 767, at paras. 30-36, per Iacobucci J. (dissenting, but not on this point); *Citadel General*; *Barnes v. Addy* (1874), L.R. 9 Ch. App. 244; *Agip (Africa) Ltd. v. Jackson*, [1992] 4 All E.R. 451 (C.A.); *El Ajou v. Dollar Land Holdings plc*, (1993), [1994] 2 All E.R. 685 (C.A.).

- (iii) If the answer to the foregoing question is “yes”, are the Listed Schedule C Companies nonetheless able to avoid joint and several liability in damages on the basis that knowing assistance liability, having its roots as an equitable doctrine, ought not to apply here?

[44] My answer to the first and second questions is “Yes” and to the third is “No”. I say that for the following reasons.

(3) Application of the Criteria

(a) Fiduciary Considerations

[45] As the Application Judge concluded, there is no issue in the present case that Ms. Walton owed a fiduciary duty to the DBDC Applicants and Dr. Bernstein, or that she fraudulently breached that duty. At para. 47 of his reasons, he found that:

There is no question that Ms. Walton knowingly breached her fiduciary obligations to the [DBDC Applicants] and that she knowingly took a risk with the money belonging to the Schedule B Companies that she had no right to take. Her activity in so doing was fraudulent and dishonest.

[46] No one contests this finding. Indeed, at the hearing before the Application Judge, the Schedule C investors all relied upon the same submission, and the same type of relationship on their part. DeJong continues to do so in asserting its claim for a constructive trust in the Listed Schedule C Properties that were the subject of its cross-motion.

[47] The Application Judge’s finding is well-supported on the evidence. Ms. Walton owed a fiduciary duty to Dr. Bernstein and the DBDC Applicants arising out of their contractual relationship, viewed in the context of their overall relationship and the manner in which the co-investments strategy was to be carried out.

[48] A contractual relationship does not necessarily give rise to fiduciary duties, obviously, but it may, depending on the nature of the relationship and the overall relationship between the parties. In *Korea Data Systems (USA), Inc. v. Amazing Technologies Inc.*, 2015 ONCA 465, 126 O.R. (3d) 81, at para. 74, this Court reiterated the criteria for a fiduciary relationship, as set out by the Supreme Court of Canada in *Frame v. Smith*, 1987 CanLII 74 (SCC), [1987] 2 S.C.R. 99, at p. 136, *Hodgkinson v. Simms*, 1994 CanLII 70 (SCC), [1994] 3 S.C.R. 377, at p. 462, and *Galambos v. Perez*, 2009 SCC 48, [2009] 3 S.C.R. 247, at para. 66: (i) the fiduciary has scope for the exercise of some discretion or power; (ii) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or practical interests; (iii) the beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power; and (iv) there exists an express or implied undertaking by the fiduciary to act in accordance with the duty of loyalty reposed in him or her.

[49] Here, the nature of the responsibilities and duties (and opportunities) created by the contractual structure, together with the nature of the factual relationship as it developed, put Ms. Walton in that category. It was the discretion and power left to her under the contracts that created the opportunities for her to utilize the various corporations that she *de facto* or otherwise controlled and the vulnerability of the DBDC Applicants (and the DeJongs and others) to the very things that happened.

[50] It is true that Dr. Bernstein, through the DBDC Applicants, made his contributions directly to the Schedule B Companies (for the most part) rather than handing the money over to Ms. Walton, but given the contractual and corporate structuring of the investments program, it was tantamount to doing that very thing. As Brown J. found, at para. 161, “The [Waltons] had complete control over all of the funds.”[8]⁶²

[51] The liability of the Listed Schedule C Companies – the “strangers” to the fiduciary relationship in this scenario – therefore turns on a determination of the third and fourth requirements for knowing assistance: their actual knowledge of the fiduciary relationship and the fraudulent breach, and their participation or assistance in the breach itself. The resolution of those issues depends primarily on whether Ms. Walton acted as the directing and controlling mind of the Schedule C Companies in question, such that her actions may appropriately be attributed to them for these purposes.

(b) The Application Judge’s Decision

[52] The Application Judge dismissed the DBDC Applicants’ claim on the basis that Ms. Walton was not the directing and controlling mind of the Listed Schedule C Companies, and accordingly that her knowledge and conduct could not be taken to be their knowledge and conduct for the purpose of the knowing assistance claim. He did not focus, therefore, on the participation element.

[53] The Application Judge arrived at this decision because of the provisions in the Schedule C shareholder/investment agreements entered into between the Waltons and the Schedule C investors. Under those agreements:

- (a) the Waltons and the investors were each to be 50% owners of the shares and each held 50% of the positions on the board of directors;
- (b) the company into which the investments were to be made was to be used solely for the property to be purchased;

62. In general, my colleague accepts the foregoing analysis, but suggests there are difficulties in asserting a claim through the Schedule B Companies because their losses were caused by the fraudulent actions of an insider, Ms. Walton, and that the claim could be met with an *ex turpi causa* defence: see *Livent Inc. v. Deloitte & Touche*, 2017 SCC 63, varying 2016 ONCA 11. The DBDC Applicants are the claimants, however, and their controlling and directing mind is that of Dr. Bernstein. There is no fraud on the part of Dr. Bernstein to be attributed to the DBDC Applicants. In these circumstances, there is little likelihood an *ex turpi causa* defence would arise, in my opinion. Nor was it argued.

- (c) the Waltons were to be responsible for the management, supervision and renovation of the property, as well as finance, bookkeeping, and “all active roles required to complete the Project”;
- (d) any significant decisions that differed from the project plan required more than 50% shareholder approval; and
- (e) if the parties disagreed on how to manage, supervise and complete construction of the project, there was to be mandatory mediation and arbitration.

[54] The Application Judge went on to conclude, at paras. 51-53:

Thus, in so far as the Schedule C Companies are concerned and their investors, Ms. Walton may have acted as if she was the sole decision maker in the Schedule C Companies, but she was not. She and her husband were 50% owners with the right to exercise 50% of the significant decisions. There is no evidence that the other investors were aware of the fraudulent conduct of Ms. Walton.

...

It would be contrary to the Schedule C investor agreements to hold that Ms. Walton could cause the Schedule C investors to be a party to her fraudulent dealings with Dr. Bernstein. Thus I cannot find that the Schedule C Companies are liable to the [DBDC Applicants] for knowing assistance. [Emphasis added.]

[55] Respectfully, I do not think this conclusion is sustainable either in law or in fact on this record.

[56] The error of law arises in two respects. First, the Application Judge failed to recognize that, for purposes of attribution and determining whether a person is the controlling mind and will of a corporation with respect to a particular transaction or series of transactions, the formal governing structure established by the contractual and corporate documentation is not dispositive. What matters is the factual reality of the situation and whether Norma Walton was acting “within the field of operation assigned to [her]” and “carrying out [her] assigned function[s]” with respect to the corporations at the time she used them as vehicles to perpetrate her fraud: see *Canadian Dredge and Dock Company Limited v. R.*, 1985 CanLII 32 (SCC), [1985] 1 S.C.R. 662, at pp. 685, 714.

[57] Secondly, the Application Judge mistakenly focused on whether it was appropriate to hold that “Ms. Walton could cause the Schedule C investors to be a party to her fraudulent dealings with Dr. Bernstein.” Respectfully, that was not the right question. The pertinent question was whether Ms. Walton had caused the Schedule C Companies to participate in her fraudulent dealings.

[58] The errors of fact, or of mixed fact and law, consist of the Application Judge’s failure to find, on this record: (i) that Ms. Walton’s position as the sole active director, officer and manager of the Listed Schedule C Companies, for all practical purposes, and her conduct and knowledge with respect to them, met the legal test for the directing and controlling mind of those companies; and (ii) that the Listed Schedule C Companies participated in the fiduciary breach. I turn to these issues now.

(c) Norma Walton Was the Directing and Controlling Mind Of the Listed Schedule C Companies For These Purposes

[59] A corporation is an abstract legal entity and has no mind or will of its own. Consequently, for civil and criminal purposes, its mind or will is found in the natural person or persons acting as the directing mind or will of the corporation: the “ego” or “alter ego” of the corporation; the centre of the corporate personality. This theory of corporate “identification” or “attribution” was first developed by Viscount Haldane L.C. in *Lennard’s Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.*, [1915] A.C. 705, at pp. 713-714, a case involving civil fault and negligence. It was explored at length in the criminal context by Estey J. in *Canadian Dredge*, at pp. 677-685, and has been found to be “equally applicable in a civil action” in Canada: *Standard Investments Ltd. v. Canadian Imperial Bank of Commerce* (1985), 1985 CanLII 164 (ON CA), 52 O.R. (2d) 473 (C.A.), at para. 55, leave to appeal refused, [1986] S.C.C.A. No. 29.

[60] The corporate identification doctrine was aptly summarized – in the civil context, but with the acknowledgement that the alter ego doctrine applies “with no divergence of approach” in civil and criminal matters – by Nourse L.J. in *El Ajou*, at pp. 695-696:

This doctrine, sometimes known as the alter ego doctrine, has been developed, with no divergence of approach, in both criminal and civil jurisdictions, the authorities in each being cited indifferently in the other. A company having no mind or will of its own, the need for it arises because the criminal law often requires mens rea as a constituent of the crime, and the civil law intention or knowledge as an ingredient of the cause of action or defence. In the oft-quoted words of Viscount Haldane LC in *Lennards Carrying Co. Ltd v. Asiatic Petroleum Co Ltd*:

‘My Lords, a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.’

The doctrine attributes to the company the mind and will of the natural person or persons who manage and control its actions. At that point, in the words of Millett J:[9]⁶³ “Their minds are its mind; their intention its intention; their knowledge its knowledge.’ It is important to emphasize that management and control is not something to be considered generally or in the round. It is necessary to identify the natural person or persons having management and control in relation to the act or omission in point...

63. The judge of first instance in *El Ajou*.

Decided cases show that, in regard to the requisite status and authority, the formal position, as regulated by the company's articles of association, service contracts and so forth, though highly relevant, may not be decisive. Here Millett J adopted a pragmatic approach. In my view he was right to do so. [Emphasis added; citations omitted.]

[61] The Application Judge quoted from the foregoing passage in *El Ajou*. However, he stopped at the words "Their minds are its mind; their intention its intention; their knowledge its knowledge." Significantly, he appears to have overlooked the emphasis placed by the court on the importance of identifying "the natural person or persons having management and control in relation to the act or omission in point" (emphasis added), and the recognition that "the formal position", as established in the corporate and other related documentation, "though highly relevant, may not be decisive" (emphasis added). As Iacobucci J. put it in *Rhône v. Peter A.B. Widener*, 1993 CanLII 163 (SCC), [1993] 1 S.C.R. 497, at p. 521, "[t]he courts must consider who has been left with the decision-making power in a relevant sphere of corporate activity". See also *Meridian Global Fund Management Asia Ltd. v. Securities Commission*, [1995] 2 A.C. 500, at p. 507.

[62] This omission appears to have led the Application Judge to accept the "formal position" set out in the terms of the Schedule C Company shareholder agreements as dispositive of whether Ms. Walton was the controlling and directing mind of those corporations. The passage from his reasons, cited in para. 54 above, confirms that to be the case.

[63] In reality, however, no one other than Ms. Walton did anything or made any decisions respecting the flow of funds that were utilized for the acquisition, management, construction and financing of the Schedule C Properties. That under the formal corporate documentation and shareholder/investor agreements the investors were 50% shareholders and, with the Waltons, directors of the Listed Schedule C Companies, and were contractually entitled to be consulted on "significant decisions that differed from the project plan", is of little import when in the here and now the Waltons were fraudulently ignoring their obligations to the investors and were keeping them in the dark, and when the investors – based on their trust of the Waltons and the terms of their agreements – were leaving all management matters to the Waltons.

[64] Had the Application Judge not adopted the approach that he did, he would have appreciated that, on any view of the evidence in these proceedings – including, it seems, even her own – Ms. Walton was the directing and controlling mind of the Listed Schedule C Companies for purposes of the acquisition, construction, renovation, financing and management of the Schedule C Properties held by the Schedule C Companies and, more particularly, with respect to the transfer of source funds from the investors and, in some cases, the re-casting of corporate shareholding structuring necessary to effect those purposes. Respectfully – "adopt[ing] a pragmatic approach", to borrow the expression employed in *El Ajou* – it is not open on this record to hold that Ms. Walton was not the alter ego and directing and controlling mind of the Listed Schedule C Companies, acting within "the field of operations delegated to her" and as the

“primary representative ... through whom [the corporation] act[ed], sp[oke] and [thought]” for these purposes: *Canadian Dredge*, at p. 682; *R. v. St. Lawrence Corp. Ltd.*, 1969 CanLII 504 (ON CA), [1969] 2 O.R. 305 (C.A.), at p. 317.

[65] Even the Application Judge’s own findings reflect his acknowledgement that, as a factual matter, Ms. Walton was acting as the sole decision-maker for the corporations. He found, at para. 51, that “Ms. Walton may have acted as if she was the sole decision maker in the Schedule C Companies, but she was not.” Further, he noted, at para. 71, that Ms. Walton “managed the day to day affairs of the business” and that “the investment of DeJong was under the complete control of the Waltons.”

[66] That Ms. Walton not only acted as if she were the sole decision maker in the Schedule C Companies but was in fact and reality that sole decision maker, is amply founded in the record, and in the previous findings in the same proceedings made by Brown J. and by the Application Judge himself:

(a) Ms. Walton was a director of each of the Schedule C Companies and, from all accounts, the only active director and officer.

(b) As found by Brown J. in the earlier portion of these same proceedings:

(i) The Schedule C Companies were owned and controlled by the Waltons;

(ii) Norma Walton presented herself to the court, through her affidavits and through her submissions, as the person who was in charge of the entire enterprise, whether it be the operation of the Schedule B companies, Rose & Thistle or the Schedule C Companies [emphasis added];

(iii) Neither Ronauld Walton nor the Chief Financial Officer of Rose & Thistle had come forward to say that the improper transfers of monies out of the Schedule B Companies were the result of directions or orders given by someone other than Norma Walton (from which he inferred that they were not); and

(iv) Ms. Walton “simply did as she saw fit irrespective of her legal obligations” and “ignored the contractual language that bound her”.

(c) The shareholder agreements respecting the Schedule B Companies (in which the DBDC Applicants were involved) and the Schedule C Companies (in which the Respondents were involved) all provided that the Waltons were to be responsible for the management, supervision and renovation of the projects.

(d) Ms. Walton deposed before Brown J. that she was managing the jointly-owned portfolio of the companies, and that she used Rose & Thistle “as a clearing house account to smooth cash flow across the portfolio”.

While the specific reference to “the jointly-owned portfolio of companies” was to the Schedule B Companies in which the Waltons and Dr. Bernstein each held a 50% interest, Ms. Walton also acknowledged that the funds Dr. Bernstein was advancing to the Schedule B Companies were being pooled amongst those companies, then transferred to Rose & Thistle and also to the Schedule C Companies.

The Schedule C investors – including the DeJongs, the Condos and the Levytams – were unaware this was occurring and did not provide any direction or input in these actions.

(e) The Application Judge himself accepted the findings of Brown J., including the finding that in many cases the funds invested by the DBDC Applicants had been transferred to the Schedule C Companies and that the Schedule C Companies were “controlled” by the Waltons.

(f) The Application Judge noted that he could not determine into which companies Schedule B money went, “[i]n light of the way in which Ms. Walton transferred money around” between the Schedule B and C corporations. [Emphasis added.]

[67] In the face of the foregoing, it was a palpable and overriding error on the part of the Application Judge, respectfully, to find that Ms. Walton was not in fact and reality the directing and controlling mind of the Schedule C Companies. The corporate documentation and contractual framework had little, if any, bearing on how the Schedule C Companies, and the Listed Schedule C Companies in particular, operated, except to provide Ms. Walton with her entrée to the corporate levers necessary to work the Waltons’ scheme.

[68] In those circumstances, her knowledge and conduct can be attributed to the corporations. Ms. Walton exercised complete management and control over all relevant actions executed by the Schedule C Companies. To paraphrase from *El Ajou*, for these purposes her mind was their mind; her intention, their intention; her knowledge, their knowledge. She was the person through whom the corporations acted, spoke and thought for these purposes: *Canadian Dredge*, at p. 682. In short, her perpetration of the scheme was their participation in the scheme.

(d) Application of the *Canadian Dredge* Criteria

[69] The Respondents argue that, even so, this is insufficient to fix the Listed Schedule C Companies with Ms. Walton’s knowledge and fraudulent conduct for purposes of establishing civil responsibility, because the criteria set out in *Canadian Dredge* – albeit in the context of criminal responsibility – have not been met. At pp. 713-714 of that decision, Estey J. said:

[I]n my view the identification doctrine only operates where the Crown demonstrates that the action taken by the directing mind (a) was within the field of operation assigned to him; (b) was not totally in fraud of the corporation; and (c) was by design or result partly for the benefit of the company.

[70] Before turning to these criteria, I think it is useful to recognize the setting in which they are being considered. The case law has applied *Canadian Dredge* in the criminal and civil contexts without discrimination. In my view, it does not follow, however, that the criteria need be applied in a rigid, identical, fashion in all circumstances. The burden of proof is less onerous in civil cases. This particular civil case involves a complex multi-real estate transaction investment fraud, perpetrated over an extended period of time, and implicating numerous corporate actors (operating at the instance of the

fraudster) and numerous victims. In these circumstances, it makes sense that, of the *Canadian Dredge* criteria, (b) and (c) at least may be approached in a less demanding fashion than would be the case were *mens rea* for purposes of establishing criminal responsibility in play.

[71] Contrary to the view expressed by my colleague, I do not think it is the case in such circumstances that the claimant must necessarily show “evidence of each company’s individual benefit from the scheme” (at para. 234). As noted earlier, and as I shall explain more fully below, liability for knowing assistance is fault-based rather than receipt-based and does not require the defendant to have obtained a benefit from the defaulting fiduciary’s breach. To apply criterion (c) of *Canadian Dredge* – “by design or result partly for the benefit of the company” – too strictly therefore makes little sense, as it would risk muddying the distinction between the two categories of claim.

[72] In addition, as I develop below, there are sound policy reasons for not adopting the narrower view favoured by my colleague. This is consistent with the approach recently taken by the Supreme Court of Canada in *Livent*. The Court declined to adopt a rigid application of the *Canadian Dredge* criteria in the context of a civil case, emphasizing that the corporate identification doctrine is one having its roots in policy considerations: see *Livent*, at paras. 100-104.

[73] In my view, policy considerations support a more flexible approach in complex and large, multi-corporation, multi-party fraud cases such as the present one, for the reasons I set out below. I do not think, in these circumstances, that it matters whether the flexibility is applied at the criteria-application phase or the overall-equitable consideration stage of the analysis.

(i) Acting Within the Assigned Field of Operation

[74] *Canadian Dredge* confirms that the attribution of an employee/manager’s conduct or knowledge to a corporation does not turn on whether the individual was acting “within the scope of his or her employment” or was “off on a frolic of their own” in the tortious sense of vicarious liability. The test is whether the directing mind “is acting within the scope of his [or her] authority...*in the sense of acting in the course of the corporation’s business*”, or with “*reference to the field of operations delegated to the directing mind*”, or “*within the scope of the area of the work assigned to him [or her]*” (underlining in original; italics added): at pp. 684-685.

[75] Here, for all the reasons articulated earlier in this decision leading to the conclusion that Ms. Walton was the directing and controlling mind of the Listed Schedule C Companies, she falls squarely within that category of individual.

[76] In her capacity as the person “in charge of the entire enterprise”, Ms. Walton was acting well within the field of operations delegated to her by the shareholder agreements of the Schedule B and C Companies, their corporate structures (she was a director and officer), and the conduct of the parties. It was her responsibility to complete the transactions by which the Schedule C Properties were acquired by

the Schedule C Companies, to manage the projects, and to arrange for the necessary financings and re-financings. That she breached the shareholder agreements by not obtaining the necessary consents from the investors and by not providing accurate and timely information, that she breached her fiduciary obligations to the DBDC Applicants and Dr. Bernstein by misusing and misappropriating the funds they invested in the Schedule B Companies, that she breached her obligations to the Respondents as well in relation to their investments in the Schedule C Companies, and that she perpetrated her fraud on both the Applicants and the Respondents by betraying their trust and exercising the corporate powers left to her – none of these considerations detracts from the reality that in fact and in law she was acting within the field of operations and the area of corporate management delegated and assigned to her. Her fraudulent actions in directing the flow of monies in and out of the various corporations were carried out within the framework of her delegated responsibilities.

[77] The first *Canadian Dredge* criterion is met.

(ii) Fraud/Benefit of the Corporation

[78] The second and third *Canadian Dredge* criteria may be considered together. They require that the action taken by the directing mind not be totally in fraud of the corporation and that, by design or result, it be partly for the benefit of the corporation. In my view, as noted earlier, their application may be approached in a broader fashion in circumstances such as these, than would be the case in a criminal law context.

[79] That said, I am satisfied the actions of Ms. Walton do meet those requirements, nonetheless. The Listed Schedule C Companies were not totally defrauded and, indeed, benefitted at least partly from Ms. Walton's actions.

[80] Although some of their investors' monies were misapplied and misused in breach of Ms. Walton's fiduciary duties – as were the investments of the DBDC Applicants – the Listed Schedule C Companies nevertheless acquired properties, as they were intended to do and as part of the investment arrangements. As a result of Ms. Walton's net transfer of at least \$23.6 million from the Schedule B Companies to Rose & Thistle and the net transfer of \$25.4 million from Rose & Thistle to the Schedule C Companies, the latter acquired funding necessary for their ongoing operations; Brown J. accepted the Inspector's conclusion that the DBDC Applicants' investments in the Schedule B Companies "[were] a major source of funds for the [Schedule C] Companies". The record shows that each of the Listed Schedule C Companies either received from or transferred to Rose & Thistle monies or monies-worth, during the relevant period. Given the co-mingling of funds, it is not possible to trace the complete path of all these transactions; however, Ms. Walton herself acknowledged that Rose & Thistle was the "clearing house" for the movement of funds as between the Schedule B Companies, Rose & Thistle, and the Schedule C Companies.

[81] My colleague suggests that a *specific* benefit flowing to each Listed Schedule C Company must be identified in order to affix the companies with Ms. Walton's knowledge for purposes of knowing assistance. As I mentioned briefly earlier in these reasons, there are sound policy reasons, in my view, for not adopting a narrow approach on this, and other, issues relevant to this appeal. My colleague's approach, in effect, incorporates a tracing requirement into the knowing assistance claim, collapsing the distinction between knowing assistance and knowing receipt where corporate actors are used to assist in breach of fiduciary duty. To do so would mean that justice could not properly be done in many cases of massive, multi-corporation, multi-party fraud because – as this case demonstrates – the fraudulent co-mingling of funds renders it impossible to accomplish that task with the degree of precision required for knowing receipt, unjust enrichment or constructive trust.

[82] My colleague's approach is also influenced by her view that the Listed Schedule C Companies are, themselves, victims of the fraud. If that were the case, it may be a consideration in determining whether liability may be avoided on overall "equity" grounds, discussed further below. However, I do not think it has much bearing on the "directing and controlling mind" analysis or on the analysis of whether the Listed Schedule C Companies in fact assisted and participated in the fraudulent breach of fiduciary duty. In addition, as I shall explain later, I do not view the Listed Schedule C Companies as being "victims" of the fraud; rather, their investors are the victims of the fraud.

[83] In my view, the foregoing factors are sufficient to meet the second and third *Canadian Dredge* criteria, for purposes of establishing that Ms. Walton was the directing and controlling mind of the Listed Schedule C Companies, in the circumstances of this civil fraud case.

(iii) The Listed Schedule C Companies Participated in or Assisted Ms. Walton's Fraudulent Conduct

[84] It flows from the foregoing that the participation/assistance requirement for the claim of knowing assistance has been met as well.

[85] Ms. Walton crafted and choreographed a scheme to enable her and her husband to stay ahead of their obligations to provide 50% of the funding for the acquisition of the properties and to otherwise enrich themselves personally at the expense of their investors. Focusing on Dr. Bernstein's circumstances, Brown J. described the fraud, at para. 278, as "the system created by the Waltons to circulate and mis-use the [DBDC] Applicants' funds". Unbeknownst to DeJong, the Condos and the Levytams, it was created to circulate and misuse their funds as well.

[86] Ms. Walton utilized the Schedule C Companies as actors in the process of orchestrating her shell game through the Rose & Thistle "clearing house" account. Funds were co-mingled, when they were supposed to be kept project-specific. Investors' funds (of both the DBDC Applicants and the Respondents) were diverted from their intended project or projects to finance the acquisition or operations of other projects, or to benefit the Waltons personally. Sometimes this was done on the pretext that the Waltons had made their contributions through a phantom "equity" increase in the value

of the property previously acquired by them. Sometimes it was done on the pretext that their contributions had been made in the form of assignment or purchaser agency fees, or management fees, or construction and maintenance costs.[10]⁶⁴ On other occasions, Ms. Walton arranged for the investors to receive preferred shareholding positions in different corporations, purportedly in exchange for investments made in other investment projects (without revealing that those earlier investments had already been lost).

[87] With two possible exceptions, the record shows that each of the Listed Schedule C Companies either received monies directly from or transferred monies directly to Rose & Thistle during the relevant period, and were therefore engaged as corporate actors in an arrangement that, at the end of the day, resulted in a net transfer of over \$23 million *from* the DBDC Applicants and a net transfer of over \$25 million *to* the Schedule C Companies.

[88] The two possible exceptions are St. Clarens Holdings Ltd. and Emerson Developments Ltd., the owners of adjoining properties at 777 St. Clarens Ave. and 260 Emerson Ave. in Toronto. Nonetheless, the record demonstrates that these two corporations were also engaged as actors in the overall fraudulent scheme.

Participation by St. Clarens/Emerson

[89] Although title to the two properties was taken in the names of the two corporations, respectively, the purchase involved a single transaction. In July, 2013, a Walton numbered company entered into an agreement of purchase and sale with the owners of the two properties. It is said that an \$80,000 deposit was paid at the time, although the source of those funds is not clear from the record. In October, 2013, the Walton numbered company assigned the agreement of purchase and sale to Rose & Thistle. Rose & Thistle agreed to pay an “assignment fee” of \$225,000 and to reimburse the Walton company for the \$80,000 deposit.

[90] On November 18, 2013, the Waltons and DeJong entered into the standard type of 50/50 shareholder/management agreement described earlier in these reasons with respect to the St. Clarens/Emerson properties. That agreement stated that the Waltons had previously entered into an agreement of purchase and sale regarding the properties, and had previously provided an \$80,000 deposit along with due diligence fees of approximately \$50,000 related to the purchase. A “Capital Required” document associated with the purchase indicated that there was a “Purchaser agency fee” of \$225,000 included as part of the purchase costs. Dr. DeJong swore that this fee was never discussed with or disclosed to her. The Application Judge accepted this evidence.

[91] The St. Clarens/Emerson transaction closed on November 26, 2013 with Rose & Thistle apparently assigning the original agreement of purchase and sale to the purchasing corporations. Apart from the possible \$80,000 deposit provided initially by the Walton numbered company – whether those

64. Brown J. found that the Waltons had proved only \$1 million in management fees and construction costs, out of a total \$30 million they had claimed.

funds came from the Rose & Thistle clearing house account is not known – the Waltons made no further contributions to the \$665,000 shareholder loan they were required to contribute. DeJong advanced its \$665,000 to St. Clarens Holdings and those funds were used to pay the balance due on closing for both properties of \$252,397.91.

[92] How the remainder of the DeJong advance was used is not known either. While it is not completely clear from the record whether Ms. Walton caused the \$225,000 “Purchaser agency fee” – or, “assignment fee” as it was initially characterized in the assignment agreement – to be made in cash to Rose & Thistle or to the Walton numbered company, at the very least it is clear that St. Clarens Holdings assumed an accrued liability for the purchaser agency fee and accepted responsibility to reimburse the Waltons for the \$80,000 deposit.

[93] The Application Judge found that “the payment of \$225,000 was clearly deceitful and in breach of the fiduciary duties owed by them to DeJong.” This finding was undoubtedly open to him on the record.

[94] The point of dwelling on the St. Clarens/Emerson transaction is not to analyse whether the corporations “benefitted” from the fraudulent scheme. Indirectly they benefitted because they acquired the properties in the course of the scheme. Perhaps they benefitted from the payment of the agency fee, which may or may not have represented a justifiable expense; we do not know. DeJong suffered a loss because, *vis-à-vis* DeJong, the undisclosed fee constituted a deceitful breach of the Waltons’ fiduciary duties to it.

[95] The point of dwelling on the St. Clarens/Emerson transaction is to show that, even though the purchasing Listed Schedule C Companies may not have either received monies directly from or transferred monies directly to Rose & Thistle, the transaction permitted Ms. Walton to skim off the \$225,000 unbeknownst to DeJong. It illustrates yet another way in which Ms. Walton engaged the Listed Schedule C Companies as actors in her overall fraudulent undertaking in breach of her fiduciary obligations to both the DBDC Applicants and DeJong.

[96] Improper as they were, each of these transactions – together with all the other in-and-out transactions – required a corporate act of one form or another. As the directing mind of the Listed Schedule C Companies for these purposes, Ms. Walton’s acts were their acts, and the Companies accordingly participated in or assisted Ms. Walton in her breach of fiduciary duties to the DBDC Applicants.

Additional Arguments Raised Against Finding Participation/Knowledge

[97] For purposes of the “participation” and “knowledge” analyses, it matters little, in my view, that the DBDC Applicants are unable to demonstrate the receipt of any *particular* Schedule B Company funds by any *particular* Listed Schedule C Company (other than the funds with respect to which Brown J. previously granted constructive trusts). It is therefore of little significance that the “net transfer analysis” was not intended to, and does not, establish such a connection.

[98] My colleague places considerable emphasis on these points. As she puts it, at para. 185 of her analysis, for example, the net transfer analysis was “never intended to be used for the purpose of establishing a claim by the DBDC Applicants against the property of other defrauded investors”, and, at para. 195, “[t]he net transfer analysis does not show where the money went after it was transferred into Rose & Thistle, or that any of the ‘net’ money ended up in any particular Walton-controlled account (including any Listed Schedule C Company account)”.

[99] Respectfully, these concerns are misplaced in the context of a claim for knowing assistance.

[100] First, as I have emphasized, they conflate knowing assistance with knowing receipt. If it were necessary to demonstrate the receipt of funds by the defendant in order to establish a claim for knowing assistance, there would be no need for the knowing assistance remedy. The claim of “knowing assistance” is designed to capture circumstances where “knowing receipt”, unjust enrichment, or a constructive trust on some other basis cannot be established, but where a fault-based remedy is appropriate to compensate for the defendant’s knowing assistance in the perpetration of a fraudulent and dishonest breach of fiduciary duty. This is one of those cases. In addition, as mentioned above, there are sound policy reasons for not importing a tracing requirement as a necessary component of the knowing assistance claim.

[101] Secondly, while the net transfer analysis may not have been suitable for purposes of tracing Schedule B Company funds into particular Listed Schedule C Company accounts, it clearly established a net outflow from the Schedule B Companies’ accounts of \$23.6 million. Both Brown J. and the Application Judge made that finding. This is relevant for all the various reasons recited above, as well as for the measure of the DBDC Applicants’ damages.

[102] Nor do I share the view that the Listed Schedule C Companies were not participants in Ms. Walton’s fraudulent breach because they were victims of the same fraudulent scheme and were merely used by Ms. Walton as “conduits” or “pawns” in the perpetration of that scheme, without the demonstration of receiving any benefit themselves.

[103] My colleague acknowledges that “the Listed Schedule C Companies may have participated in Ms. Walton’s overall fraudulent scheme, in the sense that they were used by her in the ‘shell game’ to mingle investor funds, and to avoid making her own contributions” (at para. 231). She acknowledges that “knowing assistance does not require a defendant to have received a benefit” for these purposes (at para. 234). Yet, she concludes that “the net transfer analysis does not provide the evidence that they

participated in her breach of fiduciary duty to the DBDC Applicants so as to attract personal liability for knowing assistance” (at para. 231), and that “the issue of benefit is relevant here because Ms. Walton’s conduct was in fraud of the very entities sought to be made liable for knowing assistance” (at para. 234).

[104] This approach conflates the Companies with their investors and preferred shareholders, however. It also overlooks the finding that Ms. Walton was the controlling and directing mind of the companies and that her intentions and conduct were theirs. The Listed Schedule C Companies are not defrauded victims of Ms. Walton’s fraudulent scheme; their investors and preferred shareholders are the defrauded victims. And, as noted above, they did “benefit” generally from the perpetration of the overall fraud. The Companies acquired the properties they were created to acquire. They received the funds enabling them to do so. As Brown J. found, the DBDC Applicants’ investments were used to fund their ongoing operations and provided “a major source of funds for the Walton Schedule C Properties/Companies” (at para. 269). It was the way in which the investors’ funds (the DBDC Applicants’, as well as those of DeJong and others) were fraudulently co-mingled and moved amongst the entire portfolio of properties and projects that constituted the fraud. However, it was fraud perpetrated on the investors, not on the Listed Schedule C Companies.

[105] Ms. Walton’s breach of fiduciary duty to the DBDC Applicants was to cause the funds they invested in the Schedule B Companies to be diverted out of those Companies for her own personal use. That the Schedule C investors or the Schedule C Companies were also the objects of a similar co-mingling and diversion of their funds, is not important for the “participation” and “knowledge” requirements of the knowing assistance analysis, in my view. For the Listed Schedule C Companies to be found liable on that basis, it need not be shown that they assisted directly in acts involving the diversion of Schedule B Companies’ funds into the Listed Schedule C Companies’ accounts. It need only be shown that they knowingly assisted in Ms. Walton’s fraudulent and dishonest scheme to divert monies out of the Schedule B Companies’ accounts. It is the overall fraudulent scheme, and the Listed Schedule C Companies’ knowing assistance in the perpetration of that “shell game” that provides the prism through which liability for this claim must be determined. The policy considerations respecting cases such as this, referred to above, support this analysis, in my view.

[106] It is not an answer to say that a similar claim for joint and several damages might be asserted against the Schedule B Companies on the same basis. No one is asserting such a claim in these proceedings. And, although the Schedule C investors were also victimized in the scheme, it must be remembered – as found by Brown J., and accepted by the Application Judge – that net funds of \$23.6 million *flowed out of the Schedule B Companies* into Rose & Thistle, and net funds of \$25.4 million *flowed out of Rose & Thistle into the Schedule C Companies*. It is the DBDC Applicants, not the Schedule C Companies, that suffered the net losses.

[107] DeJong and the other Respondents raise an additional argument. They submit that the fact they had no knowledge of the scheme or breaches personally, or in their capacities as lenders to or shareholders of the Schedule C Companies, shields the Listed Schedule C Companies from liability for knowing assistance. However, it is the knowledge of the *corporation* that is relevant to the establishment of liability, not the knowledge of the corporation's creditors, shareholders, or its directors or officers other than the directing mind. As noted above, the issue is not whether the co-investors were co-opted into participating in the scheme; the issue is whether the Schedule C Companies knowingly assisted Ms. Walton in carrying out the scheme.

[108] This principle is illustrated by both *Canadian Dredge* and *El Ajou*.

[109] In *Canadian Dredge*, the corporation was found to be criminally liable on the basis that the knowledge and conduct of its directing minds were attributed to it for that purpose, notwithstanding that innocent investors might be penalized: see p. 694. At p. 685, Estey J. noted that:

Acts of the ego of a corporation taken within the assigned managerial area may give rise to corporate criminal responsibility, whether or not there be formal delegation; whether or not there be awareness of the activity in the board of directors or the officers of the company; and, as discussed below, whether or not there be express prohibition. [Emphasis added.]

[110] If the existence of an express prohibition forbidding a directing mind to do an act is not sufficient, by itself, to avoid corporate criminal responsibility, the breach of a shareholder agreement on the part of the directing mind cannot be sufficient to avoid corporate civil responsibility. The fact that Ms. Walton was carrying out the transactions for a corrupt purpose, and not advising her co-investors of the details, does not, in my view, affect the attribution of her intentions and actions to the Listed Schedule C Companies: see *Meridian Global*, at p. 511.

[111] In *El Ajou*, a civil case involving corporate liability for knowing receipt, the owners of the corporation were completely unaware of the fraud perpetrated by the director, who had *de facto* management and control in respect of the fraudulent transaction. Nonetheless, the corporation was found to be liable.

[112] The Respondents seek to distinguish *El Ajou* on the basis that it applied “knowing receipt” as opposed to “knowing assistance”, and that constructive knowledge is sufficient to ground liability for the former while actual knowledge is required for the latter. In my view, *El Ajou* is not distinguishable on that basis. There is nothing to suggest that the knowledge the court was attributing to the corporation in that case was constructive knowledge. Rather, what was imputed to the corporation was the *actual* knowledge of the directing mind. As Nourse L.J. noted, at p. 695, the person found to be the directing mind of the corporation (a Mr. Ferdman) “freely admitted that he knew [of the fraudulent transactions in question]” (emphasis added). This is the language of actual knowledge, not that of constructive knowledge. Constructive knowledge arises when a person has knowledge of circumstances that would

indicate certain facts to a reasonable person, or knowledge of circumstances that would put an honest and reasonable person on inquiry: see *Air Canada*, at p. 812; *Citadel General*, at para. 22. It was the actual knowledge of Mr. Ferdman that was attributed to the corporation as its knowledge.

(e) The Requirements for “Knowing Assistance” are Met Here

[113] For all these reasons, I am satisfied that the DBDC Applicants have established the necessary components for a claim of knowing assistance in a breach of fiduciary duty: (i) Ms. Walton owed a fiduciary duty to the DBDC Applicants; (ii) she breached that duty; (iii) the Listed Schedule C Companies, as strangers to the fiduciary relationship, had actual knowledge of both the fiduciary relationship and the fraudulent and dishonest conduct of the fiduciary, because in the circumstances Ms. Walton’s mind was their mind, her intent their intent, and her knowledge their knowledge; and (iv) for similar reasons, the Listed Schedule C Companies participated in or assisted Ms. Walton’s fraudulent and dishonest conduct.

C. JOINT AND SEVERAL LIABILITY FOR DAMAGES

[114] The Respondents make an additional argument, based on equitable grounds. They submit that to give effect to the claim for damages based on knowing assistance in the circumstances of this case would be to:

[Stretch] the bounds of equity in ways not contemplated by the goals of restitutionary proprietary remedies. That is particularly so in the face of investors that actually put funds into these particular Schedule C Companies.

[115] The argument is misconceived in this context, however. It conflates a claim for damages with a claim for a proprietary remedy and, in particular, the claim for knowing assistance with the claim for knowing receipt. As I shall explain more fully, “knowing assistance” is not a remedy grounded in the principles of restitution or proprietary remedies. The DBDC Applicants are not seeking, at this stage, a restitutionary or proprietary-based remedy in respect of any of the Schedule C Properties (over and above the constructive trusts earlier granted by Brown J. with respect to certain of those Companies). They seek only a remedy in damages.

[116] Brown J. granted the DBDC Applicants a tracing order against the Listed Schedule C Companies to further the evidence available to support their claim for unjust enrichment. By the time the issue came before the Application Judge, however, the DBDC Applicants had decided to forego the tracing exercise and any claim to a proprietary interest in the Schedule C Properties held by those companies. Instead, they asserted only their claim for damages on a joint and several basis for knowing assistance and/or receipt.

[117] As noted earlier in these reasons, liability for knowing assistance – unlike knowing receipt – does not depend upon the receipt of property, and the measure of recovery does not depend upon the value of any property obtained by the stranger as a result of the breach of the fiduciary’s obligations. Whereas the essence of liability for knowing receipt is unjust enrichment, the gravamen of liability for knowing assistance is simply knowing participation or assistance in the breach in furtherance of the defaulting trustee or fiduciary’s fraudulent and dishonest conduct: *Gold v. Rosenberg*, at para. 41; *Citadel General*, at paras. 46-47.

[118] La Forest J. addressed this dichotomy in *Citadel General*, underscoring the importance of distinguishing between the knowing assistance and knowing receipt claims, and their underpinnings. After referring to a passage from the judgment of Millett J., the judge of first instance in the *Agip (Africa) Ltd.* case, La Forest J. said, at paras. 46-47:

In other words, the distinction between the two categories of liability is fundamental: whereas the accessory’s liability is “fault-based”, the recipient’s liability is “receipt-based”. In an extrajudicial opinion, Millett J. described the distinction as follows:

... the liability of the accessory is limited to the case where the breach of trust in question was fraudulent and dishonest; the liability of the recipient is not so limited. In truth, however, the distinction is fundamental; there is no similarity between the two categories. The accessory is a person who either never received the property at all, or who received it in circumstances where his receipt was irrelevant. His liability cannot be receipt-based. It is necessarily fault-based, and is imposed on him not in the context of the law of competing priorities to property, but in the application of the law which is concerned with the furtherance of fraud. [Footnotes omitted.]

“Tracing the Proceeds of “Fraud” [(1991), 107 L.Q.R. 71], *supra*, at p. 83.

The same view was expressed by the Privy Council in *Royal Brunei Airlines Sdn. Bhd. v. Tan*, [1995] 3 W.L.R. 64, at p. 70: “Different considerations apply to the two heads of liability. Recipient liability is restitution-based; accessory liability is not.” These comments are also cited with approval by Iacobucci J. in *Gold*, *supra*, at para. 41. [Emphasis added.]

[119] In a scholarly article written prior to his appointment to the bench, “Intermeddlers or Strangers to the Breach of Trust or Fiduciary Duty” (1998) 21 *Advocates’ Q* 94, at p. 107, Paul M. Perell put it this way:

To be liable for knowing assistance, the stranger must have actual knowledge of the trustee’s or fiduciary’s dishonest or fraudulent act but, beyond being shown to have participated in that design, the third party ... need not necessarily be shown to have acted in a fraudulent or dishonest fashion. And the stranger need not have taken or held any property. [Emphasis added.]

[120] The Respondents argue that they were innocent investors who had no knowledge of Ms. Walton's fraudulent and dishonest ways, and that in the contest between two sets of equally innocent victims of the Waltons' fraud it would not be equitable to grant an award of damages in favour of the DBDC Applicants, thereby placing Dr. Bernstein and his companies, as judgment creditors, in a more advantageous position over them as shareholders of the Listed Schedule C Companies or as creditors. The Application Judge appears to have accepted this contention, noting at para. 51 of his reasons that "[t]here is no evidence that the other investors were aware of the fraudulent conduct of Ms. Walton", and stating, at para. 52 that:

The issue raised by the [DBDC Applicants] is not a contest between Dr. Bernstein and the Waltons. It is a contest between Dr. Bernstein and the investors in the Schedule C Companies who suffered from the same misconduct as did Dr. Bernstein. Ms. Walton knowingly breached her fiduciary obligations to the Schedule C Companies and the Schedule C investors.

[121] That is not the point, however. As noted earlier, it is the knowledge of the Listed Schedule C Companies – the "strangers" to the fiduciary relationship in this case – rather than the knowledge of their investors or shareholders that is relevant in assessing the claim for knowing assistance. And, to repeat the words of Millett J., cited with approval in *Citadel General*, at para. 46, liability for knowing assistance "is necessarily fault-based, and is imposed on [the knowing accessory] not in the context of the law of competing priorities to property, but in the application of the law which is concerned with the furtherance of fraud" (emphasis added).

[122] It is because of the distinction between the underpinnings of the knowing assistance and knowing receipt claims that the knowledge requirement is different – actual knowledge, for knowing assistance; constructive knowledge, for knowing receipt. But it is also for this reason, in my opinion, that discretionary considerations pertaining to the application of a trust-imposed proprietary remedy are of considerably less significance when the claim of the knowing assistance plaintiff arises, as it does here, in damages.

[123] While I need not go so far as to say that a court may never exercise a discretion to decline a remedy where the four criteria for establishing liability for knowing assistance have been met, I find it hard to conceive of a case where – in the face of a defendant's participation or assistance in a fraudulent and dishonest scheme perpetrated by a fiduciary and with actual knowledge of both the fiduciary relationship and the fraudulent and dishonest scheme – a court would do so. It is the role of equity and the courts to guard against such an outcome and not to sanction such conduct.

[124] It is true here that the Schedule B Companies' money cannot be directly traced into the Listed Schedule C Companies (with the exception of those against which Brown J. awarded a constructive trust). However, these Listed Schedule C Companies transferred money to and from Rose & Thistle as a part of the scheme orchestrated by the Waltons or assumed liability in favour of Rose & Thistle as part

of the scheme. As well, it is worth repeating that the Schedule C Companies were significant net beneficiaries in the flow of funds emanating from the pooling and co-mingling of the various investors' monies.

[125] Because I do not view the Listed Schedule C Companies as themselves victims of the fraud, I see no basis for excusing them from "fault" on the ground that they were simply caught up in, and used, as part of the wrongdoer's wrongful scheme. They remained, nonetheless, participants and actors in the perpetration of that scheme. Nor do I think it significant, as my colleague notes, that the DBDC Applicants have adopted the practical choice of pursuing only those Schedule C Companies that may have assets against which to recover. While reasons relating to the likelihood of recovery under a judgment or order may explain why proceedings are taken against certain parties, those reasons should not be confused with reasons underlying liability giving rise to the judgment. In the result, I do not see any overriding "equitable" considerations that militate against application of the knowing assistance remedy in the circumstances of this case.

[126] For these reasons, I am satisfied that, once it is determined that the Listed Schedule C Companies knowingly participated in the fraudulent and dishonest breach of fiduciary duty by the Waltons, the DBDC Applicants are entitled to an award of damages against them as knowing accessories to the breach. As I have explained above, the Listed Schedule C Companies did so because Ms. Walton's knowledge and actions are to be attributed to them as their own.

[127] The appropriate measure of damages in the circumstances is the loss caused to the DBDC Applicants by the dishonest fiduciary's fraudulent scheme arising from the participation and assistance of the Listed Schedule C Companies in that scheme. That is because liability for knowing assistance is fault based and is measured by the loss flowing from the fault. As Perell summarized it in the article cited earlier in these reasons, at p. 113:

One very significant difference arising from the different rationales is that the beneficiary's recovery from knowing receipt may be less than the recovery from knowing assistance. This follows because, under the doctrine of knowing receipt, the defendant's liability is measured by his unjust enrichment while, under the doctrine of knowing assistance, the defendant's liability is measured by the plaintiff's injury consequent to the trustee's misconduct. The plaintiff's injury may exceed the defendant's benefit. [Emphasis added.]

[128] In this case, the loss is measured by the net transfer to the Schedule C Companies, globally, of \$22.6 million.

[129] Once it is established that the Listed Schedule C Companies are each liable for knowingly assisting Ms. Walton in the global scheme in breach of her fiduciary obligations to the DBDC Applicants, it follows in the circumstances that the Listed Schedule C Companies are jointly and severally liable for the losses sustained: see *Enbridge Gas*, at para. 31. In that case, this Court upheld the trial judge's

finding that the defendants were jointly and severally liable for the full extent of the losses sustained by Enbridge even though the defendants played different roles in assisting in the fraud and received unequal portions of the misappropriated funds. I see no basis for departing from that same line of reasoning.

[130] While the DBDC Applicants are entitled to an award of damages in the amount of \$22.6 million against the Listed Schedule C Companies, they are not entitled to make a double recovery. The net transfer analysis was prepared in relation to the Schedule B and Schedule C Companies. Brown J. awarded constructive trusts in favour of the DBDC Applicants against eight Schedule C Properties, for a total of \$8,128,325 (of which, we are advised, the amount of \$1,192,150 has been recovered). The constructive trusts were awarded in cases where the Inspector was able to trace funds from a Schedule B Company, through Rose & Thistle, and into a Schedule C Company, and the Schedule C Company used those funds in respect of a Schedule C Property. Those funds were necessarily part of the larger \$23.6 million (less a \$1 million reduction for management fees) that was transferred out of the Schedule B Companies.

[131] It follows, therefore, that any amounts actually recovered by the DBDC Applicants pursuant to the constructive trusts awarded by Brown J. must be applied in reduction of the damage award. I understand the DBDC Applicants to accept that conclusion.

[132] In the result, I would give effect to the ground of appeal respecting the DBDC Applicants' claim for damages against the Listed Schedule C Companies on a joint and several basis, subject to the foregoing caveat.

D. THE DEJONG CLAIM FOR CONSTRUCTIVE TRUSTS

[133] The Application Judge granted constructive trusts in favour of DeJong over four Schedule C Properties owned by the four DeJong Companies in the following amounts:

| | | |
|--|----------------|--------------------|
| 3270 American Drive (United Empire Lands Ltd.) | \$769,543.60 | |
| 324 Prince Edward Drive (Prince Edward Properties) | \$741,501.97 | |
| 777 St. Clarens Avenue (St. Clarens Holdings Ltd.)/ (Emerson Developments Ltd.) | \$665,000.00 | 260 Emerson Avenue |
| Total | \$2,176,045.57 | |

[134] These properties have since been sold, and the Manager holds the proceeds from their sale. The DeJong constructive trust against 3270 American Drive ranks subsequent to the constructive trust earlier granted by Brown J. in favour of the DBDC Applicants. It exhausts the funds currently held by the Manager from the sale of that property. The amounts granted as constructive trusts in favour of DeJong respecting the remaining three properties also exhaust the funds available from their sale. On that basis, the DeJongs would thus recover more than 50% of their lost investments.[11]⁶⁵

[135] The DBDC Applicants contest these constructive trust dispositions. They submit that the Application Judge erred in granting the constructive trusts in favour of DeJong, arguing that:

- (a) there was no unjust enrichment at the expense of the DeJong Companies resulting from the misappropriation of the DeJong investments;
- (b) the diverted DeJong investments could not be linked to the acquisition, preservation, maintenance or improvement of any property owned by a DeJong Company;
- (c) DeJong had other available remedies as against the Waltons and the DeJong Companies; and
- (d) the interests of other creditors and third parties would be adversely affected by the award of a proprietary remedy in priority to all other claims.

[136] The Application Judge did not grant constructive trusts over the properties owned by the DeJong Companies on the basis of unjust enrichment. In the case of 3270 American Drive, this was because the equity funds advanced by DeJong for the purchase of that property were diverted elsewhere and not used for that purpose (it was Dr. Bernstein's investments that were improperly diverted and used to purchase 3270 American Drive, leading to the granting of a constructive trust in the DBDC Applicants' favour over the property). In the case of 324 Prince Edward Drive, 260 Emerson Avenue and 777 St. Clarens Avenue, the DeJong monies were utilized, in part, for the purchase of the respective properties, but this did not constitute an unjust enrichment because the funds were intended to be used for that purpose.

[137] Instead, the Application Judge granted constructive trusts in favour of DeJong against the foregoing properties as a remedy for breach of fiduciary duty. In doing so, he relied upon the well-accepted principle that a constructive trust remedy is not restricted to circumstances in which there has been an unjust enrichment, but may be imposed as well "to hold persons in different situations to high standards of trust and probity and prevent them from retaining property which in 'good conscience' they should not be permitted to retain", and can "aris[e] on breach of a fiduciary relationship": *Soulos v. Korkontzilas*, 1997 CanLII 346 (SCC), [1997] 2 S.C.R. 217, at paras. 17 and 19.

65. Even with full recovery on the constructive trusts granted in their favour, the DBDC Applicants (and Dr. Bernstein) will have recovered about 28% of their \$81.6 million in lost investments (\$81.6 million, less \$11.8 million recovered prior to the hearing before the Application Judge, less \$2.99 million in equity already returned, less \$8.1 million in constructive trusts, assuming no overlap).

[138] However, in *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271, the Supreme Court of Canada revisited the factors to be taken into account by a court when imposing a constructive trust as a remedy for breach of fiduciary duty. Speaking for the majority on this point, Cromwell J. held at para. 227 that “a remedial constructive trust for a breach of fiduciary duty is only appropriate if the wrongdoer’s acts give rise to an identifiable asset which it would be unjust for the wrongdoer (or sometimes a third party) to retain.”⁶⁶ Concurring on this point, Deschamps J. affirmed, at para. 78, that “[i]t is settled law that proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property.”

[139] The decision whether to impose a constructive trust is discretionary, and there is no question that a judge of first instance is entitled to considerable appellate deference in the exercise of that discretion, absent an error in principle. Respectfully, I have come to the conclusion that the Application Judge erred in principle in two respects when he imposed a constructive trust in favour of DeJong in these circumstances: first, in his failure to apply the *Indalex* principle that the fiduciary’s wrongful acts must give rise to an identifiable asset; secondly, in his failure to give effect or consideration to the interests of other creditors and third parties, and to the fact that DeJong had other remedies available to it.

(1) The Application Judge Failed to Apply *Indalex*

[140] Drawing upon the Court’s earlier decision in *Soulos*, Cromwell J. in *Indalex*, at para. 228, reiterated the four conditions that must be present before a remedial constructive trust may be ordered for breach of fiduciary duty:

- (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
- (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligations to the plaintiff;
- (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties; and
- (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected.

[141] Referring to (2) above, Cromwell J. went on to add, at para. 230:

To satisfy the second condition, it must be shown that the breach *resulted in* the assets being in [the wrongdoer’s] hands, not simply...that there was a “connection” between the assets and “the process” in which [the wrongdoer] breached its fiduciary duty. [Underlining added; italics in original.]

66. McLachlin C.J. and Rothstein J. concurred with Cromwell J. In separate reasons, Deschamps J. (Moldaver J. concurring) agreed with Cromwell J.’s reasoning on this point. LeBel J. (Abella J. concurring) dissented.

[142] Here, the confusion arises because, while part of the DeJong investments were wrongfully diverted by Ms. Walton from the DeJong Companies to other uses (that could not be identified because of the pooling and co-mingling of funds), significant portions of the investments were used for precisely the purposes for which they were intended: they were utilized in the acquisition of the four DeJong Properties identified above. In short, the wrongdoing *vis-à-vis* DeJong did not give rise to the acquisition of those assets, although overall there may have been “a connection” between them and “the process” through which the wrongdoing took place.

[143] The Application Judge does not appear to have taken these considerations into account in arriving at his decision to impose a constructive trust in favour of DeJong, yet they posed a clear impediment to the court’s ability to do so in the circumstances, in my view. It is not enough to say that DeJong monies were used in the acquisition of the properties (the monies were intended to be used for that purpose). Nor is it sufficient to say for purposes of imposing a proprietary remedy – as the Application Judge does – that Ms. Walton breached her fiduciary obligations to DeJong by wrongfully transferring monies *out of* the DeJong Companies (the wrongful transfer did not give rise to an identifiable asset); or that the Waltons failed to comply with their agreements to provide capital for the acquisitions (those failures, similarly, did not result in the acquisition of the properties); or that they failed to comply with their obligations to manage the properties (a failure to manage would not generally give rise to a proprietary claim); or, simply, that the breach of fiduciary obligation led to the loss of the DeJong investments (the breach did not lead to the loss of the properties in question).

(2) The Application Judge Failed to Consider the Circumstances

[144] The DBDC Applicants submit as well that in an insolvency context (as is the case here) the availability of other remedies and the adverse impact of imposing a proprietary remedy on other creditors and parties need to be taken into account in determining whether to impose a constructive trust. The Application Judge did not do so, they argue.

[145] There are other creditors in the proceedings. A summary of the proposed payments accepted to date in the Claims Process indicates that the Receiver/Manager has accepted approximately \$60,000 in secured claims (principally from the Canada Revenue Agency) and approximately \$205,000 in unsecured claims.[13]⁶⁷ These claims are dwarfed by the claims at issue in these proceedings: Dr. Bernstein and the DBDC Applicants claim approximately \$66 million against the Waltons and an included \$22.6 million against the Listed Schedule C Companies; approximately \$4 million is claimed by DeJong; and \$160,000 by the Condos.[14]⁶⁸ The claims by Dr. Bernstein and the DBDC Applicants themselves similarly dwarf the DeJong and Condos claims.

67. This is excluding the DeJong claims accepted against St. Clarens Holdings and Emerson Development.

68. The claim of the Levytams has been resolved.

[146] It is significant that DeJong and the Condos did not advance their funds directly on the acquisition of the properties. They advanced their monies to the Schedule C Companies, either as equity investments (the Condos in Cecil Lighthouse; DeJong in United Empire Ltd.), or as shareholder loans (DeJong in respect of Prince Edward Properties, St. Clarens Holdings and Emerson Developments).[15]⁶⁹ They each have remedies in those respective capacities.

[147] With a minor exception concerning the St. Clarens and Emerson companies, the Waltons' shares in the DeJong Companies have been cancelled, leaving DeJong as the overwhelming majority shareholder of United Empire, Prince Edward Properties, St. Clarens and Emerson. Those corporations owned the Schedule C Properties against which DeJong is claiming constructive trusts, and whose proceeds from sale are currently being held by the Manager. DeJong remains an unsecured creditor on the basis of its shareholder loans, and may well have a personal remedy against the Waltons. Granting a constructive trust over the properties, as a remedy for breach of fiduciary duty, would enable DeJong to leapfrog over other creditors in its capacity as a lender by obtaining a proprietary remedy not available to other creditors.

[148] Although the Application Judge did not refer specifically to the relevance of other creditors or other remedies available to DeJong, I am not prepared to assume that he ignored them, experienced Commercial List judge that he was. Indeed, I suspect that these factors were the very ones driving his decision. He would well have recognized that the claims of the DBDC Applicants would overwhelm those of DeJong in an insolvency competition. Although the DBDC Applicants' outstanding losses exceed \$66 million and their recovery has been limited to only approximately \$13 million, they have nonetheless made *some* recovery. DeJong will recover very little in a priorities contest among creditors.

[149] In my view, however, it is not enough to say, simply, that, because different groups of investors have been victims of an overall fraudulent scheme involving the acquisition of various commercial properties, and one group of investors is entitled to a constructive trust against certain of those properties to which their funds can be traced, the other group of investors is in equity entitled to a proprietary remedy against those or other properties in order to achieve some similar recovery in an attempt to be equitable. I do not see the foregoing factors as justifying the imposition of a proprietary remedy, for the benefit of the latter group of investors/creditors and to the prejudice of others, where the fiduciary breach did not directly relate to the acquisition of the properties in question.

[150] For these reasons, I conclude that the granting of constructive trusts in favour of DeJong over the properties owned by the DeJong Companies cannot stand.

69. The Application Judge found that, if he had not granted constructive trusts, he would have held that the DeJong advances with respect to those companies were made by way of shareholder loans. That characterization is supported by the record, and I accept it.

E. THE COSTS AWARD

[151] Given my conclusions with respect to the joint and several damages award and the constructive trust issues, it follows that the costs award below will need to be reconsidered.

DISPOSITION

[152] For the foregoing reasons, I would allow the appeal and set aside the parts of the Judgments and Orders of the Application Judge, dated September 23, 2016, holding that the Listed Schedule C Companies are not jointly and severally liable to the DBDC Applicants, granting constructive trusts in favour of DeJong, and awarding costs against the DBDC Applicants in favour of DeJong, the Condos and the Levytams. In their place I would order that:

- (a) the Listed Schedule C Companies are jointly and severally liable to the DBDC Applicants in the amount of \$22,680,852, subject to the provision that any amounts recovered by the DBDC Applicants on account of the constructive trusts ordered by Brown J. in relation to Schedule C Properties shall be applied in reduction of that amount;
- (b) the respondent Christine DeJong Medicine Professional Corporation is not entitled to constructive trusts over the properties known as 3270 American Drive, Mississauga, Ontario; 324 Prince Edward Drive, Toronto, Ontario; 777 St. Clarens Avenue, Toronto, Ontario; and 260 Emerson Avenue, Toronto, Ontario; and
- (c) leave be granted to appeal the costs portion of the Judgments and Orders and the costs order, and that the costs order be set aside and remitted for reconsideration in view of the foregoing dispositions.

[153] If the parties are unable to agree on the costs below, and because the Application Judge has since retired, the parties may make succinct written submissions to this Court respecting those costs within 30 days of the receipt of this decision.

[154] This has been a contest between innocent victims of a fraud. I do not think this is an appropriate case for costs on the appeal.

“R.A. Blair J.A.”

“I agree E.A. Cronk J.A.”

van Rensburg J.A. (Dissenting):

OVERVIEW

[155] I have had the opportunity to read the detailed and thoughtful reasons of my colleague, Blair J.A. With respect, and for the reasons that follow, I am unable to agree with his proposed disposition of the DBDC Applicants' appeal.

[156] I agree that Norma Walton was in breach of the fiduciary duties she owed to the DBDC Applicants, a point of departure that was not disputed by anyone on the appeal. And I agree with my colleague's conclusion, and that of the Application Judge, that the DBDC Applicants are unable to establish the liability of the Listed Schedule C Companies for knowing receipt.

[157] Where I part company with my colleague, is in his conclusion that the Listed Schedule C Companies participated in or assisted Ms. Walton in the breach of her fiduciary duties to the DBDC Applicants, and in awarding damages of \$22.6 million against these ten companies.

[158] In my opinion, liability for knowing assistance in this case cannot be made out. It accepts, as evidence of both the Listed Schedule C Companies' participation in Ms. Walton's breach of fiduciary duty, and the measure of the appellants' damages, the "net transfer analysis", a summary of cash transfers that was performed by the Inspector at an earlier stage in the oppression proceedings against the Waltons, for an entirely different purpose. It equates a Listed Schedule C Company's participation as a victim in Ms. Walton's "shell game" to participation in a breach of fiduciary duty. It imputes to the Listed Schedule C Companies Ms. Walton's conduct and intent, where her actions defrauded them, and were for her own personal benefit. And it uses as a measure of damages the sum of \$22.6 million, which does not correspond with any proven benefit to or harm caused by any Listed Schedule C Company, but is simply the net amount transferred in a three-year period from the Schedule B Companies to Rose & Thistle (without regard for its source or whether any of the funds ended up in a Listed Schedule C Company).

[159] A judgment for \$22.6 million against the Listed Schedule C Companies would enable the DBDC Applicants to share as unsecured creditors in the proceeds of sale of each of ten Schedule C Properties, after satisfying the constructive trust claims they have made out against some of the properties. This judgment, which purports to reflect the collective losses of the 29 DBDC Applicants, will overwhelm the claims of the investors in the ten Listed Schedule C Companies, who were victims of the Waltons in the same way as the appellants. As my colleague notes, this is a "priorities dispute", however, the effect of a

judgment for damages in their favour is that the DBDC Applicants will receive the lion's share of the net proceeds of sale of properties to which, except for the funds that have been traced and in respect of which they have already been awarded constructive trusts, they made no contribution.

[160] I cannot agree with this result. In my view, the "participation" element of the fault-based claim of knowing assistance is not made out on this record. And, in this case of first impression for our court - where a claim of knowing assistance in a breach of fiduciary duty is made by one group of defrauded investors against another similarly situated group - there is no reason to expand the equitable claim of knowing assistance beyond its proper bounds.

[161] I would therefore dismiss the DBDC Applicants' appeal after concluding that they are not entitled to judgment for \$22,680,852 or for any amount against the Listed Schedule C Companies for knowing receipt or knowing assistance in Norma Walton's breaches of fiduciary duty to the DBDC Applicants.

OUTLINE OF THESE REASONS

[162] I will begin my discussion by identifying two general concerns that will serve to inform later parts of my analysis.

[163] First, the knowing receipt and knowing assistance claims were late-breaking add-ons to the oppression proceedings against the Waltons. I do not agree that they were, as the DBDC Applicants contend, part of the "deferred relief" that was already before Brown J. It is important to recall what was at issue and determined in the earlier proceedings to ensure that the Listed Schedule C Companies are not simply carried along as part of the collective wrong of the Waltons against the DBDC Applicants, and so that the focus, as it should be, is on whether any or all of the Listed Schedule C Companies was a knowing participant in Ms. Walton's breaches of the fiduciary duties she owed to the DBDC Applicants. As such, I find it necessary to review the proceedings leading up to the decision under appeal.

[164] Second, since the DBDC Applicants' claims against the Listed Schedule C Companies depend on the court's acceptance of the "net transfer analysis", its purpose and limitations must be understood. The net transfer analysis served a specific function in the oppression proceedings, to demonstrate the Waltons' fraud on the DBDC Applicants. I will explain why it was never intended to serve as the basis for personal claims against the Listed Schedule C Companies, and why, in my view, it is ill-suited to this purpose.

[165] After addressing these two related contextual points, I will turn to the two claims on appeal. I will explain briefly why I agree with my colleague that the DBDC Applicants cannot succeed in their claim of knowing receipt. I will then turn to knowing assistance and explain why I am unable to agree that the Listed Schedule C Companies are liable for having knowingly assisted in Ms. Walton's breaches of the fiduciary duties she owed to the DBDC Applicants.

THE EVOLUTION OF THE DBDC APPLICANTS' CLAIMS AND THE LATE-BREAKING CLAIMS FOR DAMAGES AGAINST THE LISTED SCHEDULE C COMPANIES

[166] The point of departure is that the DBDC Applicants and the Listed Schedule C Companies (and their investors) were all victims of the fraud perpetrated by the Waltons.[16]⁷⁰ The DBDC Applicants are 29 investment companies controlled by Dr. Bernstein that, in turn, invested in the 34 single-purpose Schedule B Companies, which were to acquire, hold and maintain commercial real estate properties. Dr. Christine DeJong and her husband, Michael, and Dennis and Peggy Condos and other investors did the same, through their personal investment companies, investing in the ten Listed Schedule C Companies.[17]⁷¹

[167] As my colleague describes the scheme, at para. 3, instead of investing their required 50% in the investment companies, the Waltons moved money among the accounts of the investment companies and their personal accounts, using as a clearing house the bank account of their wholly-owned company Rose & Thistle, in “a shell game designed to avoid their obligations and to further their own personal interests”.

[168] The contest throughout the proceedings, except for the recent chapter that is the subject of this appeal, was exclusively between the DBDC Applicants and the Waltons. The proceedings, commenced in 2013 as an oppression application, sought to establish the Waltons' fraud and to obtain an accounting and recovery of the monies they advanced and lost. As such, the respondents were the Waltons, Rose & Thistle and Eglinton Castle Inc. (the “Walton respondents”). The Schedule B Companies (in which Dr. Bernstein, through the DBDC Applicants, invested with the Waltons) were listed in a schedule to the Notice of Application and named as respondents to be bound by the result (hence their definition as “Schedule B Companies”). And 16 properties into which the Waltons were alleged to have diverted the

70. My colleague suggests that, while the investors in the Schedule C Companies were victims of Ms. Walton's fraudulent scheme, the Schedule C Companies were not victims. I respectfully disagree. The Waltons were in breach of their fiduciary duties to the Schedule B Companies when they diverted funds from these specific-purpose corporations (Brown J., at paras. 261 and 264). To the extent they engaged in the same conduct in relation to the Listed Schedule C Companies, the Waltons were in breach of their fiduciary duties to these parties as well. As such, the investors, and the single-purpose investment companies they were investing in, were all victims of Ms. Walton's fraudulent scheme.

71. Christine DeJong Medicine Professional Corporation invested in United Empire Lands Ltd., Prince Edward Properties Ltd., St. Clarens Holdings Ltd. and Emerson Development Ltd., while the Condos and the Levytams invested in Cecil Lighthouse Ltd. The other investors in the remaining Listed Schedule C Companies did not participate in the proceedings, which is not surprising considering the small amount of net proceeds generated by the sale of these Listed Schedule C Company properties.

DBDC Applicants' money (including their home on Park Lane Circle) were identified in a schedule to the Notice of Application (hence their definition as "Schedule C Properties"). Other parties who may have invested in those properties (including the DeJongs, the Condos and the Levytams) were not parties to the proceedings, as the DBDC Applicants only sought to trace their funds into the Waltons' interests in such properties.

[169] When the case came before Brown J. in July 2014 (with reasons released August 12, 2014), it was a chapter in the "on-going litigation between Dr. Bernstein and the Waltons concerning the need for the respondents to account for funds, and to be held accountable for funds, invested by Dr. Bernstein and his companies with them" (Brown J. Reasons, at para. 2). None of the Schedule C Companies were parties to the proceedings at this point,^[18]⁷² although the court considered a motion by Dr. DeJong's corporations seeking relief in respect of one Schedule C Property, 3270 American Drive, Mississauga, in which they had invested, including seeking approval of a settlement agreement with the Waltons.

[170] Brown J. considered the evidence, including the Inspector's reports and "net transfer analysis" (discussed below) and, after rejecting almost all of the Waltons' evidence contending that the DBDC Applicants' funds had been used for legitimate purposes, he concluded that the Waltons were liable to the DBDC Applicants for damages for breach of contract, "unlawful misappropriation" and unjust enrichment. Because the measure of damages for each cause of action would be different, Brown J. deferred the assessment of damages to another day for further argument.

[171] Brown J. also granted constructive trusts in respect of eight Schedule C Properties into which the Inspector had traced money from the DBDC Applicants. This relief was opposed by the Waltons, who filed and relied on the affidavits and statements of Dr. DeJong and 30 other investors, attesting to the value of their investments in five Schedule C Properties.^[19]⁷³ Brown J. appointed the Inspector as Receiver or Manager with power to sell the Schedule B Properties and the Schedule C Properties. At para. 271 he stated:

...While at this point of time the tracing analysis has not progressed to the stage to enable the granting of specific, fixed amount constructive trusts over the other Schedule C Properties, the evidence justifies the appointment of a receiver over all Schedule C Properties in order to sell them and deal with the competing claims against the proceeds of sale, including the Applicants' strong claims of constructive trusts over the remaining Schedule C Properties.

72. In fact, according to Dr. DeJong, the fact of the proceedings became known to the DeJongs and various other investors only after some 20 orders had already been made in the proceedings.

73. The investors whose affidavits and statements were filed by the Waltons were not parties to the proceedings in their own right. Only DeJong participated in the proceedings, making submissions at the hearing before Brown J., seeking to uphold a settlement with the Waltons and opposing the relief sought in respect of the Schedule C Properties. See para. 263 of Brown J.'s reasons.

[172] Brown J. ordered the Schedule C Companies that owned the Schedule C Properties to provide the manager with full access to their books and records, so that “a full tracing of the [DBDC Applicants’] funds [could] occur” (at para. 278). Until that point, the Inspector/Manager did not have access to any Schedule C Company accounts.

[173] Brown J. also appointed the Inspector as the Waltons’ receiver noting, at para. 231, that the appointment was necessary to ensure that the Waltons could not dispose of their Schedule C property “until proper consideration [could] be given to [the DBDC applicants’] claims and the respective interests of all creditors of the Waltons.”

[174] Brown J. anticipated that the DBDC Applicants, armed with the Receiver’s additional powers, would seek to trace their funds into additional Schedule C Properties, apart from the ones in which constructive trusts were already awarded, and that the Receiver, after selling the properties, would deal with the claims. He left the issue of priority of claims between creditors in respect of the proceeds of disposition of a Schedule C Property to be addressed in the claims process *for that Property*. He refused to enforce the settlement agreement between the Waltons and the DeJongs and concluded that “the legal entitlement, if any, of the DeJongs, as preferred shareholders, to the proceeds from the sale of 3270 American Drive should be dealt with in the claims process for that property” (at paras. 263, 271 and 289).

[175] The DBDC Applicants contend that the attendance before Newbould J. in June 2016 was for “deferred relief”. This is true, but only in the sense that Brown J. had deferred the determination of the DBDC Applicants’ damages against the Waltons. There was no deferred relief in respect of the Listed Schedule C Companies, because they were not yet parties to the litigation and no claims for damages had been asserted against them when the matter was before Brown J. While Brown J. granted a motion to amend the Notice of Application, it was not until the Notice of Application was amended by Newbould J. that the Listed Schedule C Companies were joined as parties, a cause of action was pleaded, and damages were claimed against them.[20]⁷⁴

[176] In his reasons dated September 23, 2016, Newbould J. concluded, at para. 32, that the Waltons committed civil fraud and fraudulent misrepresentation that caused Dr. Bernstein to invest his funds into the Schedule B Companies. He awarded damages of \$66,951,021.85 plus interest against the Walton respondents. In granting an order that the judgment would survive bankruptcy under ss. 178(1)(d) and (e) of the *Bankruptcy and Insolvency Act*, Newbould J., relying on certain of Brown J.’s

74. See the Order of Newbould J. dated September 23, 2016, paras. 3.4, and 5 and Appendix A. I respectfully disagree with my colleague’s summary (at para. 11) of the relief claimed by the DBDC Applicants when they were before Brown J. At para. 241 of his reasons, Brown J. referred to an amended draft judgment the DBDC Applicants put before the court containing several paragraphs of relief in relation to the Schedule C Properties, including the claims referred to by my colleague, which were for joint and several liability of the Walton respondents and the Schedule C Companies/Properties for net proceeds diverted from the Schedule B Companies. However, there is no other reference in Brown J.’s reasons to any claim for any amount of money by the DBDC Applicants against the Schedule C Companies, or to an amendment of the application to permit such a claim to be made.

earlier findings, concluded, at para. 35, that the “liability of the Waltons arose from their fraud while acting in a fiduciary duty to Dr. Bernstein”, as well as from their fraudulent misrepresentation that caused them to obtain property (at para. 36).

[177] As for their remedy in relation to the Schedule C Properties, instead of quantifying their unjust enrichment claim against the Waltons by conducting a further tracing as Brown J. had envisaged, the DBDC Applicants sought to add the Listed Schedule C Companies as respondents to the proceedings, and to advance claims for damages against them based on knowing receipt and knowing assistance in the Waltons’ breach of fiduciary duty.

[178] The claims against the Listed Schedule C Companies were not pursued in the conventional manner through an action, with pleadings and documentary and oral discovery. Rather, the claims were added to the oppression proceedings, and set out in a proposed Third Fresh as Amended Notice of Application (at paras. 1(jj), 2 and 3(rr) to (ccc) and (kkk) to (uuu)). The amendments allege, under “Unjust Enrichment,” that the Waltons, in breach of their fiduciary duties, diverted and misappropriated the DBDC Applicants’ funds, and that “various Walton-owned companies”, including the Listed Schedule C Companies, were knowing recipients of funds obtained as a result of the Waltons’ breaches of fiduciary duty against them”.

[179] Under the heading “Knowing Assistance”, the DBDC Applicants allege that the Listed Schedule C Companies had actual knowledge of (or were reckless or wilfully blind to) the Waltons’ breaches of fiduciary duty owed to the DBDC Applicants, and that they jointly assisted in the breaches. They assert, as part of their knowing assistance claim, that *each Listed Schedule C Company received property from the DBDC Applicants* as a result of the Waltons’ breach of fiduciary duties, having knowledge that the property was transferred in breach of a fiduciary duty.

[180] The claim is for \$22.6 million jointly and severally against the Walton respondents and the Listed Schedule C Companies, or in the alternative for an order awarding specific damages against each of seven of the Listed Schedule C Companies.[21]⁷⁵

[181] The record on which the DBDC Applicants seek to establish the Listed Schedule C Companies’ liability for damages was created in the context of oppression proceedings involving the Waltons, at a time when the Listed Schedule C companies were not parties. The DBDC Applicants did not advance any new evidence to support the participation of these added respondents in Ms. Walton’s breaches of her fiduciary duties, which is essential to any finding of knowing assistance. Rather, they relied on evidence already before the court about the Waltons’ fraud, certain findings of Brown J., and especially the net transfer analysis.

75. The specific claims are against 1780355 Ontario Inc., 6195 Cedar Street Ltd., Atala Investments Ltd., Bible Hill Holdings Inc., Cecil Lighthouse Ltd., The Old Apothecary Building and United Empire Lands Ltd., in amounts that correspond with the “net transfers” from Rose & Thistle to each company account between October 2010 and October 31, 2013, less any constructive trust amount already awarded.

[182] Thus, instead of pursuing the further tracing that Brown J. had anticipated would follow his appointment of the Waltons' receiver, the DBDC Applicants claimed damages against the ten Listed Schedule C Companies, with a view to sharing in the proceeds of sale of their ten properties. The net proceeds now in the hands of the Receiver against which the DBDC Applicants seek to share as unsecured creditors are:

3270 American Drive, owned by United Empire Lands Ltd.: \$656,362 (after full payment of the DBDC Applicants' constructive trust claim);

324 Prince Edward Drive, owned by Prince Edward Properties Ltd.: \$580,623;

777 St. Clarens Avenue, owned by St. Clarens Holdings Ltd.: \$431,603;

260 Emerson Avenue, owned by Emerson Developments Ltd.: \$172,376;

24 Cecil Street, owned by Cecil Lighthouse Ltd.: \$812,510;

0 Luttrell Avenue, owned by Bible Hill Holdings Inc.: \$6,235 (subject to a DBDC Applicants' constructive trust);

2 Kelvin Avenue, owned by 6195 Cedar Street Ltd.: \$11,497 (subject to a DBDC Applicants' constructive trust);

30 and 30A Hazelton Ave., owned by Atala Investments Inc.: \$17,942;

66 Gerrard Street East, owned by The Old Apothecary Building Inc.: \$86,480; and

346 Jarvis Street, Suite E, owned by 1780355 Ontario Inc.: \$0 (already subject to a DBDC Applicants' constructive trust).

[183] This chapter of the proceedings is, as my colleague points out, a priorities dispute. The DeJongs were investors in the Schedule C Companies that acquired the first four properties listed above. The Condos invested in the company that acquired the Cecil Street property. The DBDC Applicants are unable to trace their funds into these properties, so they are seeking damages against the individual companies. The only way they can share in the proceeds of properties in which they have been unable to trace their own funds is as unsecured judgment creditors of the Listed Schedule C Companies, which requires that they establish liability for knowing receipt or knowing assistance. Both causes of action, for their success, depend almost entirely on the court's acceptance of the net transfer analysis, to which I now turn.

THE NET TRANSFER ANALYSIS

[184] The DBDC Applicants rely on the “net transfer analysis” as a cornerstone of their knowing assistance claim: both as evidence of the participation of the Listed Schedule C Companies in Ms. Walton’s breaches of her fiduciary duties and for the amount of their damages. My colleague accepts the net transfer analysis in concluding that the *Canadian Dredge* test is met (at paras. 80 and 83), as the point of departure for determining the participation of the Listed Schedule C Companies in the fraudulent scheme (at paras. 84 and 87), and as the measure of the DBDC Applicants’ damages for knowing assistance (at para. 128).

[185] As I will explain, the net transfer analysis was never intended to be used for the purpose of establishing a claim by the DBDC Applicants against the property of other defrauded investors and, as I see it, it does not provide the foundation for their claim for knowing assistance.

[186] The net transfer analysis is based on a summary of cash transfers between Schedule B Company accounts and Rose & Thistle that was attached as a schedule to the Inspector’s fourth interim report. The analysis is dated December 31, 2013 and covers transactions between September 2010 and October 2013. The Inspector acknowledged that it was not intended to account for all of the dealings between the various accounts from inception, and stated in his fifth report that “the tracing charts...[were] intended to provide a snapshot of activity at a particular point of time” and “funds transferred to or from the relevant company outside of the time period [were] not captured” (Brown J., at para. 159).

[187] The cash transfer summary shows that, cumulatively, Rose & Thistle received \$23.6 million more from the Schedule B Companies’ accounts than it transferred to such accounts. This is the “net transfer” amount.

[188] The Inspector also looked at cash transfers between Rose & Thistle and all of the other Walton-controlled accounts other than Schedule B Company accounts. These 54 accounts the Inspector and Brown J. referred to as both “Walton Accounts” and “Schedule C Company Accounts”.

[189] The Schedule C Company accounts included Norma Walton’s personal account (into which the Inspector identified a net transfer of \$5.4 million from Rose & Thistle), Walton Advocates (into which the Inspector traced a net transfer of \$1.6 million from Rose & Thistle), and several Rose & Thistle accounts (into which the Inspector traced a net transfer of more than \$6.4 million). The Schedule C Company accounts also included those of the single-purpose investment companies set up by the Waltons (other than the Schedule B Companies), including the accounts of eight of the ten Listed Schedule C Companies.[22]⁷⁶

76. The Listed Schedule C Companies St. Clarens Holdings Ltd. and Emerson Developments Ltd. are not included in the net transfer analysis.

[190] The net transfer analysis showed that, during the same three-year period, cumulatively and on a net basis, the amount of \$25.4 million was transferred into the Walton-controlled accounts (other than the Schedule B Company accounts) from Rose & Thistle.

[191] Taking the largest 53 advances by the DBDC Applicants to the Schedule B Companies, the Inspector examined the activity in the relevant Schedule B Company bank account immediately following the advance and looked for any contemporaneous transfer of funds from the relevant Schedule B Company account to the Rose & Thistle bank account. Then he examined the Rose & Thistle bank account to ascertain what activity occurred following the receipt of funds transferred in from the Schedule B account, and in particular, whether there was any contemporaneous transfer of funds from the Rose & Thistle account to a Schedule C Company account (Brown J., at para. 17). The Inspector noted that, while funds could be traced directly in seven instances to the purchase of specific Schedule C Properties, in most cases monies were intermingled.

[192] Before Brown J. the DBDC Applicants relied on the net transfer analysis to obtain proprietary remedies against certain Schedule C Properties. Brown J. recognized that the net transfer analysis supported the conclusion that the DBDC Applicants had a strong claim for unjust enrichment *against the Waltons in respect of the Schedule C Properties* (at paras. 227, 231, 264 and 268). He granted constructive trusts over those properties where the Inspector established that soon after the transfer of money from a Schedule B Company account, a Schedule C Property was purchased, that is, where the Schedule B monies were traced into a Schedule C Property.[23]⁷⁷

[193] Brown J.'s findings based on the net transfer analysis are summarized by my colleague at para. 16, as follows:

- (i) the Waltons directed the transfer of a net \$23.6 million from the Schedule B Company accounts to a bank account belonging to Rose & Thistle during the period from October 2010 to October 2013;
- (ii) during the same period, the Waltons directed transfers of a net \$25.4 million from the Rose & Thistle account to the Schedule C Companies;
- (iii) in almost all cases, some or all of the amounts advanced to the Schedule B Companies by the DBDC Applicants were transferred almost immediately to the Rose & Thistle account; and

77. Brown J. found that the following amounts of the DBDC Applicants' funds were used to purchase or discharge encumbrances on Schedule C Properties: 14 College St.: \$1,314,225; 3270 American Drive: \$1.032 million; 2454 Bayview: \$1.6 million; 346E [346F] Jarvis St.: \$937,000; 44 Park Lane Circle: \$2.5 million; 2 Kelvin Street: \$221,000; 0 Trent [0 Luttrell]: \$152,900; and 26 Gerrard Street: \$371,200. He granted constructive trusts in favour of the DBDC Applicants in respect of each of these properties for the proportionate share of the purchase price that these amounts represented at the date of purchase and for any proportionate share of the increase in value to the date of realization (at paras. 264-267).

- (iv) those transfers of funds from the Schedule B Companies to Rose & Thistle constituted breaches of the agreements between the DBDC Applicants and the Waltons.

[194] The net transfer analysis does not, as the DBDC Applicants contend, “demonstrate that \$22.6 million of the funds misappropriated from the DBDC Applicants were diverted to the use and benefit of the Schedule C Companies” (DBDC Applicants’ Factum, at para. 57). There are a number of reasons why I conclude that the net transfer analysis does not support the claims against the Listed Schedule C Companies.

[195] First, the \$22.6 million amount consists of the net amount transferred from Schedule B Company accounts to Rose & Thistle (less \$1 million credited to the Waltons for proper expenses). Except as has been accounted for by constructive trust, the net transfer analysis does not show where the money went after it was transferred into Rose & Thistle, or that any of the “net” money ended up in any particular Walton-controlled account (including any Listed Schedule C Company account).

[196] Contrary to what is pleaded by the DBDC Applicants, the \$22.6 million does not represent the extent to which any Schedule C Company or even the Schedule C Companies as a whole, were enriched by the DBDC Applicants’ monies diverted from the Schedule B accounts.

[197] Second, although the net transfer analysis also indicates that Schedule C Company accounts received a net transfer of \$25.4 million, this is simply the net amount that was transferred from Rose & Thistle to all 54 Walton-controlled accounts, other than the Schedule B Company accounts. It does not identify the source of the money coming from Rose & Thistle into a Schedule C Company Account. Without a proper tracing, no particular Schedule C Company account can be said to have received the benefit of Schedule B Company monies. Where a tracing has occurred, a constructive trust have been awarded.

[198] My colleague states, at para. 80, that as a result of these net transfers, the Schedule C Companies acquired funding necessary for their ongoing operations and he refers to Brown J. accepting the Inspector’s conclusion that “the [DBDC] Applicants’ investment in the Companies was a major source of funds for the Walton Companies.” At the time this finding was made by Brown J., however, the Inspector did not yet have access to the Schedule C Company accounts, and therefore did not consider the funds invested by others, such as the DeJongs and the Condos, into the Schedule C Properties, transfers between the Schedule C Company accounts, and the movement of funds between such accounts and Rose & Thistle. Even if it could be said that the Walton or Schedule C Companies as a whole acquired funding for their operations, this tells us nothing about what was happening in the account of any specific Schedule C Company, including all of the Listed Schedule C Companies (which of course had also received funds from their investors).

[199] As I see it, the central problem with using the net transfer analysis as a basis for a claim against the Listed Schedule C Companies, is that it treats all Walton-controlled accounts in the same way, and as a collective, when the investors in the Listed Schedule C Companies (which are only a subset of the Walton-controlled companies or accounts) were equally victims of the Waltons' fraud. The Waltons used a number of corporate entities to perpetrate their fraud on the appellants and the respondents – the corporate entities were the pawns in their “shell game.” Some were entirely Walton-controlled, and others were investment companies set up in the same way as the DBDC Applicants' Schedule B Companies, to be co-owned by investors. The DBDC Applicants point to the net funds that were transferred from Rose & Thistle to all Schedule C Company accounts as a collective, but then target only ten such companies, the ones with valuable property and other defrauded investors, for the purpose of their knowing assistance claim.

[200] My colleague, at para. 106, considers it significant “that net funds of \$23.6 million *flowed out of the Schedule B Companies* into Rose & Thistle, and net funds of \$25.4 million *flowed out of Rose & Thistle into the Schedule C Companies.*” He concludes that “it is the DBDC Applicants, not the Schedule C Companies, that suffered the net losses”.

[201] In my view, the net transfers into and out of Rose & Thistle do not assist in establishing the liability of the Listed Schedule C Companies. Because it was designed to show the DBDC Applicants' losses, the net transfer analysis sets up, on one side of the ledger, the accounts of the DBDC Applicants' Schedule B Companies, and on the other, the 54 other Walton-controlled accounts. It stands to reason that the DBDC Applicants suffered the net losses, when compared to all of the Walton-controlled accounts. The DBDC Applicants invested much more than the Waltons and more than any other investor. If the Waltons failed to make their capital contributions and were siphoning money to their own personal accounts as well as moving investor money around, it follows that the amount transferred to Rose & Thistle by the Schedule B Companies would be more than the amount paid out by Rose & Thistle to such companies.

[202] The DBDC Applicants invoke the net transfer analysis as a measure of their collective losses against the Listed Schedule C Companies as a subset of the 54 Schedule C Companies. In fact, the net transfer analysis shows that, when the DBDC Applicants' Schedule B Companies are considered individually, at least nine of them were *net beneficiaries* of transfers from Rose & Thistle.[24]⁷⁸ And, when the Schedule C Companies are considered individually, an amount going into a Schedule C Company account could as easily have been money from another Schedule C Company account. The money cannot be traced from a Schedule B Company account.

[203] At paras. 57 to 59 of his reasons, the Application Judge identified the shortcomings in the net transfer analysis where he stated:

78. Bannockburn Lands Inc., Cityview Industrial Ltd., Dupont Developments Ltd., Leslie Lands, Liberty Land, Northern Dancer Lands Ltd., Queen's Corner Corp., Tisdale Mews Inc. and Twin Dragons Corporation.

[Referring to the example of 6195 Cedar Street Ltd.], there is no proof where Rose & Thistle obtained the money that was transferred to 6195 Cedar Street Ltd. It may have come from one of Dr. Bernstein's companies. It may not have. It may have come from investors in the Schedule C Companies whose money was transferred to Rose & Thistle. The report does not state where the money came from. The same can be said for all of the Schedule C Companies that the applicants seek a judgment against for knowing receipt of trust funds. Moreover, the schedule was as of a point in time and whether the balance changed over time is not known as no analysis was done.

What happened to the money transferred to the Schedule B and C Companies by Rose & Thistle is not in evidence. On the hearing before Brown J., the applicants were able to establish that Dr. Bernstein's funds went into several Schedule C Properties and a constructive trust was ordered in favour of the applicants in respect of those properties. No constructive trust was ordered with respect to the property of the Schedule C Companies that the applicants now seek a judgment against, which I take to be recognition that the applicants did not have evidence that their money went into those properties. In paragraph 13 of his formal judgment of August 12, 2014, Brown J. ordered that the applicants were permitted to trace funds provided by the applicants into and through the accounts of the Schedule B Companies into the Schedule C Companies. However the applicants did not undertake any such tracing. *The applicants have not established that it was the applicants' money that was received by the Schedule C Companies in question.*

In light of the way in which Ms. Walton transferred money around, I could not without a tracing analysis hold that Dr. Bernstein's money ended up in the Schedule C Companies against which the applicants now seek a judgment. [Emphasis added.]

[204] I agree entirely with these comments. In my opinion, not only does the net transfer analysis fail to establish the receipt by the Listed Schedule C Companies of DBDC Applicants' funds for the purpose of knowing receipt, it also cannot support the claim against them for knowing assistance. Yet, the DBDC Applicants rely on the net transfer analysis as evidence of the Listed Schedule C Companies' participation in Ms. Walton's breach of fiduciary duties and as the measure of their damages. I turn now to the substance of their claims.

A. THE KNOWING RECEIPT CLAIM

[205] My colleague concludes, and I agree, that the DBDC Applicants have failed to make out a claim for knowing receipt. "Knowing receipt" here refers to the receipt by the Listed Schedule C Companies of monies belonging to the DBDC Applicants that were entrusted to Ms. Walton's control, and diverted in breach of her fiduciary duties.

[206] At paras. 56 to 59 of his reasons, the Application Judge rejected the knowing receipt claim after referring to and rejecting the net transfer analysis, which was relied on by the DBDC Applicants. Without a tracing analysis he could not find that the DBDC Applicants' money (other than what was already accounted for by constructive trust) ended up in the Listed Schedule C Companies.

[207] In their appeal to this court, the DBDC Applicants continue to assert that knowing receipt was made out. They contend that the Application Judge made a palpable and overriding error in concluding, on a balance of probabilities, that the Listed Schedule C Companies did not knowingly receive funds misappropriated from the DBDC Applicants. Importantly, they continue to rely on the net transfer analysis as providing such evidence (see paras. 65 to 71 of their factum).

[208] The rejection of the DBDC Applicants' knowing receipt claim recognizes that the net transfer analysis does not demonstrate the receipt of their funds by the Listed Schedule C Companies. As my colleague notes, the DBDC Applicants have been unable to demonstrate "the receipt of any particular funds by any particular Schedule C Company other than the funds with respect to which Brown J. previously granted constructive trusts" (at para. 38).

[209] In my opinion, just as the net transfer analysis cannot demonstrate receipt by a Schedule C Company of any DBDC Applicants' monies, it cannot provide support for the claim of knowing assistance. Yet, as I will explain, acceptance of the net transfer analysis is essential if the DBDC Applicants are to establish the "participation" and damages elements of this claim.

[210] I turn now to the knowing assistance claim.

B. THE KNOWING ASSISTANCE CLAIM

(1) Elements of the Equitable Wrong

[211] The elements of knowing assistance in a breach of fiduciary duty were described by this court in *Harris v. Leikin*, at para. 8, as: (1) a fiduciary duty; (2) a fraudulent and dishonest breach of the duty by the fiduciary; (3) actual knowledge by the stranger to the fiduciary relationship of both the fiduciary relationship and the fiduciary's fraudulent and dishonest conduct; and (4) participation by or assistance of the stranger in the fiduciary's fraudulent and dishonest conduct.

(2) The Fraudulent and Dishonest Breach of Ms. Walton's Fiduciary Duties to the DBDC Applicants

[212] The point of departure in determining the liability of the Listed Schedule C Companies for knowing assistance is to identify the breaches of fiduciary duty in which they are alleged to have participated or assisted.

[213] The Application Judge accepted, at para. 34, that the diversion of funds out of the Schedule B Companies by the Waltons for their own purposes was in breach of their fiduciary duties, and, at para. 47, that when she knowingly took a risk with the money belonging to the Schedule B Companies that she had no right to take, Ms. Walton's activity was fraudulent and dishonest. My colleague has explained

how the duties would have been owed by Ms. Walton to the DBDC Applicants, notwithstanding that the relationship was contractual, an analysis I am prepared to accept.^[25]⁷⁹ The existence and dishonest breaches of the fiduciary duties owed by Ms. Walton to the DBDC Applicants are not contested on appeal.

[214] It is particularly important in this case, where the alleged participants were also victims of the Waltons' fraud, to keep the focus on the specific breaches of fiduciary duty in which they are alleged to have participated, rather than the overall fraud in which the Waltons were engaged. The overall fraudulent scheme involved Ms. Walton's breaches of her fiduciary duties to *both* the DBDC Applicants and the respondents (as my colleague notes at paras. 76, 80, 85 and 95). For the purpose of the wrong of knowing assistance, however, the focus must be on the breach of fiduciary duties owed to the DBDC Applicants, otherwise the risk is that Ms. Walton's use of the Listed Schedule C Companies in the "shell game" will be considered sufficient to mark them as participants for the purpose of the knowing assistance claim.

[215] My colleague's analysis of what the Listed Schedule C Companies are alleged to have done as "participants" focuses on their involvement in the overall fraudulent scheme, including as victims of that scheme. This leads him to conclude, at para. 68, that Ms. Walton's "perpetration of the scheme was their participation in the scheme." In order for the Listed Schedule C Companies to be liable as accessories to that breach, they must have done something to participate in the breach of fiduciary duty which is, as the DBDC Applicants have pleaded, and the Application Judge found, the diversion of their funds out of the Schedule B Companies for the Waltons' personal use. It is to the element of participation that I now turn.

(3) The Listed Schedule C Companies Did Not "Participate" or "Assist" in Ms. Walton's Breaches of Fiduciary Duty to the DBDC Applicants

[216] Liability for knowing assistance in a breach of fiduciary duty is fault-based. It requires an intentional wrongful act on the part of the "stranger" or accessory, to knowingly assist in the fraudulent and dishonest breach of fiduciary duty. Participation in a breach of fiduciary duty for the purpose of knowing assistance requires that the accessory "participated in or assisted the fiduciary's fraudulent and dishonest conduct": *Enbridge Gas Distribution Inc. v. Marinaccio*, at para. 23.

[217] All of the knowing assistance cases cited by the parties involved specific harmful conduct by the "stranger" that assisted in the breach of fiduciary duty or breach of trust. In *Air Canada v. M & L Travel Ltd.*, the accessory stopped the payment of trust funds, opened an account and attempted to transfer the

79. Brown J. found that Ms. Walton was in breach of the fiduciary duties she owed as a director of the Schedule B Companies. The problem with asserting a claim through these entities however is that because their losses were caused by the fraudulent actions of an insider, the claim could be met with a defence of *ex turpi causa*. See, for example, *Livent Inc. v. Deloitte & Touche*, 2016 ONCA 11, appeal allowed in part, 2017 SCC 63.

funds into the new account. In *Enbridge Gas Distribution Inc. v. Marinaccio*, the accessories prepared invoices, opened bank accounts, arranged for wire transfers and accepted cash. In *Agip (Africa) Ltd. v. Jackson et al.*, the accessory concealed a self-interested transaction, and played the role of a disinterested arms' length vendor. And in *Locking v. McCowan*, 2016 ONCA 88 (a pleadings case), the accessory was alleged to have set up company structures and controlled the fraudulent movement of money out of the payee companies.

[218] By contrast here, the DBDC Applicants do not point to any conduct by any or all of the Listed Schedule C Companies as their participation in the Walton breach of fiduciary duty – except to repeat the same allegation as in respect of knowing receipt: “the Schedule C Company Respondents received property from the Applicants as a result of the Waltons’ breach of their fiduciary duties owed to the Applicants”, and that they “each received this property from the Applicants having knowledge that the property was transferred in breach of a fiduciary duty”: Third Fresh as Amended Notice of Application, at paras. 3(ttt) and (uuu).[26]⁸⁰

[219] While my colleague does not make the finding sought by the DBDC Applicants — that each Listed Schedule C Company received their property — he is nevertheless satisfied that participation is made out. With respect, I disagree.

[220] First, as I have already noted, my colleague’s focus is on the overall fraud, and not the diversion of the DBDC Applicants’ funds to the Waltons’ personal use. At para. 57 of his reasons, he characterizes the pertinent question as whether Ms. Walton “caused the Schedule C Companies to participate in her fraudulent dealings”. He answers the “participation” question at para. 86, by saying that Ms. Walton “utilized the Schedule C Companies as actors in the process of orchestrating her shell game through the Rose & Thistle “clearing house” account”, and he then describes how she co-mingled and diverted the funds of both the DBDC Applicants and the Listed Schedule C Companies, using various pretexts. Again, at para. 95, he refers to the Listed Schedule C Companies as actors in Ms. Walton’s “overall fraudulent undertaking in breach of her fiduciary obligations to both the DBDC Applicants and DeJong”.

[221] The Listed Schedule C Companies may have “participated” in the general sense in the Waltons’ fraudulent scheme or arrangement when money was moved to and from their accounts, in the same way money was moved to and from the Schedule B Company accounts. The actions of the Listed Schedule C Companies were the same as those of the Schedule B companies – they were conduits and used as part of the Waltons’ shell game. All of the victims of Ms. Walton’s fraud, including the Listed Schedule C Companies, may well have been *used by her* in the overall fraud, but, in my view, that does not equate to their participation in the dishonest breach of fiduciary duty to the DBDC Applicants so as to attract personal liability for damages.

80. My colleague suggests that I have conflated knowing assistance with knowing receipt by requiring a benefit to have been received by a Listed Schedule C Company before knowing assistance is made out. While knowing assistance and knowing receipt are distinct wrongs, in this case the DBDC Applicants themselves rely on the same alleged fact – the diversion of their monies into the Listed Schedule C Properties – to support both claims. No other form of “participation” is alleged.

[222] Second, in finding participation, my colleague relies on the net transfer analysis to point to the collective benefit of the Waltons' arrangement to the Schedule C Companies. In his view, the Schedule C Companies were "significant net beneficiaries", they acquired properties as intended and they "benefitted at least partly from Ms. Walton's actions" (at paras. 79, 80 and 124). He states, at para. 80, that, based on the net transfers of monies from the Schedule B Companies to Rose & Thistle and from Rose & Thistle to the Schedule C Companies, "the latter acquired funding necessary for their ongoing operations" and he refers to Brown J.'s acceptance of the conclusion that the DBDC Applicants' investments in the Schedule B Companies "[were] a major source of funds for the [Schedule C] Companies" (which as I have noted was a finding made without reference to the Schedule C Company accounts).

[223] With respect, I disagree with the acceptance of the net transfer analysis to support a finding of participation. The net transfer analysis only establishes that the *collective* of the 54 Walton-controlled accounts (consisting of all accounts controlled by the Waltons other than those of the Schedule B Companies) benefitted from the Waltons' overall fraud, during the three-year period considered by the Inspector. It does not prove that any one or more of the ten Listed Schedule C Companies received a benefit or that this enabled them to acquire properties (except where constructive trusts were already imposed). Nor does the net transfer analysis demonstrate that any Listed Schedule C Company participated in Ms. Walton's diversion of the DBDC Applicants' funds.

[224] Third, even when my colleague considers the individual Listed Schedule C Companies (at paras. 87 to 96), he does not identify any evidence of their "participation" or "assistance" in the breach of fiduciary duty to the DBDC Applicants. Instead he refers to transfers from their accounts to and from Rose & Thistle, saying that, with two possible exceptions, each "either *received from or transferred to* Rose & Thistle monies or monies-worth during the relevant period", and that this both meets the test for the second and third elements of *Canadian Dredge* and for the participation/knowing assistance requirement (at paras. 80, 83, 84, 95 and 96). I respectfully disagree.

[225] Prince Edward Properties Ltd. is the Listed Schedule C Company in respect of which there was a net transfer from its account to Rose & Thistle of \$520,850 during the three-year period covered by the net transfer analysis. Only \$100 was transferred the other way. There is no evidence that it benefitted from or participated in the diversion of the DBDC Applicants' funds (or even that it was a beneficiary of the Waltons' overall fraud). There is no evidence of net Schedule B Company monies being transferred into this Listed Schedule C Company account, or that they were used to acquire its property, 324 Prince Edward Drive.

[226] The two exceptions referred to by my colleague are St. Clarens Holdings Ltd. and Emerson Developments Ltd., where there is no evidence of *any* transfer of funds between their accounts and Rose & Thistle account, let alone any evidence of a transfer of the DBDC Applicants' funds into these entities. In fact, as the respondents point out, since the Schedule C Properties, 777 St. Clarens Avenue and 260

Emerson Avenue, were acquired after the Inspector was appointed, and the Waltons had no access to the DBDC Applicants' funds, no DBDC Applicant monies could have found their way into these Schedule C Companies, or been used to acquire their properties.

[227] My colleague acknowledges that there is no evidence of any transfer between Rose & Thistle and these companies, and, at paras. 90 to 93, he describes how they were defrauded by Ms. Walton. He concludes that Ms. Walton's acts in defrauding these Listed Schedule C Companies "engaged the Listed Schedule C Companies as actors in her overall fraudulent undertaking", that "each of these transactions" required a corporate act, and that "Ms. Walton's acts were their acts, and the Companies accordingly participated in or assisted Ms. Walton in her breach of fiduciary duties to the DBDC Applicants" (at para. 96). With respect, I disagree that participation is made out here. It would mean that being a defrauded entity, as part of a larger fraud, can constitute knowing assistance in the fraudster's breach of fiduciary duty to another fraud victim.

[228] Even in the case of the seven Listed Schedule C Companies where the net transfer analysis shows a net transfer of monies from Rose & Thistle to their individual accounts during the relevant period (United Empire Lands Ltd., Bible Hill Holdings Ltd., 6195 Cedar Street Ltd., Cecil Lighthouse Ltd. and The Old Apothecary Building Inc., Atala investments Inc. and 1780355 Ontario Inc.), this is not evidence of that company benefiting from, or in any other way participating in, Ms. Walton's breach of fiduciary duty, which is her diversion of funds from the DBDC Applicants. As we have seen, the net transfer analysis does not take into account monies that were invested directly from the Schedule C Company investors, including the investors in the Listed Schedule C Companies, or transfers between Schedule C Company accounts.

[229] The only benefit that is demonstrated here is a "net benefit" to the Schedule C Companies as a collective, from the transfer of Rose & Thistle monies. I have already identified what I view as the limits of the net transfer analysis. Even if more money flowed from Rose & Thistle into a Listed Schedule C Company than what that company paid to Rose & Thistle, this is not evidence that the Listed Schedule C Company benefited from or participated in the specific breach of fiduciary duty, which was the diversion of the DBDC Applicants' funds from their intended purpose.

[230] The actions my colleague relies on for the Listed Schedule C Companies' participation, are that the Listed Schedule C Companies received and paid monies to Rose & Thistle (and in some cases were simply defrauded by the Waltons). In my view, this conduct does not rise to the level of knowing assistance by the Listed Schedule C Companies in a breach of a fiduciary duty any more than it would engage the Schedule B Companies in such a breach. They were not participants acting in their own right to further a breach of fiduciary duty. They were *used by* the Waltons as part of a fraudulent scheme. In this regard the Schedule B companies and the innocent investor Schedule C Companies are on an equal footing.

[231] As such, while the Listed Schedule C Companies may have participated in Ms. Walton's overall fraudulent scheme, in the sense that they were used by her in the "shell game" to co-mingle investor funds, and to avoid making her own contributions, the net transfer analysis does not provide the evidence that they participated in her breach of fiduciary duty to the DBDC Applicants so as to attract personal liability for knowing assistance. Nor is there any other evidence of their participation. In my opinion, the DBDC Applicants' claim against the Listed Schedule C Companies should fail for this reason alone.

(4) The Knowledge Element

[232] As the authorities such as *El Ajou* instruct, "it is necessary to identify the natural person or persons having management and control *in relation to the act or omission in point*" (at p. 695). Here, the determination of whether Ms. Walton's fraudulent intent is to be attributed to a Listed Schedule C Company depends on the wrongful act the company committed. Because of my conclusion on the participation issue, I do not propose to say anything about my colleague's discussion of the knowledge element, except to indicate that I take issue with two points: the result of applying the three *Canadian Dredge* criteria for the corporate identification doctrine in this case, and my colleague's suggestion that the second and third criteria should be approached "in a less demanding fashion".

[233] One of the reasons that my colleague specifically addresses whether each Listed Schedule C Company received a benefit is to meet the requirements of *Canadian Dredge* for attaching liability to a corporation for the fault of its directing mind. As he notes, at para. 69, *Canadian Dredge* instructs that where a corporation's alleged wrongdoing involves fraud by its directing mind, the court must be satisfied that (i) the directing mind was acting within her assigned field of operation, and that her actions (ii) were not totally in fraud of the Listed Schedule C Company, and (iii) were by design or result partly for the benefit of the corporation.

[234] My colleague's analysis shows that there are difficulties meeting these requirements in this case (even if the alleged wrong was participation in Ms. Walton's overall fraud) because the scheme was for the Waltons' personal benefit and defrauded the Listed Schedule C Companies, and because the evidence of each company's individual benefit from the scheme is questionable. While it is true, as my colleague notes, that knowing assistance does not require a defendant to have received a benefit, the issue of benefit is relevant here because Ms. Walton's conduct was in fraud of the very entities sought to be made liable for knowing assistance, and there is no other act of participation alleged. And, the overall "net" benefit to the Schedule C Companies is central to the DBDC Applicants' claim. Without a tracing of Schedule B Company money into their accounts, there is no evidence that any of the Listed Schedule C companies benefited from the diversion of the DBDC Applicants' funds by Ms. Walton.

[235] My colleague suggests, at para. 70, that the second and third criteria of *Canadian Dredge* should be approached in a less demanding fashion, because this is a civil case, where the burden of proof is less onerous, and because of the nature of the case (a complex multi-real estate transaction investment fraud, perpetrated over an extended period of time, and implicating numerous corporate actors (operating at the instance of the fraudster) and numerous victims).

[236] With respect, I disagree. When the *Canadian Dredge* criteria have been accepted and applied in civil cases, this has occurred without relaxing the criteria for finding a corporation is liable for a wrong, when its directing mind is acting fraudulently (see, for example, *Standard Investments Ltd. v. Canadian Imperial Bank of Commerce*, at p. 493 and *Golden Oaks Enterprises Inc. (Trustee of) v. Lalonde*, 2016 ONSC 5313, 133 O.R. (3d) 513, at paras. 127-131).

[237] I do not accept that the adoption of a less demanding standard is warranted here. As I see it, neither the civil burden of proof nor the nature and extent of the fraud would justify a less rigorous approach if the Listed Schedule C Companies are to be fixed with responsibility for the conduct of their director, Ms. Walton.⁸¹ Knowing assistance in the breach of a fiduciary duty is a serious wrong that requires actual and not constructive knowledge by the participant. The investors in the Listed Schedule C Companies did not themselves know about or cause the companies to participate in Ms. Walton's breach of fiduciary duty. The rationale for the claim is that the participant's actual knowledge of and assistance in the fraudulent conduct is sufficient to "bind the stranger's conscience so as to give rise to personal liability": *Air Canada v. M & L Travel Ltd.*, at p. 812. I see no justification in the circumstances of this case to lessen the requirement for knowledge before one victim of a fraud is tagged with the conduct of a fraudster. The conduct here was in fraud of the Schedule B Companies and their investors, the DBDC Applicants, and the Listed Schedule C Companies and their investors, and was for the personal benefit of the Waltons.

(5) The Damages Award of \$22.6 Million is Arbitrary and Not a True Measure of Damages for Knowing Assistance

[238] Finally I turn to the question of damages. I disagree with my colleague's conclusion that the measure of damages for knowing assistance in this case is \$22.6 million, and that the Listed Schedule C Companies are liable jointly and severally for this amount.

[239] Under the doctrine of knowing assistance, "the defendants' liability is measured by the plaintiff's injury consequent to the trustee's misconduct": see the P. Perell article, cited by my colleague at paras. 119 and 127. This is because the wrong is in acting as an accessory to the principal breach, and the

81. In *Livent*, in any event, the Supreme Court of Canada expressed the view that courts retain the discretion to refrain from applying the corporate identification doctrine where, in the circumstances of the case, it would not be in the public interest to do so (at para. 104). There is no policy reason for the corporate identification theory to apply to impose liability on the Listed Schedule C Companies for Ms. Walton's fraudulent breaches of fiduciary duty to the DBDC Applicants.

accessory is liable jointly and severally *with the principal wrongdoer*. This is why the accessories in the *Enbridge Gas* case acknowledged that, if liable, the damages would be the full amount paid by Enbridge as a result of the principal's scheme and not just their share of the profit (at para. 50).

[240] Here, instead of asserting that the Listed Schedule C Companies are liable together with the Waltons for the \$66.9 million amount awarded as damages for breach of fiduciary duty, the DBDC Applicants claim \$22.6 million, which they say is the portion of that amount "which the Schedule C Company respondents knowingly assisted the Waltons in diverting to the benefit of the Schedule C Companies". My colleague accepts this measure of damages when he states, at para. 128, that "the loss is measured by the net transfer to the Schedule C Companies, globally, of \$22.6 million.

[241] In my view, the \$22.6 million amount, which is based on the net transfer analysis, is not a true measure of the damages for which the Listed Schedule C Companies could be liable to the DBDC Applicants for knowing assistance. It does not correspond with the loss caused by the actions of the fiduciary, or even with the loss caused by, or benefit to, some or all of the Schedule C Companies. It is simply the net amount transferred between the Schedule B Company accounts and Rose & Thistle (less \$1 million credited to the Waltons).

[242] And even if it could be assumed that all of the \$22.6 million transferred to Rose & Thistle was a net gain to the Schedule C Companies, this is simply the amount by which all of the Walton-controlled accounts, other than the Schedule B Company accounts, would have benefited. As we have seen (at para. 189 above), it includes over \$12 million of net transfers to Ms. Walton personally, to "Walton Advocates", and to other Rose & Thistle companies.

[243] Two of the Listed Schedule C Companies (Emerson and St. Clarens) received no funds from Rose & Thistle under the net transfer analysis, and one (Prince Edward) transferred considerably more money to Rose & Thistle than it received (see paras. 225 and 226). Even considered as a collective, the Listed Schedule C Companies received only the net amount of \$4,367,204 from Rose & Thistle, according to the net transfer analysis.

[244] Finally, if the net amount transferred from the DBDC Applicants to Rose & Thistle to the Schedule C Companies could be a proper measure of damages, the \$22.6 million figure includes and therefore double counts the amounts the DBDC Applicants were awarded for their constructive trust claims (a total of \$8,128,325: Brown J. at para. 264). The constructive trusts resulted from a tracing of DBDC Applicants' funds into specific Schedule C Properties with reference to the transfers shown on the net transfer analysis. These diversions of funds into specific Schedule C Properties have already been accounted for, and would need to be deducted from the \$22.6 million damages award.[28]⁸² I say this, not because I view the \$22.6 million amount as a proper measure of the DBDC Applicants' damages

82. This is not a question of double recovery, which my colleague seeks to address at para. 130. Rather, the Listed Schedule C Companies could not have been the beneficiaries of amounts already accounted for by their tracing into specific properties in the constructive trust claims, and the inclusion of these amounts in their damages would double count such amounts.

against the Listed Schedule C Companies, individually or as a collective, but to further emphasize that it is an arbitrary and purely convenient number that emerges from the net transfer analysis, an analysis that was never intended to inform a claim for knowing assistance.

(6) Equity Does Not Support the Knowing Assistance Claim

[245] My colleague recognizes that knowing assistance is an equitable doctrine, however he rejects the argument that equity should not intervene in this case. In my view, there are important equitable concerns here that should prevent the court from finding the Listed Schedule C Companies liable for damages for knowing assistance.

[246] First, the Listed Schedule C Companies would be subject to an award of damages that is based on equitable grounds when they themselves are victims of the same fraudulent conduct. The liability of the stranger in a knowing assistance claim is fault-based. To the extent that any “fault” could be found here, it results from being caught up in or used as part of the wrongdoer’s fraudulent scheme.

[247] Second, the Listed Schedule C Companies are tagged with damages based on the full extent to which all of the Walton-controlled companies (that is all the Schedule C Companies) benefited. The DBDC Applicants have chosen to proceed only against the ten Listed Schedule Companies for the full amount of the “net transfer” from Rose & Thistle to all of the Walton-controlled or Schedule C Companies. The DBDC Applicants contend that they have limited their relief to these companies “based on the work of the receiver/manager and for efficiency” (DBDC Applicants’ Factum, at para. 16). This is not a satisfactory explanation – the reality is that these are the only entities that have assets or proceeds worth pursuing. Even if the full \$22.6 million could be accepted as a measure of their loss from the conduct of the Schedule C Companies (if it were assumed that all of the net monies flowing into the Schedule C Companies came from the DBDC Applicants, which as I stated earlier is not supported on the evidence), this includes over \$12 million of net transfers to Ms. Walton personally, to “Walton Advocates”, or to other Rose & Thistle companies. To place the entire burden of the claim on the ten Listed Schedule C Companies, overwhelming the claims for losses of the investors in those companies, in my view, would be an unjust result.

[248] Finally, I conclude that the knowing assistance remedy should not be utilized in these exceptional circumstances – where one group of defrauded investors seeks to obtain judgment sounding in knowing assistance against another group that has been defrauded in a similar manner. The DBDC Applicants were able to trace certain funds into the purchase of Schedule C Properties, including five of the Listed Schedule C Company properties and to obtain a constructive trust that gives them priority over the proceeds of sale of such properties. I agree with my colleague that the remedy of constructive trust, as argued by DeJong, is not available as a matter of law, and that the Application Judge erred in giving DeJong priority over the proceeds of four properties on that basis. That said, there is no question that DeJong’s money went into the purchase of these properties (and indeed the Application Judge found, and my colleague accepts, that its advances were as shareholder loans, and that it is a creditor for the

full amounts it claims). In my view, it would be unfair for DeJong's claims to its advances, which can be traced, but not in a way that would justify a constructive trust, to be obliterated by a damages claim of \$22.6 million by the DBDC Applicants, without any evidence that their funds were used in any way (except where a tracing has occurred) to acquire these properties. This result alone is such that the equitable claim of knowing assistance should be denied in this case.

CONCLUSION

[249] For these reasons, I would dismiss the appeal of the DBDC Applicants with respect to the knowing receipt and knowing assistance claims. I would allow their appeal of the DeJong constructive trust awards essentially for the reasons outlined by my colleague. In the circumstances, however, my proposed disposition would result in the priorities over the Listed Schedule C Properties being determined by the Receiver without regard to any claim to such proceeds by the DBDC Applicants, except to the extent of their constructive trusts.

Released: January 25, 2018

"K. van Rensburg J.A."

SCHEDULE "A" COMPANIES

1. Dr. Bernstein Diet Clinics Ltd.
2. 2272551 Ontario Limited
3. DBDC Investments Atlantic Ltd.
4. DBDC Investment Pape Ltd.
5. DBDC Investments Highway 7 Ltd.
6. DBDC Investments Trent Ltd.
7. DBDC Investments St. Clair Ltd.

8. DBDC Investments Tisdale Ltd.
9. DBDC Investments Leslie Ltd.
10. DBDC Investments Lesliebrook Ltd.
11. DBDC Fraser Properties Ltd.
12. DBDC Fraser Lands Ltd.
13. DBDC Queen's Corner Inc.
14. DBDC Queen's Plate Holdings Inc.
15. DBDC Dupont Developments Ltd.
16. DBDC Red Door Developments Inc.
17. DBDC Red Door Lands Inc.
18. DBDC Global Mills Ltd.
19. DBDC Donalda Developments Ltd.
20. DBDC Salmon River Properties Ltd.
21. DBDC Cityview Industrial Ltd.
22. DBDC Weston Lands Ltd.
23. DBDC Double Rose Developments Ltd.
24. DBDC Skyway Holdings Ltd.
25. DBDC West Mall Holdings Ltd.
26. DBDC Royal Gate Holdings Ltd.
27. DBDC Dewhurst Developments Ltd.
28. DBDC Eddystone Place Ltd.
29. DBDC Richmond Row Holdings Ltd.

SCHEDULE "B" COMPANIES

1. Twin Dragons Corporation
2. Bannockburn Lands Inc. / Skyline – 1185 Eglinton Avenue Inc.
3. Wynford Professional Centre Ltd.
4. Liberty Village Properties Ltd.
5. Liberty Village Lands Inc.
6. Riverdale Mansion Ltd.
7. Royal Agincourt Corp.
8. Hidden Gem Developments Inc.
9. Ascalon Lands Ltd.
10. Tisdale Mews Inc.
11. Lesliebrook Holdings Ltd.
12. Lesliebrook Lands Ltd.
13. Fraser Properties Group
14. Fraser Lands Ltd.
15. Queen's Corner Corp.
16. Northern Dancer Lands Ltd.
17. Dupont Developments Ltd.
18. Red Door Developments Inc. and Red Door Lands Ltd.
19. Global Mills Inc.
20. Donalda Developments Ltd.
21. Salmon River Properties Ltd.
22. Cityview Industrial Ltd.
23. Weston Lands Ltd.

24. Double Rose Developments Ltd.
25. Skyway Holdings Ltd.
26. West Mall Holdings Ltd.
27. Royal Gate Holdings Ltd.
28. Royal Gate Nominee Inc.
29. Royal Gate (Land) Nominee Inc.
30. Dewhurst Development Ltd.
31. Eddystone Place Inc.
32. Richmond Row Holdings Ltd.
33. El-Ad (1500 Don Mills) Limited
34. 165 Bathurst Inc.

SCHEDULE "C" PROPERTIES

1. 3270 American Drive, Mississauga, Ontario
2. 0 Luttrell Ave., Toronto, Ontario
3. 2 Kelvin Avenue, Toronto, Ontario
4. 346 Jarvis Street, Suites A, B, C, E and F, Toronto, Ontario
5. 1 William Morgan Drive, Toronto, Ontario
6. 324 Price Edward Drive, Toronto, Ontario
7. 24 Cecil Street, Toronto, Ontario
8. 30 and 30A Hazelton Avenue, Toronto, Ontario
9. 777 St. Clarens Avenue, Toronto, Ontario
10. 252 Carlton Street and 478 Parliament Street, Toronto, Ontario
11. 66 Gerrard Street East, Toronto, Ontario
12. 2454 Bayview Avenue, Toronto, Ontario
13. 319-321 Carlaw, Toronto, Ontario
14. 260 Emerson Ave., Toronto, Ontario

- 15. 44 Park Lawn Circle, Toronto, Ontario
- 16. 19 Tennis Crescent, Toronto, Ontario
- 17. 646 Broadview Avenue, Toronto, Ontario

Annexe "A"

Listed Schedule C Companies/Properties

| | Schedule C Company | Corresponding Schedule C Property |
|----|----------------------------------|--|
| 1. | United Empire Lands Ltd. | 3270 American Drive, Mississauga, Ontario |
| 2. | Bible Hill Holdings Inc. | 0 Luttrell Ave., Toronto, Ontario |
| 3. | 6195 Cedar Street Ltd. | 2 Kelvin Avenue, Toronto, Ontario |
| 4. | Prince Edward Properties Ltd. | 324 Prince Edward Drive, Toronto, Ontario |
| 5. | Cecil Lighthouse Ltd. | 24 Cecil Street, Toronto, Ontario |
| 6. | Atala Investments Ltd. | 30 and 30A Hazelton Avenue, Toronto, Ontario |
| 7. | St. Clarens Holdings Ltd. | 777 St. Clarens Avenue, Toronto, Ontario |
| 8. | The Old Apothecary Building Inc. | 66 Gerrard Street East, Toronto, Ontario |

| | | |
|-----|---------------------------|--|
| 9. | 1780355 Ontario Inc. | 346 Jarvis Street, Suite F, Toronto, Ontario |
| 10. | Emerson Developments Ltd. | 260 Emerson Ave., Toronto, Ontario |

TAB 15

Christine DeJong Medicine Professional Corp. v. DBDC Spadina Ltd., 2019 SCC 30 (CanLII), [2019] 2 SCR 530

Date: 2019-05-14
File number: 38051
Other citations: 435 DLR (4th) 379 – 89 BLR (5th) 1 – 48 ETR (4th) 1 – 69 CBR (6th) 1 –
[2019] SCJ No 30 (QL)
Citation: **Christine DeJong Medicine Professional Corp. v. DBDC Spadina
Ltd., 2019 SCC 30 (CanLII), [2019] 2 SCR 530, <[https://canlii.ca/
t/joc7d](https://canlii.ca/t/joc7d)>, retrieved on 2024-05-06**

SUPREME COURT OF CANADA

CITATION: Christine DeJong Medicine
Professional Corp. v. DBDC Spadina Ltd., 2019
SCC 30, [2019] 2 S.C.R. 530

APPEAL HEARD: May 14, 2019

JUDGMENT RENDERED: May 14, 2019

DOCKET: 38051

BETWEEN:

Christine DeJong Medicine Professional Corporation

Appellant

and

DBDC Spadina Ltd.,

Dr. Bernstein Diet Clinics Ltd.,

2272551 Ontario Limited,
DBDC Investments Atlantic Ltd.,
DBDC Investment Pape Ltd.,
DBDC Investments Highway 7 Ltd.,
DBDC Investments Trent Ltd.,
DBDC Investments St. Clair Ltd.,
DBDC Investments Tisdale Ltd.,
DBDC Investments Leslie Ltd.,
DBDC Investments Lesliebrook Ltd.,
DBDC Fraser Properties Ltd.,
DBDC Fraser Lands Ltd.,
DBDC Queen’s Corner Inc.,
DBDC Queen’s Plate Holdings Inc.,
DBDC Dupont Developments Ltd.,
DBDC Red Door Developments Inc.,
DBDC Red Door Lands Inc.,
DBDC Global Mills Ltd.,
DBDC Donalda Developments Ltd.,
DBDC Salmon River Properties Ltd.,
DBDC Cityview Industrial Ltd.,
DBDC Weston Lands Ltd.,
DBDC Double Rose Developments Ltd.,
DBDC Skyway Holdings Ltd.,
DBDC West Mall Holdings Ltd.,
DBDC Royal Gate Holdings Ltd.,

DBDC Dewhurst Developments Ltd.,

DBDC Eddystone Place Ltd. and

DBDC Richmond Row Holdings Ltd.

Respondents

- and -

**Schonfeld Inc., in its capacity as the court-appointed
Inspector and Manager of Twin Dragons Corporation,
Bannockburn Lands Inc. / Skyline — 1185 Eglinton Avenue Inc.,
Wynford Professional Centre Ltd.,
Liberty Village Properties Ltd., Liberty Village Lands Inc.,
Riverdale Mansion Ltd., Royal Agincourt Corp.,
Hidden Gem Developments Inc., Ascalon Lands Ltd.,
Tisdale Mews Inc., Lesliebrook Holdings Ltd.,
Lesliebrook Lands Ltd., Fraser Properties Group,
Fraser Lands Ltd., Queen's Corner Corp.,
Northern Dancer Lands Ltd., Dupont Developments Ltd.,
Red Door Developments Inc. and Red Door Lands Ltd.,
Global Mills Inc., Donalda Developments Ltd.,
Salmon River Properties Ltd., Cityview Industrial Ltd.,
Weston Lands Ltd., Double Rose Developments Ltd.,
Skyway Holdings Ltd., West Mall Holdings Ltd.,
Royal Gate Holdings Ltd., Royal Gate Nominee Inc.,
Royal Gate (Land) Nominee Inc., Dewhurst Development Ltd.,**

**Eddystone Place Inc., Richmond Row Holdings Ltd.,
EI-Ad (1500 Don Mills) Limited, 165 Bathurst Inc.,
3270 American Drive, Mississauga, Ontario,
0 Luttrell Ave., Toronto, Ontario,
2 Kelvin Avenue, Toronto, Ontario,
346 Jarvis Street, Suites A, B, C, E and F, Toronto, Ontario,
1 William Morgan Drive, Toronto, Ontario,
324 Prince Edward Drive, Toronto, Ontario,
24 Cecil Street, Toronto, Ontario,
30 and 30A Hazelton Avenue, Toronto, Ontario,
777 St. Clarens Avenue, Toronto, Ontario,
252 Carlton Street and 478 Parliament Street, Toronto, Ontario,
66 Gerrard Street East, Toronto, Ontario,
2454 Bayview Avenue, Toronto, Ontario,
319-321 Carlaw, Toronto, Ontario,
260 Emerson Ave., Toronto, Ontario,
44 Park Lane Circle, Toronto, Ontario,
19 Tennis Crescent, Toronto, Ontario,
646 Broadview Avenue, Toronto, Ontario and
Canadian Chamber of Commerce**

Interveners

CORAM: Wagner C.J. and Abella, Karakatsanis, Côté, Brown, Rowe and Martin JJ.

REASONS FOR JUDGMENT:

(paras. 1 to 2)

Brown J. (Wagner C.J. and Abella, Karakatsanis, Côté, Rowe and Martin JJ. concurring)

Christine DeJong Medicine Professional Corp. v. DBDC Spadina Ltd., 2019 SCC 30, [2019] 2 S.C.R. 530

Christine DeJong Medicine Professional Corporation

Appellant

v.

DBDC Spadina Ltd.,

Dr. Bernstein Diet Clinics Ltd.,

2272551 Ontario Limited,

DBDC Investments Atlantic Ltd.,

DBDC Investment Pape Ltd.,

DBDC Investments Highway 7 Ltd.,

DBDC Investments Trent Ltd.,

DBDC Investments St. Clair Ltd.,

DBDC Investments Tisdale Ltd.,

DBDC Investments Leslie Ltd.,

DBDC Investments Lesliebrook Ltd.,

DBDC Fraser Properties Ltd.,

DBDC Fraser Lands Ltd.,

DBDC Queen's Corner Inc.,

DBDC Queen's Plate Holdings Inc.,

DBDC Dupont Developments Ltd.,

DBDC Red Door Developments Inc.,

DBDC Red Door Lands Inc.,

DBDC Global Mills Ltd.,

DBDC Donalda Developments Ltd.,

DBDC Salmon River Properties Ltd.,

DBDC Cityview Industrial Ltd.,

DBDC Weston Lands Ltd.,

DBDC Double Rose Developments Ltd.,

DBDC Skyway Holdings Ltd.,

DBDC West Mall Holdings Ltd.,

DBDC Royal Gate Holdings Ltd.,

DBDC Dewhurst Developments Ltd.,

DBDC Eddystone Place Ltd. and

DBDC Richmond Row Holdings Ltd.

Respondents

and

Schonfeld Inc., in its capacity as the court-appointed

Inspector and Manager of Twin Dragons Corporation,

Bannockburn Lands Inc. / Skyline — 1185 Eglinton Avenue Inc.,

Wynford Professional Centre Ltd.,

Liberty Village Properties Ltd., Liberty Village Lands Inc.,

Riverdale Mansion Ltd., Royal Agincourt Corp.,

Hidden Gem Developments Inc., Ascalon Lands Ltd.,

Tisdale Mews Inc., Lesliebrook Holdings Ltd.,
Lesliebrook Lands Ltd., Fraser Properties Group,
Fraser Lands Ltd., Queen's Corner Corp.,
Northern Dancer Lands Ltd., Dupont Developments Ltd.,
Red Door Developments Inc. and Red Door Lands Ltd.,
Global Mills Inc., Donalda Developments Ltd.,
Salmon River Properties Ltd., Cityview Industrial Ltd.,
Weston Lands Ltd., Double Rose Developments Ltd.,
Skyway Holdings Ltd., West Mall Holdings Ltd.,
Royal Gate Holdings Ltd., Royal Gate Nominee Inc.,
Royal Gate (Land) Nominee Inc., Dewhurst Development Ltd.,
Eddystone Place Inc., Richmond Row Holdings Ltd.,
El-Ad (1500 Don Mills) Limited, 165 Bathurst Inc.,
3270 American Drive, Mississauga, Ontario,
0 Luttrell Ave., Toronto, Ontario,
2 Kelvin Avenue, Toronto, Ontario,
346 Jarvis Street, Suites A, B, C, E and F, Toronto, Ontario,
1 William Morgan Drive, Toronto, Ontario,
324 Prince Edward Drive, Toronto, Ontario,
24 Cecil Street, Toronto, Ontario,
30 and 30A Hazelton Avenue, Toronto, Ontario,
777 St. Clarens Avenue, Toronto, Ontario,
252 Carlton Street and 478 Parliament Street, Toronto, Ontario,
66 Gerrard Street East, Toronto, Ontario,
2454 Bayview Avenue, Toronto, Ontario,

319-321 Carlaw, Toronto, Ontario,

260 Emerson Ave., Toronto, Ontario,

44 Park Lane Circle, Toronto, Ontario,

19 Tennis Crescent, Toronto, Ontario,

646 Broadview Avenue, Toronto, Ontario and

Canadian Chamber of Commerce

Interveners

Indexed as: Christine DeJong Medicine Professional Corp. v. DBDC Spadina Ltd.

2019 SCC 30

File No.: 38051.

2019: May 14.

Present: Wagner C.J. and Abella, Karakatsanis, Côté, Brown, Rowe and Martin JJ.

on appeal from the court of appeal for ontario

Torts — Knowing assistance in breach of fiduciary duty — Attribution of individual wrongdoing to corporation — Applicable criteria — Complex multi-million dollar fraud perpetrated by husband and wife — Couple convincing investors to invest with them in specific-project corporations to acquire and hold commercial real estate properties — Couple taking funds for personal use instead — Investors claiming damages against husband and wife personally for fraudulent misrepresentation, deceit and breach of fiduciary duty — Investors also claiming liability for knowing assistance against specific-project corporations on basis that wife who committed fraud was their directing mind — Application judge awarding damages against husband and wife personally, but dismissing knowing assistance claim on basis

that wife's knowledge of fraud could not be imputed to specific-project corporations — Majority of Court of Appeal allowing knowing assistance claim — Dissenting judge finding that liability for knowing assistance could not be made out against specific-project corporations — Claim of knowing assistance must fail.

Cases Cited

Referred to: *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63, [2017] 2 S.C.R. 855; *Canadian Dredge & Dock Co. v. The Queen*, 1985 CanLII 32 (SCC), [1985] 1 S.C.R. 662.

APPEAL from a judgment of the Ontario Court of Appeal (Cronk, Blair and van Rensburg JJ.A.), 2018 ONCA 60, 419 D.L.R. (4th) 409, 78 B.L.R. (5th) 183, 56 C.B.R. (6th) 174, 33 E.T.R. (4th) 173, [2018] O.J. No. 578 (QL), 2018 CarswellOnt 1571 (WL Can.), setting aside a decision of Newbould J., 2016 ONSC 6018, 40 C.B.R. (6th) 230, [2016] O.J. No. 5017 (QL), 2016 CarswellOnt 15044 (WL Can.). Appeal allowed.

Jeremy Opolsky, Jonathan Silver and Alicja Puchta, for the appellant.

Shara N. Roy, Paul-Erik Veel and Madison Robins, for the respondents.

Geoff R. Hall, Anu Koshal and Natalie V. Kolos, for the intervener the Canadian Chamber of Commerce.

Mark Dunn and Carlie Fox, for the other interveners.

The judgment of the Court was delivered orally by

[1] BROWN J. — We agree with Justice van Rensburg, dissenting, at the Court of Appeal that the respondents' claim for knowing assistance must fail, and we adopt her reasons as our own.

[2] In view of the statement of the majority at the Court of Appeal that this Court's decision in *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63, [2017] 2 S.C.R. 855, invited a "flexible" application of the criteria stated in *Canadian Dredge & Dock Co. v. The Queen*, 1985 CanLII 32 (SCC), [1985] 1 S.C.R. 662, for attributing individual wrongdoing to a corporation, we respectfully add this. 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. The appeal is allowed, with costs throughout.

Judgment accordingly.

Solicitors for the appellant: Torys, Toronto.

Solicitors for the respondents: Lenczner Slaght Royce Smith Griffin, Toronto.

Solicitors for the intervener the Canadian Chamber of Commerce: McCarthy Tétrault,
Toronto.

Solicitors for the other interveners: Goodmans, Toronto.

TAB 16

At para(s) 9-12

Bedard v. Bedard, 2018 ONSC 2220 (CanLII)

Date: 2018-04-06

File number: CV-17-575026

Citation: **Bedard v. Bedard, 2018 ONSC 2220 (CanLII)**, <<https://canlii.ca/t/hrdv9>>, retrieved on 2024-04-25

CITATION: Bedard v. Bedard, 2018 ONSC 2220

COURT FILE NO.: CV-17-575026

DATE: 20180406

SUPERIOR COURT OF JUSTICE – ONTARIO

RE: HILDA R. BEDARD ET AL, Respondents

AND:

RICHARD D. BEDARD ET AL, Appellants

BEFORE: Stinson J.

COUNSEL: *Shara N. Roy and Laura E. Robinson*, for the Respondents

Clifford I. Cole and Brent J. Arnold, for the Appellants

HEARD at Toronto: March 29, 2018

REASONS FOR DECISION

Background and Facts

[1] These reasons concern an appeal under s. 45 of the *Arbitration Act, 1991*, S.O. 1991, c. 17. The appeal is brought by Richard D. Bedard and the Richard Bedard Family (2001) Trust (to whom I shall refer collectively as “Ric” or the “Ric parties”). The respondents to the appeal are Hilda R. Bedard, Delano E. Bedard and Thorncrest Management Limited (to whom I shall refer collectively as “Del” or the “Del parties”). The Del parties bring a cross-application under s. 50 of the *Arbitration Act* for an order enforcing the arbitrator’s awards.

[2] The arbitration in question took place pursuant to an arbitration agreement, in which the Del parties were the claimants and the Ric parties were the respondents. The arbitration proceeded over a period of years and resulted in a series of five interim and final awards. This appeal concerns the fifth such award (“Award No. 5”), dated April 12, 2017. All five awards were incorporated into a formal judgment, but this appeal concerns just one specific provision in that judgment, as I will explain below. The formal judgment erroneously bears the date April 12, 2016, but it plainly was intended to be dated April 12, 2017.

[3] For purposes of these reasons, I accept as accurate and incorporate by reference the summary of facts set out in the following paragraphs of Del's factum dated March 14, 2018: paragraphs 7 to 15; paragraphs 17 to 34; paragraphs 36 to 39; paragraphs 42 to 53; and paragraphs 55 and 56.

[4] In addition to those facts, I note the following points that are material for this decision:

- a) The only named parties to the arbitration agreement were the Del parties and the Ric parties.
- b) The parties expressly agreed in the arbitration agreement that any awards and directions that may be made would also be binding upon the corporate entities Actco Systems Inc. (“ASI”) and Cetaris Canada Inc. (Canadian corporations controlled by Del), although they were not named as claimants or respondents in the arbitration agreement.
- c) Cetaris Inc. (“Cetaris US”), a Delaware Corporation controlled by Ric, was not a party to the arbitration agreement.
- d) The arbitration agreement provided that parties could be added to the arbitration on the motion of any party. Although in his defence to Del’s claim in the arbitration Ric pleaded that Cetaris US was not a party to the arbitration and that no claim was or could be made against it, no motion was brought to add Cetaris US as a party.
- e) In Award No. 5, as incorporated into paragraph 14 of the formal judgment, the arbitrator directed that the profits of Cetaris US (which are payable ultimately to Del under the parties’ 50/50 profit sharing agreement) be determined by the board(s) of directors of ASI and Cetaris Canada.

Issues and Analysis

[5] On this appeal, the contention of Ric is that by granting authority to the board(s) of directors of ASI and Cetaris Canada to determine the profits of Cetaris US and thus purporting to oblige Cetaris US to remit those profits, the arbitrator exceeded his jurisdiction. Put simply, because Cetaris US was not a party to the arbitration agreement, it cannot be ordered by the arbitrator to do anything nor can its affairs be governed or affected by a decision of an arbitrator to whose authority it never submitted its rights.

[6] In response, Del argues that: (1) Ric is attempting to appeal aspects of the arbitrator's earlier awards for which the time for appealing has expired; (2) Ric is trying to re-litigate issues that are res judicata; (3) this appeal is an abuse of process; and (4) Ric is further delaying the final resolution of the parties' long-standing disputes.

[7] At the outset of the hearing before me, I posed a series of questions to Ric's counsel and received the following responses:

- a) Ric concedes and acknowledges that the 50/50 division of profits as found by the arbitrator is a binding determination of that issue that he does not and cannot challenge.
- b) Ric further concedes and acknowledges that the 50/50 division of profits extends to the profits of Cetaris US.
- c) Ric acknowledges that he controls Cetaris US and thus he is able to control the determination of its profits.
- d) In the event Ric conducts the affairs of Cetaris US in such a fashion as to undermine the rule that all profits are to be divided 50/50, Del could pursue a remedy against him for failure to comply with the previous determinations of the arbitrator.

Counsel for Ric also confirmed that the only aspect of the arbitrator's awards that his clients were seeking to set aside was the provision in paragraph 14 of the formal judgment, based on Award No. 5, in which the arbitrator purported to confer on the board(s) of directors of ASI and Cetaris Canada the power to determine the profits of Cetaris US.

[8] In light of these concessions, I disagree with Del that the time for appealing has expired. The sole provision in dispute in this appeal is paragraph 14 of the judgment dated April 12, 2017, which flowed from Award No. 5. Ric's Notice of Appeal was served within the required time limit in relation to that award. I also disagree that Ric is trying to delay the process of resolving the parties' disputes. There is no evidence of intentional or improper delay. The right of appeal was something the parties themselves included in their arbitration agreement. And as my analysis below concludes, Ric's appeal is meritorious.

[9] I turn now to Del's submissions that Ric is trying to re-litigate issues that are res judicata and that this appeal is an abuse of process. The acknowledgments of Ric's counsel confirm he does not and cannot dispute the binding determination of all issues that affect Ric and all other parties to the arbitration agreement. Simply stated, Ric is bound by all such determinations. What Ric contests in this appeal is the purported exercise of authority by the arbitrator over a non-party, Cetaris US. That is an issue that was decided for the first time in Award No. 5, and thus there is no attempt by Ric to re-litigate anything that has been finally determined previously. For the same reason I conclude that the doctrine of abuse of process is inapplicable.

[10] It is important to recognize what an arbitrator can and cannot decide. As noted by Echlin J. in *Canadian Musical Reproduction Rights Agency Ltd. v. Canadian Recording Industry Assn.* [2005] O.J. No. 6387 (S.C.J.) (at paras. 9 and 11) an “arbitrator ha[s] no inherent jurisdiction, unlike a Superior Court judge” and “an arbitration agreement cannot give an arbitrator jurisdiction over a non-party.”

[11] In *Rampton v. Eyre*, [2006] O.J. No. 5222 (S.C.J.), Lalonde J. correctly stated as follows (at para. 37):

[T]he right to submit a dispute to arbitration, rather than proceed through the ordinary litigation process, is a right that is governed by contract. The parties must consent to refer a proceeding to arbitration. Quite simply, non-parties cannot be bound by the arbitration provisions of an agreement, and cannot be compelled to submit to this method of dispute resolution. Without the consent of the parties and their participation in the process, an arbitrator does not have the jurisdiction to bind the parties or determine their rights.

[12] In *Pirner v Pirner* (1997), 1997 CanLII 12165 (ON SC), 34 O.R. (3d) 386 (Gen. Div.), Jarvis J. noted (at para. 18) that an “arbitral award which purports to dispose of the rights of non-parties to the arbitration constitutes an excess of jurisdiction rendering the award void. See *Machinists, Fitters, and Helpers, Local No. 3 v. Victoria Machinery Depot Co.* (1960), 1960 CanLII 290 (BC CA), 31 W.W.R. 564 at 570-71 (B.C.C.A.) per Sidney Smith, J.A.”

[13] Del relies on *Advanced Explorations Inc. v Storm Capital Corp.*, 2014 ONSC 3918 and submits that, despite full knowledge that proper accounting for and payment of the profits of Cetaris US were in issue in the arbitration, Ric did not dispute the authority of the arbitrator to deal with that topic, as required by s. 17(3) of the *Arbitration Act*. As a consequence, the submission continues, Ric cannot now challenge the arbitrator’s jurisdiction. Unlike the present case, however, the alleged “excess of jurisdiction” in the *Advanced Explorations* case did not affect the rights or status of a non-party to the arbitration agreement. I therefore would not fault Ric for failing to object under s. 17(3) on these facts.

[14] Del further argues that the determination of profits for Cetaris US directed to be performed by ASI and Cetaris Canada is only “[f]or purposes of the 50/50 agreement” between Del and Ric. The problem with that submission is that, as a result of such determination, Cetaris US would be obliged to remit that sum to Del. Thus the result of the arbitration was to purport to bind or govern the affairs of a non-party.

[15] As mentioned above, Cetaris US was not a party to the arbitration agreement. Despite the fact that this issue was raised by Ric at the pleadings stage, Del took no steps to add Cetaris US as a party. Consistent with the authorities quoted above, Cetaris US cannot be bound by a decision made in an arbitration process to which it was not a party.

[16] Cetaris US is a distinct legal entity, separate and apart from its controlling shareholder, Ric. This was recognized by the arbitrator himself in Award No. 3 dated April 12, 2016, in which he commented (at para. 28) that he had “serious doubts that I possess the authority or jurisdiction in these proceedings to give effect to a corporate reorganization of Cetaris US, a Delaware corporation that is not a party to this arbitration.” In my respectful view, despite that concern, this is what the arbitrator went on to do in Award No. 5: he removed certain corporate authority from the board of directors of Cetaris US and assigned it to the board(s) of ASI and Cetaris Canada. In so doing, he “dispose[d] of the rights of non-parties to the arbitration” and thereby exceeded his jurisdiction.

[17] I therefore conclude that, although Ric is obliged to respect all determinations made by the arbitrator because he was a party to the arbitration agreement, paragraph 14 of the formal judgment, as it relates to Cetaris US, cannot stand and must be set aside. To that extent alone, the appeal is allowed.

[18] I should mention that Del argues that this appeal by Ric was inappropriate, given that the true objector to the arbitrator’s decision was Cetaris US. In the circumstances, the argument goes, Cetaris US should have applied under s. 48(1)(d) of the *Arbitration Act*, seeking declaratory relief as a party who has not participated in the arbitration. I do not read that provision as either mandatory or as prohibiting a party to an arbitration from raising an issue concerning an arbitrator’s purported exercise of jurisdiction over a non-party. Further, the sole relief available under s. 48(1) is a declaration that the arbitration is invalid. It is telling that, although Ric controls Cetaris US, he did not cause it to pursue that remedy. Rather, as mentioned previously, Ric concedes that the 50/50 division of profits as found by the arbitrator is a binding determination of that issue that extends to the profits of Cetaris US.

Disposition

[19] Under s. 45(5) of the *Arbitration Act*, on an appeal of a question of law (which this case involves) the “court may confirm, vary or set aside the award or may remit the award to the arbitral tribunal with the court’s opinion on the question of law, in the case of an appeal on a question of law, and give directions about the conduct of the arbitration.” As explained above, I have decided that paragraph 14 of the formal judgment, as it relates to Cetaris US, must be set aside. I am thus empowered to remit the award to the arbitrator and give directions. In my view, this is the route I should follow, rather than attempting to redraft paragraph 14 myself.

[20] As the arbitrator noted, the submissions before him were presented on a “binary basis” in which he was asked to choose between each party’s version of the various paragraphs of the formal judgment. Based on the submissions before me, it is apparent that the issue of how Ric should discharge his obligation to cause Cetaris US to comply with the 50/50 agreement is somewhat nuanced, which makes me reluctant to insert language of my own crafting.

[21] What the parties need to do is fashion a suitable directive to Ric to include in the formal judgment that will oblige him to (1) carry out fully the implementation of the 50/50 agreement to which he is bound; (2) cause the affairs of Cetaris US to be carried out in a fashion consistent with that obligation, including the timely determination of its profits consistent with the arbitrator’s conclusions,

together with remittance of the funds owing; and (3) disclose fully and regularly to Del all information regarding Cetaris US that is required for Del to be satisfied that Ric is discharging his obligations properly.

[22] To accomplish the result described in paragraph 21 above, I direct the parties to collaborate in attempting to draft language that will accomplish this purpose and, if necessary, to make in-person submissions to the arbitrator. After the parties have done so, the arbitrator shall prepare and issue a further award consistent with these reasons. In this fashion a suitable and uncontestable directive can be incorporated into the arbitrator's final formal judgment that will guide and govern the parties' future conduct.

[23] In view of the foregoing disposition, I question whether it is appropriate and also whether I have jurisdiction to grant the relief sought in Del's cross-application under s. 50 of the *Arbitration Act*, for an order to enforce the remaining portions of the April 12, 2017 formal judgment. I therefore decline that request, without prejudice to the right of Del to renew it (before me, if that can be arranged conveniently) once the further award is issued by the arbitrator. Should either party disagree with this approach, they may arrange a telephone conference with me through my assistant to discuss that issue within the next 20 days. Despite these invitations to return to me or to arrange any required telephone conference, I do not consider myself seized of this matter.

[24] In relation to costs, I urge the parties to reach agreement. Should they be unable to do so within 20 days of the date of release of these reasons, I direct as follows:

- (a) Ric shall serve his Bill of Costs on Del, accompanied by written submissions, within 30 days of the release of these reasons.
- (b) Del shall serve his response on Ric within 20 days thereafter. I expressly invite Del to submit the Bill of Costs he would have presented had he been successful on this appeal.
- (c) Ric may, but is not obliged to, serve a reply within 10 days thereafter.
- (d) In all cases, the written submissions shall be limited to three double-spaced pages, plus Bills of Costs.
- (e) I direct counsel for Ric to collect copies of all parties' submissions and arrange to have that package delivered to me in care of Judges' Administration, Room 170 at 361 University as soon as the final exchange of materials has been completed. To be clear, no costs submissions should be filed individually: rather, counsel for Ric will assemble a single package for delivery as described above.

Stinson J.

Date: April 6, 2018

TAB 17

At para(s) 7 and 8

Temple Consulting Group Ltd. v. Abakhan & Associates Inc., 2011 BCCA 540 (CanLII)

Date: 2011-12-12
File number: CA039498
Other citations: 315 BCAC 9 — 90 CBR (5th) 155
Citation: Temple Consulting Group Ltd. v. Abakhan & Associates Inc., 2011 BCCA 540 (CanLII), <<https://canlii.ca/t/fprkx>>, retrieved on 2024-05-06

COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Temple Consulting Group Ltd. v. Abakhan & Associates Inc.*,
2011 BCCA 540

Date: 20111212

Docket: CA039498

**In Bankruptcy and Insolvency
In the Matter of the Bankruptcy of
Steven B. Friedland and Western Liquid Funding Inc.**

Between:

Temple Consulting Group Ltd.

Appellant

(Claimant)

And

**Abakhan & Associates Inc., in its capacity as Trustee of
the Estates of Steven B. Friedland and Western Liquid Funding Inc.**

Respondent

(Trustee)

Before: The Honourable Madam Justice Saunders
(In Chambers)

On appeal from: Supreme Court of British Columbia, November 10, 2011
(*Friedland (Re)*, 2011 BCSC 1557, Vancouver Registry B101439)

Oral Reasons for Judgment

Counsel for the Appellant: M.T. Kruger

No one appearing on behalf of the Respondent:

Place and Date of Hearing: Vancouver, British Columbia
December 12, 2011

Place and Date of Judgment: Vancouver, British Columbia
December 12, 2011

[1] **SAUNDERS J.A.:** Temple Consulting Group Ltd. (“Temple”) is seeking directions as to whether leave to appeal is required to appeal the order of Mr. Justice Pearlman pronounced on November 10, 2011. If I conclude that leave to appeal is required, they seek leave in addition. Counsel for the respondent does not oppose the appeal going forward – the only question is whether it does so with leave or as of right.

[2] The issue on the proposed appeal is the interpretation of s. 135(4) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, and the *Bankruptcy and Insolvency General Rules*, C.R.C., c-368. Mr. Justice Pearlman concluded that a notice of appeal must be both filed and served within 30 days after service of a trustee’s notice of disallowance of claim. He held further that failure to comply with the requirement was not a procedural defect that could be cured by the Court, and that the defect operated to deprive the Court of jurisdiction to hear the appeal.

[3] The issues arise from a secured debt. Temple is the assignee of that debt in the amount of \$500,000 claimed by Skeena Contracting Ltd. in the bankruptcy of Mr. Friedland. On April 29, 2011, Temple filed its proof of claim, claiming the secured debt plus interest. On July 18, 2011, the Trustee

disallowed that security with the Notice of Disallowance communicated by way of an email. There was some correspondence exchanged. On August 17, 2011, counsel for Temple emailed copies of affidavits and the Notice of Application (Notice of Appeal from Trustee's Disallowance of Claim) to counsel for the Trustee. The Notice of Appeal, however, was not filed until August 18, 2011, when it, along with the supporting affidavits, was filed. The copies of the filed materials were delivered to counsel for the Trustee by email on August 19, 2011.

[4] Thus, we have a very tight timeline and it turns out that the Notice of Appeal and supporting affidavits were filed one day late. Mr. Justice Pearlman concluded, as I have said, that late filing deprived him of jurisdiction to deal with the matter.

[5] Thus in the nearer look, the appeal concerns a limitation period problem, but the consequence is that a claim in bankruptcy of \$500,000 is not allowed to be advanced further than it has been.

[6] The matter of leave to appeal is determined by s. 193 of the *Bankruptcy and Insolvency Act*: Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:

- (a) if the point at issue involves future rights;
- ...
- (c) if the property involved in the appeal exceeds in value ten thousand dollars.

[7] Counsel for Temple advances the proposition that leave is not required because it fits within both s.s. (a) and (c). In my view, this matter does not come within s.s. (a). The only aspect which could be a future right is simply the right to appeal. That is not, in my view, the type of right being discussed in s. 193 which deals with property and property rights. The question then is whether the proposed appeal comes within s.s. (c). On this there is a case to which Ms. Kruger refers, *Re Roman Catholic Episcopal Corp. of St. George's*, 2007 NLCA 17, a decision of Chief Justice Wells (in Chambers). It is somewhat close to this case. In paras. 24 and 25, Chief Justice Wells said:

[24] With respect to the argument of the Trustee that it is entitled to appeal as a matter of right because the property involved exceeds in value \$10,000.00, counsel for the four respondents argues that the decision of the bankruptcy judge is procedural only and does not involve any sum of money. He submits that the bankruptcy judge made no determination as to entitlement of any of the respondents and, therefore, the issue in the appeal is only as to procedure. He also argues that there was no "property in peril" in the decision of the bankruptcy judge, and for that reason also, paragraph (c) is inapplicable.

[25] On examination of the actual words of paragraph (c), I am unable to accept either of the arguments of counsel for the four respondents. Admittedly there was no "property in peril" but, in my view, the statute does not require a prospective appellant to establish property to have been in peril in

the decision intended to be appealed. In **Fallis et al. v. United Fuel Investments Ltd.**, [1962 CanLII 96 (SCC)], 1962 CanLII 96 (SCC), [1962] S.C.R. 771, the Court was considering a similar phrase in the **Winding-up Act**, R.S.C. 1952, c. 296. The phrase was: “An appeal, if the amount involved therein exceeds two thousand dollars, lies by leave of a judge ...”. There, the Court referred to and followed its approach in an earlier decision, **Orpen v. Roberts et al.**, [1925 CanLII 2 (SCC)], 1925 CanLII 2 (SCC), [1925] S.C.R. 364. The Court in **Orpen** was quoted as concluding that:

... the subject matter of the appeal is the right of the respondent to build on the street line on Carlton street in the city of Toronto. “The amount or value of the matter in controversy” (section 40) is the loss which the granting or refusal of that right would entail. The evidence sufficiently shows that the loss – and therefore the amount or value in controversy – exceeds \$2,000.

[Emphasis added]

[8] While that decision is not binding upon me, I consider the reasoning in it persuasive and, although not exactly the same point before me, is a guide to the decision that should be made here. It seems to me that this is a matter that comes within s. 193(c) in that the end result of all the jurisdictional wrangling and limitation period wrangling is to deprive Temple of its ability to pursue its claim which clearly exceeds \$10,000.

[9] Accordingly, I conclude that leave to appeal is not required. If, however, I am in error in that conclusion, it seems to me that the interpretation of the section relied upon by Mr. Justice Pearlman is a viable appeal. It is an important question to the practice and to the community, and it comes within the criteria for leave to appeal. Had I not concluded that leave is not required, I would, in any event, have granted leave to appeal. All of which is to say, the appeal may proceed.

“The Honourable Madam Justice Saunders”

TAB 18

At para(s) 25-27

Roman Catholic Episcopal Corporation of St. George's v. John Doe - 49 - GBS, 2007 NLCA 17 (CanLII)

Date: 2007-03-06

File number: 07/07

Other citations: 265 Nfld & PEIR 49 — 805 APR 49 — 31 CBR (5th) 61 — [2007] NJ No 100 (QL)

Citation: **Roman Catholic Episcopal Corporation of St. George's v. John Doe - 49 - GBS, 2007 NLCA 17 (CanLII)**, <<https://canlii.ca/t/1qtzg>>, retrieved on 2024-05-06

Date: 20070306

Docket: 07/07

Citation: 2007 NLCA 17

IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR COURT OF APPEAL

IN THE MATTER OF THE AMENDED PROPOSAL

OF THE ROMAN CATHOLIC EPISCOPAL CORPORATION

OF ST. GEORGE'S, AN INSOLVENT

BETWEEN:

ERNST & YOUNG INC., AS TRUSTEE
PURSUANT TO THE AMENDED PROPOSAL
OF THE ROMAN CATHOLIC EPISCOPAL
CORPORATION OF ST. GEORGE'S

INTENDED APPELLANT

AND:

JOHN DOE - 49 – GBS

INTENDED

FIRST RESPONDENT

AND:

JOHN DOE – 51 – GBS

INTENDED

SECOND RESPONDENT

AND:

JOHN DOE – 48 – GBS

INTENDED

THIRD RESPONDENT

AND:

JOHN DOE – 50 – GBS

INTENDED

FOURTH RESPONDENT

Before: Wells, C.J.N.L.

Court Appealed From: Supreme Court of Newfoundland and Labrador

Trial Division 20050111521

Application Heard: March 6, 2007

Decision Rendered: March 6, 2007

Reasons for Oral Decision Filed: March 14, 2007

Counsel for the Intended Appellant: John Stringer, Q.C. and Ms. Stacey O'Dea

Counsel for the Intended First, Second, Third and Fourth Respondents: Mr. Harry Mugford

REASONS FOR ORAL DECISION

Wells, C.J.N.L.:

[1] The appellant (the Trustee) seeks to appeal a decision of a judge of the Trial Division sitting in bankruptcy. That decision reversed an earlier determination the Trustee made in the course of administering a proposal (the Proposal) made by the Roman Catholic Episcopal Corporation of St. George's (the Corporation) and approved by the bankruptcy judge pursuant to the provisions of the **Bankruptcy and Insolvency Act**, R.S.C. 1985, c. B-3 (the **Act**).

[2] The Trustee relies on section 193 of the **Act** which provides as follows:

Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:

- (a) if the point at issue involves future rights;
- (b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;
- (c) if the property involved in the appeal exceeds in value ten thousand dollars;
- (d) from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and

(e) in any other case by leave of a judge of the Court of Appeal.

[3] Rule 31(2) of the **Bankruptcy and Insolvency General Rules**, C.R.C. 1978, c. 368 (the **General Rules**) provides that:

Where an appeal is brought under paragraph 193(e) of the Act, the notice of appeal must include the application for leave to appeal.

The notice filed by the Trustee gives notice that the Trustee,

... pursuant to paragraph 193(a)(c) or alternatively paragraph 193(e) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3 (BIA), appeals, and if necessary, seeks leave to appeal the decision of the Honourable Justice Faour delivered on the 18th day of January, 2007 ...

Background Facts

[4] As a result of being held liable in the case of some claims, and having a total of some four dozen claims made against it, for damages arising out of alleged sexual abuse, the Corporation made a proposal pursuant to the **Act**. During the course of proceedings it was amended and, as amended, was accepted by the parties as the Proposal. It establishes four classes of creditors, as follows:

Class 1: All Creditors of the Corporation known to the Corporation as of the Court Approval Date, whose Claims against the Corporation arose prior to the Filing Date as a result of the sexual abuse of such Creditor by priests, employees, or agents of the Corporation or any other person where the Corporation is either directly or vicariously liable for such Claims;

Class 2: All regular trade creditors, Preferred Creditors, Crown Claim Creditors and Secured Creditors of the Corporation;

Class 3: All Creditors of the Corporation [agreeing] to postpone their Claims to the Claims of the Class 1, Class 2 and Class 4 Creditors ...

Class 4: All Unknown Creditors who the Corporation becomes aware of after the Court Approval Date whose Claims against the Corporation arose prior to the Filing Date as a result of the sexual abuse of such Creditor by priests, employees or agent of the Corporation or any other person where the Corporation is either directly or vicariously liable for such Claims. Such Unknown Creditors shall file Proofs of Claim with the Trustee not later than two months following the last advertising date set out in the Unknown Creditor identification process described in Article 12.1 herein, otherwise, their claims shall be barred and they shall not be entitled to participate in any distributions hereunder ...

The Proposal also provided that Class 4 creditors would not vote because, by definition, at the time of voting they would be unknown to the Corporation.

[5] The Proposal put in place an alternate dispute resolution process, (ADR Process) for determination of all claims based on sexual abuse in respect of which liability has not previously been determined. It also requires the realization of all the assets of the Corporation and immediate payment

of all Class 2 creditors, after bankruptcy court approval of the Proposal. With the exception of an amount set aside for certain specified purposes of the Corporation, the Proposal provides that 95% of the remaining proceeds of asset realization be placed in a Class 1 creditors trust fund, and the remaining 5% in a Class 4 creditors trust fund. With respect to the Class 4 creditors trust fund it also provides that:

... Should no claims be received from Class 4 Creditors pursuant to the Unknown Creditors identification process described in Article 12.1 herein, or should such Claims not exceed the Class 4 Creditors' Trust Fund, then any balance remaining in such Class 4 Creditors' Trust Fund shall be first transferred to the Class 1 Creditors' Trust Fund, to the limit of the Class 1 Creditor's Trust Fund Total, and second to fund any Class 3 Creditors' Claims, and third, to be returned to the Corporation.

[Emphasis added]

[6] The "Unknown Creditor's identification process" referred to in the foregoing excerpt is that set out in the Proposal. It provides for identification of potential Class 4 creditors through a course of newspaper advertising over a stated period of time. It also established a date after which no further claims could be made (the Claims Bar Date). With respect to finality of potential claims, the Proposal provides that:

The effect of this Proposal shall be to fully and forever satisfy and extinguish the Claims of all Creditors, as against the Corporation, upon performance of the proposal. Any Creditor who has not submitted a Proof of Claim pursuant to the terms hereof, with[in] the time limit set out herein, or whose Proof of Claim has been disallowed, and such Creditor has not appealed such disallowance, shall not be entitled to any distribution hereunder and such Creditor shall be forever barred from asserting such Claims. ... Nothing in the Release or this Proposal shall impair the ability of a Class 1 or Class 4 Creditor to pursue an action against the Corporation, with leave of the Court and with the prior consent of the Corporation, to obtain a final money judgement [sic] in respect of damages for which the Corporation is liable but no such judgement [sic] shall alter the entitlement of any Class 1 or Class 4 Creditor to payment in respect [of] his Claim under this Proposal. It is acknowledged that for Class 1 Creditors the amount of such damages may not equal the amount reflected in Schedule "A" hereto.

[Emphasis added]

[7] The Proposal was approved at a meeting of all identified creditors. Of the Class 1 creditors 42, representing claims of more than \$14,000,000.00, voted in favour and one creditor, representing a claim of \$2,500,000.00, voted against it. One hundred percent of the Class 2 and Class 3 creditors voted in favour of the Proposal. The Proposal was approved by the bankruptcy judge.

[8] All parties are agreed that the Claims Bar Date is March 15, 2006. The Trustee received proofs of claim from two of the four respondents on March 29, 2006, one other on April 26, 2006 and the fourth on May 5, 2006. Each of the four claimed \$500,000.00 damages for alleged sexual abuse of them by a priest. The Trustee rejected all four because they had not been presented by the Claims Bar Date. The four respondents appealed to the bankruptcy judge.

Decision of the bankruptcy judge now sought to be appealed

[9] The bankruptcy judge noted the authority conferred by subsection 135(4) of the **Act** “to deal with the actions of the trustee”. He also noted the authority conferred by section 37 “to confirm, reverse or modify the act or decision complained of”. With respect to the manner in which he should exercise his jurisdiction, the bankruptcy judge decided:

[20] Whether I should view this as an appeal where my task would be to determine whether the trustee made an error of law in disallowing the claims, or approve a late claim *nunc pro tunc*, or with retroactive effect, the effect is the same. Either the claims may be made, or they were out of time. I prefer the approach which would permit me to deal with the substantive issue of whether the claims ought to be considered rather than rule on whether the trustee has made an error at law. My preference is to take the approach that I should not let the procedures chosen by the applicants dictate the outcome of the proceeding, but deal with the substantive effect of filing the claims after the claims bar date. In taking this approach it may be necessary to consider that the application to set aside the trustee’s decision is in reality an application to give leave *nunc pro tunc* to the applicants to file their claims after the deadline. I’m satisfied that whether or not I find an error of law I can deal with the substance of whether it’s appropriate to permit these claims to be made rather than focus this proceeding on whether there was an error of law in the decision to disallow.

However, later in his reasons, he also observed that:

[50] I do want to say that I do not believe the trustee could have acted differently. The trustee was obligated to follow the terms of the proposal. The proposal created a deadline and gave him no discretion to vary it. The Court in its role of supervision of the process can authorize a variation of these terms.

[10] The bankruptcy judge stated that he had to “consider two approaches taken in Canada on the question of delay in these circumstances”. He identified one approach as being that approved by the Alberta Court of Appeal in **Enron Canada Corp. v. National-Oilwell Canada Ltd.** (2000), 193 D.L.R. (4th) 314, 2000 ABCA 285 (referred to by the bankruptcy judge as **Re Blue Range Resources**). That decision set out four factors to be considered in deciding whether to allow late claims. They are: (1) if inadvertence is involved, did the claimant act in good faith; (2) any relevant prejudice that might be caused by permitting the claim; (3) can any relevant prejudice be alleviated; and (4) if relevant prejudice cannot be alleviated, are there other factors which would permit late filing.

[11] The alternative approach identified by the bankruptcy judge is that which he described as being exemplified in the case of **Re Noma Co.**, [2004] O.J. No. 4914 (Sup. Ct. J.) (QL). That approach, the bankruptcy judge concluded, would “place emphasis on the contractual nature of the proposal and the inherent unfairness which would result if a late creditor could prejudice the delicate balance between the corporation and the creditors who were part of the arrangement.”

[12] Ultimately, the bankruptcy judge chose the approach set out in **Enron Canada Corp.** On application, of the factors identified in that case, to the facts of this case, the bankruptcy judge decided the four additional claims should be accepted by the Trustee for determination through the ADR Process established under the Proposal, notwithstanding that they were filed after Claims Bar Date. It is that decision which the Trustee seeks to appeal.

[13] At the conclusion of the hearing I directed that an appeal as of right existed and, if I were wrong in so concluding, I would grant leave to appeal. I also indicated I would file a fuller expression of my reasons for so deciding. What follows are those reasons.

Is there an appeal as of right and, if not, should leave to appeal be granted?

[14] At the hearing before me, the Trustee argued that it was entitled to appeal as of right by virtue of paragraphs (a) and (c) of section 193. In the alternative, the Trustee argued that if it was not entitled to appeal as of right then leave should be granted pursuant to paragraph (e) of section 193. Counsel for the respondents argued that the decision of the bankruptcy judge was purely a procedural one and there was no basis for appeal, as of right, under any one of paragraphs (a) to (d) of section 193. He also argued that the bankruptcy judge made no error in following **Enron Canada Corp.**, and exercising his discretion as he did. Therefore, he submitted, there was no basis for granting leave to appeal under paragraph (e) of section 193.

[15] There was one aspect of the interpretation of section 193 which the parties did not specifically address. While it cannot alter the substantive outcome of this application, I have to consider it because it impacts the approach to be taken in deciding the application. That aspect is the question of whether I should consider, first, whether there is a right of appeal or, first, whether leave should be granted. That also leads to a question of whether, if it is determined that there is an appeal as of right, the question of leave can or should also be determined. There are inconsistent, if not conflicting, decisions, one from this Court, relating to these matters.

[16] In **Kenco Developments Ltd. v. Miller Contracting Ltd.** (1984), 1984 CanLII 350 (BC CA), 53 C.B.R. (N.S.) 297 (B.C.C.A.), Macdonald J.A. followed an earlier decision of that court (**Bank of British Columbia v. First National Investments Ltd.** (1980), 34 C.B.R. (N.S.) 282) in which an application for leave was dismissed “because the material showed that the subject of the proceedings was substantially in excess of \$500 in value”. Justice Macdonald then observed:

If such is the case leave should not be given. Leave should only be given in any other case, that is, a case not falling within provisions (a) to (d) inclusive.

[17] In **Robert Davies McNeill v. Roe, Hoops & Wong** (1996), 1996 CanLII 2397 (BC CA), 39 C.B.R. (3rd) 147, 20 B.C.L.R. (3d) 274 (B.C.C.A.), Finch J.A., as he then was, held it was not necessary to decide whether leave to appeal should have been granted because there was an appeal as of right. He noted, but did not discuss, the above quoted conclusion of Macdonald J.A. in **Kenco Developments**.

[18] In **Nautical Data International Inc., Re** (2005), 250 Nfld. & P.E.I.R. 201, 2005 NLCA 62, Welsh J.A., in an application for leave to appeal from a decision of a judge sitting in bankruptcy, decided:

[8] For the reasons which follow, I have concluded that leave to appeal should be granted. Accordingly, it is unnecessary to consider the application of section 193(a) or (c).

[19] That is a markedly different approach than that taken by the judges of the British Columbia Court of Appeal. While I can understand the thinking leading to the conclusion of Macdonald J.A. in **Kenco Developments**, I can see nothing in the **Act** that would require that leave be given only “in a case not falling within the provisions of (a) to (d) inclusive”. In my view, the approach of Welsh J.A., in **Nautical Data**, is an equally valid approach and not inconsistent with any provision of the statute.

[20] As a practical matter, as this case will demonstrate, it may be in the interest of all parties, and the courts, that a judge be able to take either approach and, in an appropriate case, also make a decision in the alternative. It may well be that an appeal court, upon hearing the fuller argument and considering the whole of the record during the course of an appeal, might conclude that the decision of an applications judge, that an appeal as of right existed, was not sound. In that circumstance, even though the facts of the case may be such that leave to appeal would have been given, the appeal could be dismissed on the basis that there was no jurisdiction to hear it, because there was no appeal as of right and leave had not been obtained. In **Re 518494 Ontario Limited (Petrochem)** (1985), 57 C.B.R. (N.S.) 272 (Ont. C.A.) Houlden J.A. decided:

In this case the appellant combined its notice of appeal and application for leave as required by R. 49(2); but, instead of applying to a single judge for leave, it brought its application, for leave and its appeal before a full panel of this Court. This was wrong. The appellant should first have moved before a single judge for leave. It is only if leave to appeal is granted that the appellant can proceed with its appeal. ...

[21] I can find nothing in the **Act** that would prevent a judge, hearing an application for leave combined with a notice of appeal as Rule 31(2) of the **General Rules** requires, from coming to a conclusion that an appeal exists as a matter of right under one or more of paragraphs (a) to (d) of section 193, while also making a decision, in the alternative, as to whether or not, in that particular case, leave ought to be granted. In fact, for the reason set out above, it seems to me that that would be the most efficient way to approach such an application. Accordingly, I propose to deal with the application in this case in that manner.

Appeal as of right

[22] With respect to the argument of the Trustee that it has an appeal as of right under paragraph (a), I have not been satisfied that this appeal involves future rights. I come to that conclusion after considering the views expressed in **Re Kostiuk** (2006), 24 C.B.R. (5th) 160, 2006 BCCA 371, **McKay v. Cameron** 2002 ABCA 183; and **Elias v. Hutchinson** (1981), 1981 ABCA 31 (CanLII), 37 C.B.R. (N.S.) 149, 121 D.L.R. (3d) 95 (Alta. C.A.). I would adopt the conclusion to be drawn from those cases that, "A present right exists presently; a future right is inchoate in that while it does not now exist, it may arise in the future". A current allegation on existing facts, although for some reason procedurally blocked, is an existing claim. It cannot be said to involve future rights. Future rights are rights which may come into existence in the future but are not yet in existence. While the claims of the four respondents have not yet been proven, they are allegations based on existing facts. The right to assert claims in respect of those allegations are rights that now exist. If it were otherwise they could not now be asserted. Therefore, no right of appeal can be asserted by the Trustee, pursuant to paragraph (a), as the point in issue does not involve future rights.

[23] During the hearing I raised with counsel the question of whether there might be a right to appeal under paragraph (b) on the basis that the decision is likely to affect claims of a similar nature in the bankruptcy proceedings, i.e. the claims of the Class 1 creditors. As counsel for the Trustee is not relying on paragraph (b), I will make no determination. I mention it simply to ensure that this decision is not taken to be an acknowledgement by the Court that, in the circumstances of this case, the Class 1 claims were considered not to be "cases of a similar nature in the bankruptcy proceedings."

[24] With respect to the argument of the Trustee that it is entitled to appeal as a matter of right because the property involved exceeds in value \$10,000.00, counsel for the four respondents argues that the decision of the bankruptcy judge is procedural only and does not involve any sum of money. He

submits that the bankruptcy judge made no determination as to entitlement of any of the respondents and, therefore, the issue in the appeal is only as to procedure. He also argues that there was no “property in peril” in the decision of the bankruptcy judge, and for that reason also, paragraph (c) is inapplicable.

[25] On examination of the actual words of paragraph (c), I am unable to accept either of the arguments of counsel for the four respondents. Admittedly there was no “property in peril” but, in my view, the statute does not require a prospective appellant to establish property to have been in peril in the decision intended to be appealed. In **Fallis et al. v. United Fuel Investments Ltd.**, 1962 CanLII 96 (SCC), [1962] S.C.R. 771, the Court was considering a similar phrase in the **Winding-up Act**, R.S.C. 1952, c. 296. The phrase was: “An appeal, if the amount involved therein exceeds two thousand dollars, lies by leave of a judge ...”. There, the Court referred to and followed its approach in an earlier decision, **Orpen v. Roberts et al.**, 1925 CanLII 2 (SCC), [1925] S.C.R. 364. The Court in **Orpen** was quoted as concluding that:

... the subject matter of the appeal is the right of the respondent to build on the street line on Carlton street in the city of Toronto. “The amount or value of the matter in controversy” (section 40) is the loss which the granting or refusal of that right would entail. The evidence sufficiently shows that the loss – and therefore the amount or value in controversy – exceeds \$2,000.

[Emphasis added]

[26] Finch J.A. applied the **Fallis** decision in interpreting section 193(c) in **McNeill**. He adopted the test underlined in the above excerpt from **Fallis**. He also noted that it had been adopted by other judges of the British Columbia Court of Appeal, and drew attention to the fact that section 2 of the **Act** defines “property” as including money.

[27] Relying on that definition, and applying the test adopted in **Fallis**, I can only conclude that “the loss which the refusal of a right of appeal would entail” in this case is clearly more than \$10,000.00. From the point of view of Class 1 creditors, Class 3 creditors, and the Corporation, the loss is potentially \$2,000,000.00. The Proposal, as noted above, provides that any funds in the Class 4 creditors trust fund not required for Class 4 creditors are to be available: first, for the Class 1 creditors; second, for the Class 3 creditors; and any residue for the Corporation. Unquestionably, refusal of a right of appeal potentially involves their interests in a significant sum of money. The Trustee is obligated to protect the interests of those parties to the Proposal, in the assets realized. In my view, therefore, the Trustee has a right of appeal pursuant to paragraph (c) of section 193.

Leave to appeal

[28] The Trustee has asked that, if I conclude that there is no appeal as a matter of right then, in the alternative, I grant leave to appeal. Having decided that there is an appeal as of right, it is not, strictly speaking, necessary for me to decide the question of leave. However, I have also to be concerned about efficient use of court time and efficient conclusion of proceedings for the benefit of all parties. There remains the possibility that the panel of this Court that ultimately hears the appeal may come to a conclusion that there is no appeal as a matter of right. For the reasons expressed above I consider it prudent, especially where the four respondents have so strongly contested the Trustee’s claim to an appeal as of right, and where the issue of leave has been fully argued, that I consider, as an alternative, whether or not leave to appeal should be granted.

[29] As noted above, the bankruptcy judge recognized the possibility of two different approaches to his review of the decision of the Trustee. He chose not to consider whether the Trustee had made an error in law. In fact, he acknowledged that the Trustee had no alternative but to decide as he did. Instead, the bankruptcy judge chose to decide, himself, the substantive issue that was before the Trustee. He also recognized that there were two lines of authority with respect to the approach to be taken in deciding the substantive issue of whether to permit or reject the late claims of the four respondents. He chose to follow the approach **Enron Canada Corp.** instead of giving priority to the contractual nature of the Proposal and its overwhelming acceptance at a meeting of the creditors. In the process he wrote:

[33] In considering all the arguments I reviewed the cases submitted. It is hard to find cases directly on point as the circumstances reflect different situations. First, virtually all of the cases reflect commercial creditors, and not the kind of creditors we have in this case. Second, none of the cases cited dealt with a proposal that contemplated unknown creditors and established a process for dealing with them as this one did.

[Emphasis added]

[30] The circumstances referred to in the preceding paragraph satisfies me that my discretion, as to whether to grant or refuse leave to appeal, should be exercised in favour of granting the Trustee leave to appeal. Clearly, there is an arguable case on appeal. The issues which the bankruptcy judge identified as being before him are of importance to the parties in this case and appellate court guidance on the issues would be of benefit to bankruptcy and insolvency practice generally. As well, as the bankruptcy judge noted, the circumstances of this case are different than the usual bankruptcy and insolvency cases, and none of the authorities he was considering dealt with a proposal that contemplated unknown creditors and established a process for dealing with them as this one did. In these circumstances, even if I am in error in concluding that there is an appeal as of right under paragraph (c) of section 193, I would grant leave to appeal under paragraph (e).

[31] Accordingly, it is ordered that:

- (a) The Trustee is entitled to appeal as of right pursuant to paragraph 193(c);
- (b) in the event that the court hearing the appeal concludes otherwise, leave to appeal is granted pursuant to paragraph 193(e); and
- (c) costs are in the cause.

C.K. Wells, C.J.N.L.

TAB 19

At para(s) 27

Flight (Re), 2022 ONCA 526 (CanLII)

Date: 2022-07-13

File number: C69594

Other citation: 162 OR (3d) 641

Citation: **Flight (Re), 2022 ONCA 526 (CanLII)**, <<https://canlii.ca/t/jqfmm>>, retrieved on 2024-04-26

COURT OF APPEAL FOR ONTARIO

CITATION: Flight (Re), 2022 ONCA 526

DATE: 20220713

DOCKET: C69594

Lauwers, Nordheimer and Zarnett JJ.A.

In the Matter of the Bankruptcy of Brian Wayne Flight of the City of London, in the County of Middlesex
in the Province of Ontario

Haddon Murray, for the appellants Adamson & Associates Inc. and John Adamson

Tara Vasdani, for the respondents Brian Wayne Flight and Amber Nicole Flight

Jacob Pollice and Jennifer L. Caruso, for the intervener the Superintendent of Bankruptcy

Heard: April 28, 2022

On appeal from the order of Justice Kelly C. Tranquilli of the Superior Court of Justice dated June 15, 2021,
with reasons reported at 2021 ONSC 4278, 90 C.B.R. (6th) 54.

Zarnett J.A.:

INTRODUCTION

[1] Section 215 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the “*BIA*”) requires that permission of the court be obtained to bring an action against, among others, a trustee in bankruptcy “with respect to a report made under, or any action taken pursuant to, this Act”. This appeal^[1]⁸³ concerns the type of lawsuit to which s. 215 of the *BIA* applies.

[2] The motion judge decided that the respondents did not require permission of the court, under s. 215 of the *BIA*, to bring an action against the appellant, John Adamson, related to the administration of four bankruptcies of the respondent Brian Wayne Flight. Mr. Adamson’s firm was the trustee in each bankruptcy. The motion judge held that the section did not apply because the action was against the trustee in a personal capacity and because it alleged omissions. She did not assess whether, if s. 215 did apply, permission to proceed with the action should be granted.

[3] For the reasons that follow, I would grant leave to appeal and set aside the order of the motion judge. Permission to bring the action under s. 215 is required. I would direct the matter back to the bankruptcy court to consider whether that permission should be granted.

[4] The motion judge erred in concluding that the capacity in which Mr. Adamson was sued made s. 215 inapplicable. An action does not fall outside of s. 215 because it names an individual rather than the corporate trustee as the defendant, where the action alleges that the individual owed the duties of a trustee and is liable as if he were the trustee. Nor does an action fall outside of s. 215 because the claim asserts that it is brought against the trustee in a personal capacity, where the gist of the claim is wrongdoing in the performance of the trustee’s role.

[5] The motion judge also erred in holding that an action that makes any allegation of an omission falls outside of s. 215. Although s. 215 does not apply to an action premised on the failure of a trustee to do an act specifically and expressly mandated by the *BIA*, that is not the core allegation in the respondents’ claim. Section 215 applies to the respondents’ action, which alleges common law wrongdoing in the performance of the trustee’s role, even if an aspect of that wrongdoing is described as an omission to act.

BACKGROUND

[6] Mr. Flight made assignments into bankruptcy on four occasions: in 2004, 2006, 2011, and 2016. The appellant Adamson and Associates Inc. (“Adamson Inc.”) was the trustee in respect of each of these bankruptcies. The appellant Mr. Adamson was the individual at Adamson Inc. with carriage of Mr. Flight’s bankruptcies.

[7] The total of the proven claims in the first three bankruptcies was \$324,800. The total amount distributed to creditors of those bankruptcies was about \$3,200. Proven claims in the fourth bankruptcy were \$127,870.

83. The appellants also seek leave to appeal, if required.

[8] In 2018, during his fourth bankruptcy, Mr. Flight discovered that between 2003 and 2018, Julie LeBlanc – his former spouse, bookkeeper, and power of attorney – had misappropriated substantial sums from Mr. Flight’s business. Ultimately, Mr. Flight determined that the amount of the misappropriations was approximately \$206,000.

[9] Mr. Flight was able to recover about \$30,300 from Ms. LeBlanc, which he did not turn over to Adamson Inc. In April 2018, he complained to the Office of the Superintendent of Bankruptcy about the trustee’s failure to detect what Ms. LeBlanc had done. As a consequence of that complaint, the appellants learned of Ms. LeBlanc’s activities and the payments Mr. Flight recovered from her.

[10] Disputes then arose between the trustee and Mr. Flight concerning whether and on what terms he would be discharged from bankruptcy and how the payments from Ms. LeBlanc should be treated. In August 2019, Mr. Flight was granted a conditional discharge on terms that, if complied with, allowed him to receive an absolute discharge after twelve months. The trustee and Mr. Flight did not agree as to whether those conditions were met.

[11] In September 2019, Mr. Flight and his current spouse, the respondent Amber Nicole Flight, commenced an action against Mr. Adamson, seeking declaratory and monetary relief (the “Action”). The Action does not name, or refer to, Adamson Inc., but it treats Mr. Adamson as though he were the trustee. The central allegation in the Action is that Mr. Adamson, as the “Licensed Insolvency Trustee” for each of the bankruptcies, ought to have detected Ms. LeBlanc’s misappropriations and, once told about them, ought to have taken steps including suing Ms. LeBlanc. As Mr. Flight states in his affidavit: “At the heart of this action is the Trustee’s failure to detect, prevent, and once he became aware of it, to litigate, the theft and fraud committed by my former Accountant, Bookkeeper, and Power of Attorney, Julie LeBlanc”.

[12] Mr. Adamson, and Adamson Inc., objected to the Action on the basis that at the time of its commencement, (i) Mr. Flight had not been discharged from bankruptcy, and (ii) no permission was obtained under s. 215 of the *BIA* to bring the Action.

[13] Mr. Flight brought a motion, in his bankruptcy proceeding, seeking directions with respect to whether he had the right to commence the Action as an undischarged bankrupt and, if required, seeking leave to do so under s. 215 of the *BIA*.

[14] In September 2020, and before the motion for directions was heard, Mr. Flight launched, but did not proceed with, a motion for an absolute discharge. In October 2020, working with a different insolvency professional, he filed a Consumer Proposal pursuant to s. 66.11 of the *BIA*. It was accepted by Mr. Flight’s sole significant creditor in February 2021, and his bankruptcy was deemed annulled.

[15] Following acceptance of the Consumer Proposal, the motion judge heard the motion for directions with respect to the Action.

The Motion Judge's Decision

[16] The motion judge, sitting in the bankruptcy court, determined that permission was not required under s. 215 to commence the Action. She expressly did not determine whether, if permission were required, it should be granted. She did not address whether Mr. Flight's status as an undischarged bankrupt at the time the Action was started prevented him from bringing it.

[17] The motion judge described the Action as one seeking "a declaration that the defendant [Mr. Adamson] engaged in misfeasance, negligence, fraud and breach of fiduciary duty in his personal capacity, and that the defendant was unjustly enriched." She described the claims in the Action as alleging a theft (by Ms. LeBlanc) that caused Mr. Flight's repeated bankruptcies, and as alleging that Mr. Adamson was liable since the "defendant trustee ought to have detected this fraud in the administration of the four bankruptcies". She described the Action as claiming damages flowing from Mr. Adamson's alleged failure to: "take any meaningful action to address the alleged fraud and its impact on the fourth bankruptcy after its discovery"; "diligently commence an action against the former bookkeeper"; "investigate the fraud"; "adjust the plaintiff's surplus income"; "recommend a consumer proposal in alternative to bankruptcy"; and "have the plaintiff promptly discharged from his fourth bankruptcy".

[18] The motion judge gave two reasons for finding that the Action did not require permission under s. 215. First, in her view, actions against trustees in their personal capacity do not require permission. Second, actions that allege omissions do not require such permission.

[19] The motion judge stated:

There is authority to support the plaintiffs' position that leave is not required where the trustee is being sued in its personal capacity: *Canadian Glacier Beverage Corp. v. Barnes & Kissack Inc.*, 1999 CanLII 6577 (BCSC), *Re 298157 Alberta Ltd.*, 2005 ABQB 941 (CanLII), *Environmental Metal Works Ltd. v. Murray, Faber & Associates*, 2013 ABQB 479 (CanLII). More particularly, the Supreme Court of Canada held that the leave provision under the *BIA* is not to be interpreted as though it applied to any action arising out of the administration of the estate. That is not the way the section is worded. To allege that the trustee made an act of omission is not with respect to a report made under or any action taken pursuant to the *BIA*: *Mercure v. Marquette & Fils*, 1975 CanLII 195 (SCC), [1977] 1 S.C.R. 547 at 551-552.

Analysis

[20] I begin by explaining why, although the appellants do not have an appeal as of right from the motion judge's decision, I would grant leave to appeal. I then explain why, in my view, the motion judge's interpretation of the scope of s. 215 was erroneous and that, on the proper interpretation of s. 215, permission to bring the Action is required. I explain why the issue of whether that permission

should be granted should be returned to the bankruptcy court for determination. I also discuss where Mr. Flight's status as an undischarged bankrupt at the time the Action was started factors into the analysis.

(1) Is the Appeal as of Right, and if Not, Should Leave to Appeal be Granted?

[21] Appeals to this court from orders made under the *BIA* are governed by s. 193, which provides:

Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:

- (a) if the point at issue involves future rights;
- (b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;
- (c) if the property involved in the appeal exceeds in value ten thousand dollars;
- (d) from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and
- (e) in any other case by leave of a judge of the Court of Appeal.

[22] The appellants describe their appeal as having two aspects – one concerning the decision of the motion judge about whether s. 215 of the *BIA* applied to the Action, and the other concerning the failure of the motion judge to address the question of Mr. Flight's status to commence an action as (at the time) an undischarged bankrupt. As I explain, only the first aspect controls whether the appellants have an appeal as of right.

[23] The appellants argue that the appeal may be brought as of right because either s. 193(b) or s. 193(c) applies to the decision concerning whether permission under s. 215 of the *BIA* was required. I agree with the respondents that neither is applicable.

[24] Section 193(b) applies only where the order sought to be appealed is likely to affect other cases in the same bankruptcy proceedings: *2403177 Ontario Inc. v. Bending Lake Iron Group Limited*, 2016 ONCA 225, 396 D.L.R. (4th) 635, at para. 32. There are no other cases in Mr. Flight's bankruptcy that would be affected by the decision about the applicability of s. 215. The appellants' argument that the decision will have precedential value for bankruptcy law generally does not bring the proposed appeal within s. 193(b).

[25] Section 193(c) does not apply to orders that refuse permission to proceed with an action: see *Romspen Investment Corporation v. Courtice Auto Wreckers Limited*, 2017 ONCA 301, 138 O.R. (3d) 373, at paras. 21-22, leave to appeal refused, [2017] S.C.C.A. No. 238. All the more so, this provision

does not apply to an order determining that no permission to sue is required. Such an order does not decide the merits of the proceeding; it simply decides that the *BIA* screening process is inapplicable, leaving the merits to be determined in the forum in which the action is brought. Orders that are procedural in nature do not come within s. 193(c): *Bending Lake*, at para. 53.

[26] In oral argument, the appellants submitted that, because an aspect of the appeal concerns the status of an undischarged bankrupt to sue, the decision should be appealable without leave under s. 193(b) because it would impact other proceedings Mr. Flight commenced before his bankruptcy was deemed annulled. I do not accept that this changes the analysis. In the context of a motion for directions in a bankruptcy proceeding, the motion judge could only properly reach the status to sue issue if she decided that s. 215 was applicable and thus had to decide whether the Action had sufficient merit to be granted permission to proceed. If s. 215 was not applicable, then the merits of the Action, including the capacity of a plaintiff to commence it, are matters to be decided according to the procedures governing the Action itself, not as a freestanding bankruptcy court determination.

[27] I would, however, grant leave to appeal under s. 193(e) because the proposed appeal, which relates to the proper scope of s. 215 of the *BIA*, meets the test for leave to appeal. It (a) raises an issue – the circumstances in which a trustee can be sued without leave of the court – that is of general importance to the practice in bankruptcy/insolvency matters; (b) is *prima facie* meritorious; and (c) would not unduly hinder the progress of the bankruptcy proceedings: *Business Development Bank of Canada v. Pine Tree Resorts Inc.*, 2013 ONCA 282, 115 O.R. (3d) 617, at para. 29.

(2) Does s. 215 Apply to the Action?

[28] As noted above, the motion judge found that s. 215 did not apply because “the trustee is being sued in its personal capacity” and because the Action alleges omissions. In order to explain why, in my view, the motion judge erred in these findings, I first examine the nature of the allegations in the Action and then turn to the text, context, and purpose of s. 215.

(a) The Nature of the Action

[29] The Action names Mr. Adamson as the only defendant. The amended statement of claim seeks a number of declarations based on common law causes of action including that “the Defendant engaged in misfeasance, negligence, fraud, and breach of fiduciary duty”. It asserts that he did so “in a personal capacity” but does not further explain that reference. It seeks damages, including damages for Ms. Flight under the *Family Law Act*, R.S.O. 1990, c. F.3.

[30] Although the claim is lengthy, it is clear that at its core, it is rooted in an alleged relationship between Mr. Flight, on the one hand, and Mr. Adamson in his role as trustee in Mr. Flight’s bankruptcies on the other. The statement of claim pleads Mr. Flight’s bankruptcies, and although it does not name or refer to Adamson Inc., which was actually the trustee in the bankruptcies, it describes

Mr. Adamson in equivalent terms. It states that: “The Defendant, John Adamson ... is a Licensed Insolvency Trustee, licensed to practice insolvency ... and during each of Mr. Flight’s four (4) bankruptcies ... was Mr. Flight’s acting Licensed Insolvency Trustee”.^[2]⁸⁴

[31] After describing Ms. LeBlanc’s alleged defalcations and their discovery, the claim alleges that Mr. Adamson’s wrongdoing consisted of the failure to: (i) correct records and reports; (ii) investigate Ms. LeBlanc’s fraud; (iii) have Mr. Flight promptly discharged from bankruptcy; and (iv) sue Ms. LeBlanc.

[32] For the claim in negligence, the Action alleges that Mr. Adamson owed a duty of care to the respondents because of his role as the “Licensed Insolvency Trustee” in each of the bankruptcies and was negligent in that role. It alleges among other things, that:

[A]s the acting Licensed Insolvency Trustee, the Defendant owed a duty to the Plaintiffs to administer Mr. Flight’s bankruptcy and prior bankruptcies diligently, and with due regard for [the Flights’] livelihood, and Mr. Flight’s finances.

...

As the only individual with the ability to administer Mr. Flight’s assets and his estate, the Defendant was sufficiently proximate to Mr. Flight to discover the theft, and moreover, to prosecute Ms. LeBlanc for it.

Furthermore, as the acting Licensed Insolvency Trustee, the Defendant was entrusted with administering Mr. Flight’s estate in the most financially reasonable, and expeditious fashion.

Finally, the Defendant remained the **only** individual capable of prosecuting Ms. LeBlanc, of discharging Mr. Flight, and of initiating a Consumer Proposal, from 2004-2020.

The Defendant owed a duty to perform his duties in a timely manner and to carry out his functions with competence, integrity, honesty, and due care in accordance with paragraph 36 of the *Trustee’s Code of Ethics*. [Emphasis in original.]

[33] The claim grounded in “misfeasance” is also premised on the role and power Mr. Adamson is alleged to have had as trustee. It asserts:

The Defendant’s position as a public officer exercising his power as the Licensed Insolvency Trustee for Mr. Flight, and his knowledge that he as Licensed Insolvency Trustee to Mr. Flight had the power to have Mr. Flight discharged, to investigate the theft and fraud of Julie LeBlanc, to correct the falsified records, and to file a Consumer Proposal, was absolute, and the Defendant failed to exercise these powers.

84. “Licensed Insolvency Trustee” is a term used by the Office of the Superintendent of Bankruptcy to identify a trustee holding a valid licence issued by the Superintendent under s. 13 of the BIA.

[34] The claims in fraud and breach of fiduciary duty have a similar grounding. They consist of allegations of knowingly false representations in reports to the court, creditors, and the Canada Revenue Agency (“CRA”). The claim asserts that as “the Licensed Insolvency Trustee for Mr. Flight, the Defendant was in a fiduciary relationship with Mr. Flight, and breached this relationship when he failed to act in good faith, and to place Mr. Flight’s interests first.”

[35] In summary, the Action sues Mr. Adamson as trustee. The claims against him, although common law causes of action, are grounded in, and alleged to flow from, his role and responsibilities as trustee.

(b) Section 215 of the *BIA*

[36] Section 215 of the *BIA* states: “Except by leave of the court, no action lies against the Superintendent, an official receiver, an interim receiver or a trustee with respect to any report made under, or any action taken pursuant to, this Act.”

[37] The Supreme Court explained the context in which s. 215 is to be understood, its purpose, and the test that governs whether permission to sue a trustee should be granted, in *GMAC Commercial Credit Corporation – Canada v. T.C.T. Logistics Inc.*, 2006 SCC 35, [2006] 2 S.C.R. 123.

[38] In general, “the duty of the trustee is to protect both the creditors and the public interest in the proper administration of the bankrupt estate”: *GMAC*, at para. 58. But the *BIA* does not, except for specific matters, confer immunity from suit on a trustee. Instead, s. 215 serves a gatekeeping function. It allows the bankruptcy court to screen out or prevent actions that are frivolous or vexatious or that do not disclose a cause of action, or for which there is no factual support, so that the trustee need not respond to them. This avoids the cost and distraction of litigation that would make the bankruptcy process unworkable. Section 215 sets a low threshold of review for the bankruptcy court, which does not involve a final determination of the merits of a claim. Rather, the section focuses on screening out only “manifestly unmeritorious claims”, ensuring that legitimate claims can be advanced for adjudication in forums, other than the bankruptcy court, that have jurisdiction over the merits of the claim: *GMAC*, at paras. 55-61, 66.

(c) Is the Action Against Mr. Adamson in a Personal Capacity and Therefore Outside the Scope of s. 215 of the *BIA*?

[39] The appellants argue that there is uncertainty about what the motion judge meant when she found that the Action did not require leave under s. 215 of the *BIA* because it was against the trustee in a personal capacity. They submit that if she meant that s. 215 was not applicable because Mr. Adamson, rather than Adamson Inc., was named as defendant, then she erred.

[40] The appellants submit that when an individual who is a director, officer, or employee of a corporate trustee is sued in relation to the performance of the trustee’s duties, s. 215 is applicable just as it would be if the corporate trustee was sued. They rely on *Braich (Re)*, 2007 BCSC 1604, 41 C.B.R. (5th) 260, a decision of the Supreme Court of British Columbia that stated, at paras. 35-36:

The object of s. 215 is to ensure that the bankruptcy process is not rendered unworkable by the Trustee being hindered by actual or threatened vexatious lawsuits in connection with the administration of the bankruptcy.

In Canada many trustees in bankruptcy are corporations. The *BIA* imposes on bankruptcy trustees many duties, some of which have been described above. A corporate entity can only discharge its duties through its directors, officers and employees. If the scope of s. 215 were limited to protecting only the corporate trustee in bankruptcy itself, then the trustee's directors, officers and employees who execute the trustee's obligations under the *BIA* could be subjected to vexatious lawsuits without leave of the bankruptcy court. Such a result cannot have been the intention of Parliament when it passed the statute. Such a restriction would undermine the entire purpose of s. 215 as consistently articulated by the courts.

See also Lloyd W. Houlden, Geoffrey B. Morawetz and Janis P. Sarra, *Bankruptcy and Insolvency Law of Canada*, loose-leaf (2022-Rel. 6), 4th ed. (Toronto: Thomson Reuters, 2009), at para. 10-6.

[41] I agree with the view expressed in *Braich*. Section 215 applies when an action alleges that the individual was the trustee and the alleged wrongdoing is predicated on the individual having the powers and responsibilities of the trustee.

[42] However, it is not clear that the motion judge was relying on the distinction between Mr. Adamson and Adamson Inc. when she referred to the Action as having been brought against the trustee in its personal capacity. She nowhere makes that distinction, and the distinction is not made in the amended statement of claim in the Action. The motion judge analysed the claim as one against the trustee, and the claim itself refers to Mr. Adamson as though he was the trustee.

[43] As illuminated by the cases she cited, the motion judge might have been relying on a different distinction, one that juxtaposes an action against a trustee in a representative capacity with one complaining that the trustee's conduct was in a personal capacity. The distinction is made in a case referred to by the motion judge, *Environmental Metal Works Ltd. v. Murray, Faber & Associates Inc.*, 2013 ABQB 479, 568 A.R. 198, at para. 48, in these terms:

Had the legislature not enacted s. 215, the bankrupt's creditors would have the right to commence an action and obtain a judgment against the trustee in its representative capacity for actions taken pursuant to the *BIA*. Such creditors would thereby subvert the bankruptcy process by suing the trustee as representative instead of proving their claims in bankruptcy. Therefore, a plaintiff must only apply for leave when suing the trustee in its representative capacity not when suing the trustee in its personal capacity. [Emphasis added.]

[44] With respect, I doubt the analytical utility of this distinction in identifying what s. 215 covers.

[45] Section 215 requires a relationship between the substance of the action and the role of the defendant as trustee. The text of the section specifies that it applies to an action "with respect to any report made under, or any action taken pursuant to, this Act". The words "with respect to" connote the broadest possible connection between two subject matters: *R. v. Nowegijick*, 1983 CanLII 18 (SCC),

[1983] 1 S.C.R. 29, at p. 39; *R. v. Penunsi*, 2019 SCC 39, [2019] 3 S.C.R. 91, at para. 41. And the section clearly contemplates that in the course of an “action taken pursuant to” the *BIA*, an actionable wrong may be committed; otherwise, there would be no point in providing that the court may grant permission to bring such an action.

[46] The phrase “suing the trustee in its personal capacity” is intended to describe an action where the required connection is lacking, while the phrase “suing the trustee in its representative capacity” is intended to describe an action where the required connection is made. The problem is that the phrases simply reflect a conclusion without explaining how that conclusion is reached.

[47] The central question in deciding whether s. 215 applies is whether the connection contemplated by the section is present, and this question is answered by examining the relationship between the alleged wrongdoing complained of in the Action and the role of a trustee. Neither the descriptive tags applied to the causes of action, such as negligence or breach of fiduciary duty, nor the assertion in the statement of claim that those causes of action are advanced against Mr. Adamson in a personal capacity are determinative.

[48] Here, Mr. Adamson’s alleged involvement in the trustee’s administration of Mr. Flight’s bankruptcies forms the basis of the negligence claim. It is the basis on which Mr. Adamson is alleged to have owed a duty to the respondents, and it sets the standard of care he is alleged to have breached. It undergirds the fiduciary duty claim, as it forms the basis on which he is alleged to have owed, and breached, his fiduciary duties. Each of his alleged failures is of something he is said to have been required to do, and failed to do, and in some cases had the sole power to do, as trustee. The misfeasance alleged is misfeasance in his role as trustee. Even the allegation of fraud is in respect of statements made to creditors, the court, and the CRA in his role as trustee.

[49] Where a person sued was involved in the acts complained of as a trustee in a bankruptcy, is alleged to have been performing duties incidental to the administration of the estate, and is alleged to have owed the plaintiff duties as a trustee, the claim falls within s. 215: *Grimanis v. Harris & Partners Inc.*, 2009 CanLII 10673 (Ont. S.C.), at paras. 31-34, *per* Morawetz J. That is the situation here.

[50] It follows that the motion judge erred in finding that because the Action alleged that Mr. Adamson was sued in “his personal capacity”, the Action was outside the scope of s. 215.

(d) Does an Action Complaining of Omissions Fall Outside of s. 215?

[51] The other basis of the motion judge’s conclusion was that an action alleging omissions falls outside s. 215. In support of this proposition, she cited the Supreme Court of Canada’s decision in *Mercure v. Marquette & Fils Inc.*, 1975 CanLII 195 (SCC), [1977] 1 S.C.R. 547. *Mercure* dealt with a claim against a trustee who was specifically required by the *BIA* at the time to insure the debtor’s property but did not do so.

[52] In holding that permission was not required to sue the trustee for the consequences of that omission under the predecessor to s. 215, the Supreme Court stated, at pp. 551-52:

The Court of Appeal, in the words of Salvas J., rejects this conclusion [that permission under s. 171, which is now s. 215 of the *BIA*, was required] for reasons I find entirely acceptable (at p. 577):

[TRANSLATION] Plaintiff does not complain of ‘any report made under, or any action taken pursuant to, the provisions of this Act’. On the contrary, it blames the trustee for not having taken action expressly required by the Act (s. 9(1)), that of insuring the debtor’s buildings against fire. It seems obvious to me that s. 171, the wording of which does not lend itself to misinterpretation, cannot apply in this case.

I would add only this: appellant asks this Court to read s. 171 as if any action arising out of his administration came under the provisions of this section. To be more precise, he asks the Court to find that leave of the Court is a prerequisite whenever an action is brought against a trustee by reason of his fault, whether this be an act of omission or commission. This is not the way in which the legislation is worded, however. Since the legislator used a much more restrictive wording in s. 171, it is not possible to come to any conclusion other than the one reached by the Court of Appeal.

[53] The parties disagree on the reach of the decision in *Mercure*. The respondents argue that the reasoning in *Mercure* extends beyond the particular scenario that was in issue – in which the trustee had failed to do something the *BIA* expressly required – and implies that if the claim is for any omission to act, then s. 215 does not apply. Because the Action alleges a number of failures by Mr. Adamson as trustee – to detect, prevent, and litigate about Ms. LeBlanc’s misappropriations – it therefore comes within this extended reading of *Mercure*. This is the interpretation the motion judge seems to have applied.

[54] The appellants, supported by the intervener, argue that *Mercure* applies, and that an action is outside of s. 215, only where the gist of the action is the omission to do something expressly and specifically required by the *BIA*. They submit that *Mercure* should not be read so broadly as to take every claim which asserts any kind of an omission outside of s. 215. Here, the gist of the Action is failures to act which allegedly give rise to common law claims, rather than failures to do something specifically and expressly required by the *BIA*.

[55] I agree with the argument of the appellants and the intervener on this point.

[56] Section 215 contemplates that in the course of making a report under, or taking an action pursuant to, the *BIA*, a trustee might commit an actionable wrong; indeed, it contemplates wrongs that would be litigated in civil courts. Most civil claims involve the defendant having failed, in some way, to do what was required – for example, by failing to fulfill a contract, meet a standard of care, fulfill a fiduciary duty, tell the full truth, or correct a misstatement. In a civil claim, what was done by the defendant is often criticized by comparing it to what should have been, but was not, done. Doing the wrong thing and omitting to do the right thing can be two ways of describing the same complaint.

[57] The extended reading of *Mercure* advocated by the respondents, beyond the specific circumstance *Mercure* addressed, would therefore put any claim that could be characterized as asserting some omission as part of the wrongdoing outside of the application of s. 215, even if the omission does not relate to something specifically and expressly required by the *BIA*. Such an interpretation would rob s. 215 of its screening function for such claims, and subject trustees to the type of claims it is designed to weed out. This would be inconsistent with the description of the section's gatekeeping role in *GMAC*, which analyzed s. 215 in light of its context and purpose. Nor is it possible to reconcile this extended reading with many decisions that have applied s. 215 to actions in which the claims could be seen as asserting, in whole or in part, some omission on the part of the trustee: see, for example, *The Bank of Nova Scotia v. David Allin*, 2013 ONSC 7937, 12 C.B.R. (6th) 315 (in which it was alleged that a trustee failed to provide notice of a proposal, sale, or bankruptcy to a creditor), and *Society of Composers, Authors and Music Publishers of Canada v. Armitage* (2000), 2000 CanLII 16921 (ON CA), 50 O.R. (3d) 688 (C.A.) (in which it was alleged, in the underlying application for permission under s. 215, that the trustee failed to receive payments for post-proposal creditors and to remit them to these creditors in breach of the trustee's duty to do so).

[58] In my view, the extended reading of *Mercure* is not required by the decision itself, which was addressing a specific scenario. While a trustee who fails to do something expressly required by the *BIA* is not acting "pursuant to" the *BIA* within the meaning of s. 215, nothing in the language of s. 215 requires giving similar effect to other kinds of alleged omissions. An action can be in relation to anything done pursuant to the *BIA*, even if it involves an alleged omission in the course of acting pursuant to the *BIA* that is said to make the trustee's performance of its role under the *BIA* wrongful and therefore actionable.

[59] The central omissions asserted by the respondents in the Action – that Mr. Adamson failed to detect or prevent Ms. LeBlanc's misappropriations or take the right steps as a consequence of learning about them – are not omissions to do things specifically and expressly required by the *BIA* akin to the duty to insure the debtor's property in *Mercure*. The omissions are asserted as breaches of common law duties arising from the role of trustee, making aspects of the performance of the trustee role wrongful and actionable. Section 215 therefore applies.

[60] The respondents also refer, in their factum, to actions they claim the trustee failed to take that are required by various provisions of the *BIA*, such as an obligation under s. 21 to verify the bankrupt's statement of affairs. However, whether the Action falls within s. 215 should be assessed on the basis of the core claims in the statement of claim, not claims that are "incidental to the main complaint": see *Mpampas v. Schwartz Levitsky Feldman Inc.*, 2008 ONCA 581, at para 4; *World Class Bakers Corporation, Re*, 2005 CanLII 47752 (Ont. S.C.), at para 20. Mr. Flight described the allegations of the failure to detect, prevent, and litigate Ms. LeBlanc's fraud as being at the heart of the Action. I agree with that assessment.

[61] In my view, s. 215 applies to the Action, and the motion judge erred in concluding otherwise.

(3) Should the Matter be Returned to the Bankruptcy Court to Determine Whether Permission to Sue Should be Granted?

[62] The motion judge explicitly declined to express her opinion as to whether, if she had decided s. 215 was applicable, she would have granted permission to bring the Action.

[63] The appropriate disposition is to return the matter to the bankruptcy court to determine whether leave under s. 215 should be granted. I reach this conclusion for the following reasons.

[64] The appellants argue that the Action is a nullity since it was commenced while Mr. Flight was an undischarged bankrupt. Although raised as a freestanding issue by the appellants, as I have indicated above, this issue is properly considered on the question of whether permission to proceed with the Action should be granted.

[65] The appellants submit that the conclusion must be that Mr. Flight could not commence the Action while an undischarged bankrupt, and that this is an incurable defect despite the subsequent annulment of his bankruptcy. They rely on the provisions of the *BIA* that a bankrupt ceases to have capacity to deal with their property upon bankruptcy (under s. 71 of the *BIA*) and that “property” is defined (under s. 2 of the *BIA*) to include “things in action”, which encompasses rights to sue, as well as Mr. Flight’s own assertions that only the trustee could sue Ms. LeBlanc for her alleged wrongdoing.

[66] None of the authorities cited by the appellants, however, expressly deal with the ability of an undischarged bankrupt to sue the trustee. It is one thing to say that, as against a third party, the bankrupt has no capacity to bring an action because only the trustee can. Without deciding the question, I simply note that it may be another thing to make this assertion where the claim is against the trustee itself.

[67] *Re New Alger Mines Limited* (1986), 1986 CanLII 2530 (ON CA), 54 O.R. (2d) 562 (C.A.), leave to appeal refused, [1986] S.C.C.A. No. 201, involved an action by the bankrupt against (among others) the trustee in bankruptcy. The action alleged wrongdoing that led to the occurrence of the bankruptcy and negligence of the trustee in the administration of the bankruptcy. The action was commenced without permission first being obtained under what is now s. 215 of the *BIA*.

[68] This court upheld the decision of the bankruptcy judge, who found that the action was not frivolous or vexatious and that it should be given retrospective (*nunc pro tunc*) permission to proceed under what is now s. 215 to avoid the consequence of a limitation period having expired between the date the action was started and the date permission was obtained: at pp. 565, 570-71.

[69] *New Alger* is frequently cited on the question of when it is appropriate to grant s. 215 permission retrospectively, but it cannot be overlooked that this court decided that permission was appropriate for an action by a bankrupt against a trustee for wrongdoing leading to a bankruptcy and in the

administration of the bankrupt estate. Although the decision of the bankruptcy judge quoted in this court's decision is brief, it was upheld and there is no suggestion in this court's decision that the bankrupt was without capacity to assert the claims in the action.

[70] Because the motion judge did not express a view on the issue, we do not have the benefit of a first instance analysis of the legal questions involved, including whether Mr. Flight's claim, or any aspect of it, arguably fits within a category of case in which a bankrupt will be permitted to sue a trustee for the way the bankruptcy occurred and was administered despite initially failing to seek leave, and whether, if it does, it has the required factual support. We do not have the benefit of any findings of fact on disputed matters, such as whether there is a viable assertion that Mr. Flight (rather than his creditors) would have been financially better off if the trustee had sued Ms. LeBlanc earlier^[3]⁸⁵, given the amount and timing of the alleged misappropriations, the amounts owed to creditors in each bankruptcy, the value of lost opportunities to avoid any of the bankruptcies or to exit from them earlier, and so on. Whether a cause of action has factual support is a critical part of the *GMAC* enquiry: *GMAC*, at para. 59.^[4]⁸⁶

Disposition

[71] In light of the foregoing, I would grant leave to appeal, allow the appeal, and return the matter to the bankruptcy court to determine whether the respondents should be granted permission to sue Mr. Adamson. The appellants are entitled to the costs of the appeal, fixed in the amount of \$13,000, inclusive of disbursements and applicable taxes. No costs are awarded for or against the intervener.

Released: July 13, 2022 "PDL"

"B. Zarnett J.A."

"I agree. P. Lauwers J.A."

"I agree. I.V.B. Nordheimer J.A."

85. Adamson Inc. commenced an action against Ms. LeBlanc on September 11, 2020.

86. In highlighting these matters, I am not to be taken as limiting what should be considered on the question of whether permission to sue should be granted. These comments simply respond to the specific matters that were raised in argument.

TAB 20

In the matter of the bankruptcy of Brian Wayne Flight, et al. v. John Adamson, 2023 CanLII 28900 (SCC)

Date: 2023-04-13

File number: 40417

Citation: **In the matter of the bankruptcy of Brian Wayne Flight, et al. v. John Adamson, 2023 CanLII 28900 (SCC), <<https://canlii.ca/t/jwmg8>>, retrieved on 2024-04-26**

No. 40417

April 13, 2023

Le 13 avril 2023

BETWEEN:

ENTRE :

In the matter of the bankruptcy of Brian Wayne Flight and Amber Nicole Flight

Affaire intéressant la faillite de Brian Wayne Flight et Amber Nicole Flight

Applicants

Demandeurs

- and -

- et -

John Adamson

John Adamson

Respondent

Intimé

JUDGMENT

The application for leave to appeal from the judgment of the Court of Appeal for Ontario, Number C69594, 2022 ONCA 526, dated July 13, 2022, is dismissed.

JUGEMENT

La demande d'autorisation d'appel de l'arrêt de la Cour d'appel de l'Ontario, numéro C69594, 2022 ONCA 526, daté du 13 juillet 2022, est rejetée.

J.S.C.C.

J.C.S.C.

IN THE MATTER OF THE NOTICES OF INTENTION OT MAKE A PROPOSAL OF YG LIMITED PARTNERSHIP AND YSL RESIDENCES
INC. OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO

Court of Appeal File No.:

Court File No. BK-21-02734090-0031

**COURT OF APPEAL FOR ONTARIO
IN BANKRUPTCY AND INSOLVENCY**

PROCEEDING COMMENCED AT TORONTO

**BOOK OF AUTHORITIES OF THE APPELLANTS,
THE CLASS A LPS**

THORNTON GROUT FINNIGAN LLP

100 Wellington Street West
Suite 3200
Toronto ON M5K 1K7

D.J. Miller LSO#: 343939P

djmiller@tgf.ca

Tel: 416 304 0559

Alexander Soutter LSO#: 72403T

asoutter@tgf.ca

Tel: 416 304 059

Lawyers for the Appellants, YongeSL Investment Limited
Partnership, 2124093 Ontario Inc., SixOne Investment Ltd., E&B
Investment Corporation, and TaiHe International Group Inc.

LAX O'SULLIVAN LISUS GOTTLIEB LLP

Counsel
Suite 2750, 145 King Street West
Toronto ON M5H 1J8

Shaun Laubman LSO#: 51068B

slaubman@loig.ca

Tel: 416 360 8481

Xin Lu (Crystal) Li LSO#: 766670

cli@loig.ca

Tel: 416 956 0112

Lawyers for the Appellants, 2504670 Ontario Inc., 8451761
Canada Inc.
and Chi Long Inc.