Corporate Brief

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DIRECTORS' AND OFFICERS' LIABILITY FOR FAILURE TO OBTAIN AN IMPORT PERMIT

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The Government of Canada (in particular, Global Affairs Canada, the Canada Border Services Agency, and the Canadian Food Inspection Agency) may pursue directors and officers of a corporation who fail to obtain the required import permits, licenses and certifications. Corporations cannot act on their own. Individuals make decisions that cause the corporation to take actions. With respect to imports, individuals take the steps that cause the import to occur. It may be that an individual makes the decision to not obtain the required import permit, license or certificate. For example, a good may be on *Canada's Import Control List* and an officer/director may be prosecuted for failing to obtain an import permit when that officer/director authorized an import of the good in circumstances where a general import permit or exemption does not apply.

It is important to note that many of Canada's import restrictions relate to textiles and apparel, chemicals, steel, and agricultural products. Canada also imposes restrictions on imports of firearms, related goods and ammunition.

Section 14 of the *Export and Import Permits Act* states:

"No person shall import or attempt to import any goods included in an Import Control List except under the authority of and in accordance with an import permit issued under this Act."

A person does not contravene section 14 of the *Export and Import Permits Act* if, at the time of importation, the person would have imported the goods under the authority of and in accordance with an import permit issued under the *Export and Import Permits Act* had they applied for it, and if, after the importation, the permit is issued.

Section 20 of the *Export and Import Permits Act* states:

"Where a corporation commits an offence under this Act, any officer or director of the corporation who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted."

There are a number of important points:

1. The Crown can pursue an officer/director even if the Crown has not prosecuted (and the Court has not convicted) the corporation;
2. An officer or director who directed, authorized, assented to, acquiesced in or participated in the commission of the offence may be prosecuted for the offence;

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3. Employees are not identified in section 20 of the *Export and Import Permits Act*, which means that only officers and directors may be pursued personally; and
4. The limitation period in subsection 19(2) of the *Export and Import Permits Act* (that is, three years after the time when the subject-matter of the complaint arose) applies to prosecutions of officers and directors.

Subsection 19(1) of the *Export and Import Permits Act* states that:

"Every person who contravenes any provision of this Act or the regulation is guilty of (a) an offence punishable on summary conviction and liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding twelve months, or to both; or (b) an indictable offence and liable to a fine in an amount that is in the discretion of the court or to imprisonment for a term not exceeding ten years, or to both."

This means that the Crown may elect to pursue a corporation (or officer/director) by way of summary conviction or indictment. If the Crown pursues the corporation (or officer/director) by way of summary conviction, the maximum penalty is $25,000 and/or imprisonment of no more than 12 months. However, if the Crown pursues the corporation (or officer/director) by way of indictment, the judge has discretion to set a fine in any amount. The judge cannot impose a term of imprisonment in excess of 10 years.

Canadian importers of food products should also watch the *Safe Food for Canadians Act*, which was passed and received Royal Assent in 2012. The *Safe Food for Canadians Act* consolidates a number of food related laws, including the *Meat Inspection Act*, the *Fish Inspection Act*, the *Canada Agricultural Products Act* and the food labeling provisions of the *Consumer Packaging and Labelling Act*. The *Safe Food for Canadians Act* was to come into force in 2015 and no statement was issued before the federal election. When and if the *Safe Food for Canadians Act* comes into effect, more robust offence provisions will also come into effect. Section 39 of the *Safe Food for Canadians Act* provides.

"A person who contravenes a provision of this Act, other than sections 7 and 9, or a provision of the regulations — or fails to do anything the person was ordered to do by, or does anything the person was ordered not to do by, the Minister or an inspector under this Act other than subsection 32(1) — is guilty of an offence and is liable

(a) on conviction on indictment, to a fine of not more than $5,000,000 or to imprisonment for a term of not more than two years or to both; or (b) on summary conviction, for a first offence, to a fine of not more than $250,000 or to imprisonment for a term of not more than six months or to both and, for a subsequent offence, to a fine of not more than $500,000 or to imprisonment for a term of not more than 18 months or to both."

Pursuant to subsection 39(4) of the *Safe Food for Canadians Act*, any of the person's directors or officers, or agents or mandataries, who directs, authorizes, assents to or acquiesces or participates in the commission of the offence is a party to the offence and is liable on conviction to the punishment provided for by this Act, even if the person is not prosecuted for the offence.

Due Diligence

Unlike many directors and officer's liability provisions, there is no due diligence defense in the *Export and Import Permits Act* for offences committed by the corporation or officer/director. There is a due diligence defence in the *Safe Food For Canadians Act*. An argument may be raised that common law allows for a due diligence defense where the officer/director can show that reasonable care was taken to avoid the commission of an offence. A failure to obtain an import permit is a strict liability offense. For example, if an officer/director implemented a policy to obtain import permits and underlings failed to follow proper procedures, it may be that the facts would support a due diligence defense.

A due diligence defense is available where a Canadian corporation obtains an import permit for a non-resident and that non-resident commits an offence. Section 21 of the *Export and Import Permits Act* states:

"Where a permit under this Act is issued to a person who has applied for it for, on behalf of, or for the use of, another person who is not a resident of Canada and that other person commits an offence under this Act, the person who applied for the permit is, whether or not the non-resident has been prosecuted or convicted, guilty of the like offence and liable, on conviction, to the punishment provided for the offence, on proof that the act or omission constituting the offence took place with the knowledge or consent of the person who applied for the permit or that the person who applied therefor failed to exercise due diligence to prevent the commission of the offence."

If the officer/director can show that that he/she exercised due diligence to prevent an offence from taking place, he/she should not be convicted (depending on the facts).

IN THE NEWS

Privacy Commissioner of Canada and Australian Information Commissioner Release Takeaways for all Organizations after Ashley Madison Investigation

On August 23, 2016, the Privacy Commissioner of Canada and the Australian Privacy Commissioner published the results of their joint investigation following the 2015 breach of infidelity site Ashley Madison, and its parent company, Toronto-based Avid Life Media ("ALM"). The investigation examined ALM's compliance with both the *Personal Information Protection and Electronic Documents Act* and Australia's *Privacy Act*.

In connection with the release of the report of findings into the hack (the "Report"), several key takeaways ("Key Takeaways") from the investigation were released as set forth below:

1. **General**
   - Harm extends beyond financial impacts.
   - Safeguards should be supported by a coherent and adequate governance framework.
2. **Safeguards**
   - Documentation of privacy and security practices can itself be part of security safeguards.
   - Use multi-factor authentication for remote administrative access.
3. **Deletion and Retention**
   - There is a high bar associated with charging a fee for deletion.
   - Retention policies should be based on demonstrable rationale and timeline.
4. **Accuracy**
   - The level of accuracy required is impacted by the foreseeable consequences of inaccuracy, and should also consider interests of non-users.
5. **Transparency**
   - False or misleading statements may impact the validity of consent.
   - Omission or lack of clarity of material statements may also impact the validity of consent.

To view the Report, please visit: https://www.priv.gc.ca/en/opc-actions-and-decisions/investigations/investigations-into-businesses/2016/pipeda-2016-005/.

To view the Key Takeaways, please visit: https://www.priv.gc.ca/en/opc-actions-and-decisions/investigations/investigations-into-businesses/2016/2016_005_ta/.

Competition Bureau Issues a Template for Merger Consent Agreements

The Competition Bureau (the "Bureau") has issued a template for merger consent agreements (the "Template") with the aim of providing the Canadian legal and business communities with better insight into the Bureau's expectations when negotiating measures to address competitive issues likely to arise from a proposed merger.

The Bureau's mandate in reviewing a merger is to determine whether the proposed transaction will likely result in a substantial lessening or prevention of competition. A consent agreement contains remedial measures that the

Commissioner of Competition has determined are appropriate to address a proposed transaction's likely anti-competitive effects. A consent agreement has the force and effect of a court order once it is registered with the Competition Tribunal.

When the Bureau finds that a transaction is likely to have anti-competitive effects, its preference is to negotiate a consent agreement rather than challenge a transaction before the courts. Since court proceedings are costly and time-consuming for all parties, the Bureau's position is that negotiated consent agreements provide value for Canadians and benefit the Canadian economy.

To view the Bureau's Template, please visit: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02310.html.

LEGISLATIVE UPDATE

Federal

Government Introduces a Bill to Change the Process of Electing Corporate Directors

On September 28, 2016, the Honourable Navdeep Bains, Minister of Innovation, Science and Economic Development, announced the tabling of Bill C-25 entitled *An Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act*.

This legislation provides as follows for publicly traded corporations incorporated under the *Canada Business Corporations Act*:

- holding annual elections for the board of directors;
- individual votes for director candidates; and
- directors being elected by a majority voting model when the number of candidates is the same as the number of positions to be filled.

A key provision allows shareholders to vote against a candidate for the board of directors. Under current legislation, shareholders can either vote for a candidate or withhold their votes. This new legislation would ensure that a nominee for the board of directors is elected only if he or she receives a majority of votes.

Bill C-25 also includes the following:

- requiring corporations to report annually on diversity, identifying the gender composition of their boards and senior management and disclosing their diversity policies or explaining why none are in place;
- replacing the *Canada Business Corporations Act*'s requirements for paper-based communications by a "notice and access" system, allowing corporations to use electronic communications to provide notice of meetings to shareholders and online access to relevant documents;
- simplifying the deadline for shareholders to submit proposals;
- clarifying that all shares and share warrants must be in registered form, prohibiting the issuance and use of bearer shares.

Ontario

Government Introduces a Bill Eliminating Requirement that Board of Directors Meet at Registered Office

The *Burden Reduction Act, 2016* (Bill 218) received first reading on September 27, 2016. This legislation amends the *Business Corporations* Act. Currently, with certain exceptions, a meeting of the board of directors of a corporation must be held at its registered office. The amendment provides that, unless the articles or by-laws of a corporation provide otherwise, a meeting of the board of directors may be held at any place.

RECENT CASES

Appeal Court Finds that Transfer of Consulting Business to Avoid Paying Judgment did not Amount to Oppression or Fraudulent Conveyance

British Columbia Court of Appeal, September 9, 2016

The plaintiff, Mr. Hilden, controlled the corporate plaintiff, Finness Yachting Inc. ("Finness"), and the defendant, Mr. Menzies, controlled the corporate defendant, Coastal Pacific Investments Inc. ("Coastal"), through which he conducted his management consulting business. Finness and Coastal owned a yacht called the Amici, with respect to which a dispute arose, and the parties agreed to arbitrate that dispute. Coastal subsequently agreed to pay Finness and Mr. Hilden an arbitral award, and to consent to that award being converted into a consent judgment (the "Judgment"). Finness and Mr. Hilden agreed not to enforce that Judgment unless Coastal failed to pay it after the Amici was sold. Mr. Menzies personally guaranteed payment of a portion of the arbitral award, which he paid after the Amici had been sold. Coastal, however, made no payments on the Judgment. At an examination in aid of executing the Judgment against Coastal, Mr. Menzies admitted that he had begun carrying on his consulting business through the corporate defendant, Menzies Investments Group Inc. ("Menzies Investments"), to prevent Coastal from having the funds available to satisfy the Judgment. As a result, Finness and Mr. Hilden commenced proceedings against Mr. Menzies, Coastal, and Menzies Investments, for the balance owing by Coastal on the Judgment. Their position was that: (a) the transfer of the consulting business to Menzies Investments constituted a fraudulent conveyance or a fraudulent preference; and, in the alternative, (b) Mr. Menzies had exercised his power as director of Coastal in an oppressive manner, which gave rise to an oppression remedy. In dismissing the plaintiffs' claims, the trial judge concluded that: (a) although Mr. Menzies clearly sought to frustrate the plaintiffs' ability to collect on the Judgment by nominating Menzies Investments to receive payment for his management and consulting services instead of Coastal, the plaintiffs failed to demonstrate that he perpetrated a fraudulent conveyance or preference, as defined by the relevant legislation; (b) the plaintiffs also failed to satisfy the test for an oppression remedy set out in *BCE v. 1976 Debentureholders*, 2008 SCC 19, in that they failed to show that they had a reasonable expectation that Coastal and Mr. Menzies would not take steps to render Coastal insolvent, or to defeat their ability to realize on the Judgment; and (c) to protect their interests, the plaintiffs could have required Mr. Menzies to guarantee the full amount of the Judgment, or to assure them that he would continue to nominate Coastal to receive the management fees from his business on his behalf. On appeal, the plaintiffs argued, in essence, that the trial judge erred with respect to the following: (a) in failing to find that the defendants had made a "disposition of property" which constituted a fraudulent conveyance; (b) in finding that Coastal was a "mere nominee" rather than a corporation operating Mr. Menzies' management consulting business as a going concern; and (c) in concluding that the plaintiffs did not have a reasonable expectation that Mr. Menzies, as a director of Coastal, would not take steps to render the corporation insolvent, or otherwise intentionally defeat their ability to realize on the Judgment.

The appeal was dismissed. On the evidence, it was reasonably open to the trial judge to find that the contracts between Mr. Menzies and his clients showed that these clients were his, and not those of Coastal. As a result, the transfer by Mr. Menzies of his management consulting business from Coastal to Menzies Investments did not amount to a fraudulent conveyance. In addition, there was no basis on which to interfere with the trial judge's finding that the expectation asserted by Finness and Mr. Hilden, that Mr. Menzies would continue to operate Coastal as a going concern, was not objectively reasonable. Accordingly, their oppression claim could not succeed.

Finness Yachting Inc. v. Menzies,
2016 ACLG ¶ 79,716
2016 BCLG ¶ 79,140
2016 CCLR ¶ 201,297
2016 CCSG ¶ 51,577
2016 OCLG ¶ 51,953

Motion Judge Erred by Awarding Full Amount Owing Under Agreement in Absence of Acceleration Clause

Ontario Court of Appeal, April 28, 2016

Following the settlement by the parties of oppression proceedings, the parties entered into a Share Purchase and Sale Agreement, secured by a Share Pledge Agreement, pursuant to which the appellants agreed to purchase from the respondent shares of certain corporations. The appellants defaulted on the required monthly payments, and the parties again tried to resolve the matter through an exchange of offers in November 2014 between their counsel. However, when the appellants remained in default, the respondent brought a motion for summary judgment requesting either enforcement of the Share Purchase and Sale Agreement, including the Share Pledge Agreement, or, in the alternative, enforcement of the settlement that he claimed was reached by letter dated November 28, 2014. The motion judge found that there was no binding settlement reached in November 2014, but granted the respondent judgment for both the past and future amounts owing on the Share Purchase and Sale Agreement, despite the fact that this agreement contained no acceleration clause. On appeal, the appellants argued that, in the absence of an acceleration clause, the motion judge erred in ordering them to pay the full amounts, past and future, owing on the Share Purchase and Sale Agreement. The respondent submitted that, based on the Share Purchase and Sale Agreement, the Share Pledge Agreement, and on the surrounding circumstances, the parties intended that, upon default, the full balance outstanding would become due and owing. The respondent also cross-appealed, alleging that the exchange of correspondence in November 2014 between the parties' counsel constituted a binding settlement.

The appeal was allowed, and the cross-appeal was dismissed. The Share Purchase and Sale Agreement and the Share Pledge Agreement lacked an acceleration clause. However, they clearly stipulated what was to happen in the event of the appellants' default: interest was to accrue, and the respondent's shares were to be held in escrow pending payment in full. In addition, the respondent did not treat the appellants' default as accelerating the balance owing under both agreements, or as entitling him to realize on the security of the shares being held in escrow. The motion judge, therefore, erred by collapsing the outstanding payments into the amount owing by the appellants in the absence of an acceleration clause. However, he was correct in finding that the exchange of correspondence between the parties in November 2014 did not amount to a binding agreement of settlement.

Scamurra v. Sandy Scamurra & Sons Limited,
2016 ACLG ¶ 79,717
2016 BCLG ¶ 79,141
2016 CCLR ¶ 201,298
2016 CCSG ¶ 51,578
2016 OCLG ¶ 51,954

CCAA Judge Did Not Have Jurisdiction To Apply US Legal Doctrine of "Equitable Subordination" in Assessing Creditors' Claims

Ontario Court of Appeal, September 9, 2016

United States Steel Corporation ("USS"), a large steel producer, acquired Stelco in 2007 while Stelco was under the protection of the *Companies Creditors Arrangement Act*, RSC 1985, c. C-36 (the "CCAA"), and changed Stelco's name to U.S. Steel Canada Inc. ("USSC"). On September 16, 2014, USSC was again granted CCAA protection. USS filed its proofs of claims against USSC, most of which arose from USS's acquisition and reorganization of Stelco, and from advances of working capital. USS moved for court approval of its claims, and Notices of Objection were filed by the Province of Ontario and the Superintendent of Financial Services in his capacity as administrator of the Pension Benefits Guarantee Fund (the "Province"), by the United Steelworkers union (the "Union"), by counsel for a group of non-unionized employees and retirees, and by a former president of Stelco and his wife (the "Milbournes"). The CCAA judge determined that: (a) the Province's claims could be determined within the CCAA proceedings; (b) some of the claims of the Union and the Milbournes could be approached as third party claims against USS for oppression under section 241 of the *Canada Business Corporations Act*, RSC 1985, c. C-44, and for breach of fiduciary duty; (c) the remaining claims of the Union and the Milbournes, except for the equitable subordination claim, could be determined within the CCAA proceedings; and (d) the Milbournes' claim to subordinate USS's claims to those of other unsecured creditors based on the American legal doctrine of "equitable subordination" could not be determined, because the CCAA judge lacked jurisdiction under the CCAA to apply this doctrine. In the CCAA judge's view: (a) there was no express provision in the CCAA conferring jurisdiction to grant the remedy of equitable subordination, so that any jurisdiction to do so would have to be found in section 11 of the CCAA, which provided that the court may make any order that it considers appropriate in the circumstances, subject to the restrictions set out in the CCAA; (b) there was no Canadian case law supporting that authority, and when given the occasion to confirm the existence of the doctrine of equitable subordination on two occasions, the Supreme Court declined to do so; (c) one could infer from this that the Supreme Court rejected the principle of equitable subordination; and (d) to the extent that the issue remained open, the CCAA evidenced an intention to exclude equitable subordination, since when Parliament gave authority under subsection 6(8) of the CCAA to subordinate debt as being in substance equity, it did not enact any provision to subordinate a claim based on the conduct of the creditor. An appeal was filed dealing with the question as to whether the CCAA judge had jurisdiction to deal with the equitable subordination issue.

The appeal was dismissed, but for reasons other than those provided by the CCAA judge. Despite the CCAA judge's comments to the contrary, the silence of the Supreme Court of Canada on the issue of equitable subordination could not be taken as an outright rejection of the doctrine. The Supreme Court simply left the issue for another day, although it was unnecessary to decide that issue in the present proceedings, since the only issue here was whether the CCAA judge was right in deciding that he had no jurisdiction to grant equitable subordination under the CCAA, assuming that such remedy was available in Canadian law. It is inconsistent with the anatomy and history of the CCAA to maintain that, if Parliament had intended that a CCAA judge would have the authority to make a certain type of order, it would have said so. The Supreme Court has made it clear that "the general language of the CCAA should be read as being restricted by the availability of more specific orders" (see *Century Services v. Canada (AG)* 2010 SCC 60). That said, however, the words "may ... make any order it considers appropriate in the circumstances" in section 11 of the CCAA must be read to mean that any order *in furtherance of the remedial purposes of the Act* may be made, if considered appropriate. The wording does not support the concept that section 11 provides an at-large equitable jurisdiction to reorder priorities to grant remedies as between creditors. In this case, the appellant failed to identify how equitable subordination would further the remedial purpose of the CCAA. In addition, nowhere in the words of the CCAA is there authority, express or implied, to apply the doctrine of equitable subordination, and that doctrine does not fall within the scheme and purpose of the CCAA, which focuses on the implementation of a plan of arrangement or compromise, as opposed to the establishment or rearrangement of a scheme of priorities. Furthermore, there is no provision in the CCAA equivalent to section 183 of the *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3 (the "BIA"), or §105(a) of the US *Bankruptcy Code*. Section 183 of the BIA invests the bankruptcy court with "such jurisdiction at law and in equity" as will enable it to exercise its bankruptcy jurisdiction. This is significant, because if equitable subordination is to become a part of Canadian law, it would appear that the BIA gives the bankruptcy court explicit jurisdiction as a court of equity to ground such a remedy and a legislative purpose that is more relevant to the potential reordering of priorities.

U.S. Steel Canada Inc. (Re),
2016 ACLG ¶ 79,718
2016 BCLG ¶ 79,142
2016 CCLR ¶ 201,299
2016 CCSG ¶ 51,579
2016 OCLG ¶ 51,955

Plaintiff Forced to Retire from Partnership; Summary Judgment Issued Awarding Damages for Breach of Contract

Ontario Superior Court of Justice, March 31, 2016

The plaintiff, Mr. Ludwig, was a 62-year-old chartered accountant and a licensed trustee in bankruptcy. From 1992 until 2014, Mr. Ludwig's professional corporation, the corporate plaintiff, was a partner of the defendant BDO Canada LLP ("BDO"), an accounting firm. Article 17.4 of the partnership agreement deemed a partner to have resigned from the partnership once the firm's Policy Board unanimously determined that it was "not in the best interests of the Partnership" for that partner to remain in the partnership, and such partner was notified of that determination. On July 8, 2014, Mr. Ludwig was called into a meeting with two partners of the firm and was told that: (a) in accordance with the decision of the firm's CEO, he would have to retire at the end of the year and the decision was not negotiable; (b) the firm was "over-partnered"; (c) the firm's non-competition clause would apply after his retirement; and (d) the decision requiring him to retire had nothing to do with his performance. On October 8, 2014, the Policy Board unanimously voted to compel Mr. Ludwig to retire in the best interests of the firm, pursuant to article 17.4 of the partnership agreement. Mr. Ludwig and his professional corporation subsequently sued BDO for damages for breach of contract, alleging, in part, that article 17.4 did not support his expulsion from the firm because no grounds for expulsion particular to him were cited in support of the Policy Board's expulsion decision of October 8, 2014. BDO alleged, in part, that: (a) Mr. Ludwig was identified as suitable for removal from the firm in or about July 2014; (b) this was because of the poor performance of the Edmonton office, the challenges that were anticipated to affect the Edmonton economy, and Mr. Ludwig's under-performance, particularly in the areas of "business development activities"; and (c) the Policy Board only invoked article 17.4 because of Mr. Ludwig's intransigence and the plaintiffs' refusal to recognize BDO's power to compel his mandatory resignation. The parties agreed that the matter was suitable for summary judgment.

The plaintiffs were awarded judgment. Sections 25, 28, and 45 of the *Partnerships Act*, RSO 1990, c. P.5 (the "Act"), along with certain common law principles, governed the legal analysis relevant to this case. Under section 25 of the Act, no majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners. Under section 28 of the Act, partners are bound to render true accounts and full information affecting the partnership to any partner. Under section 45 of the Act, the rules of equity and common law applicable to partnerships continue in force, except to the extent that they conflict with any provision of the Act itself. The common law rules relevant to this case were: (a) since a true power of expulsion is expropriatory in nature it will always be construed strictly; (b) partners at a firm are fiduciaries so that the utmost good faith is due from every one of them; (c) where a discretion is conferred on the management of the firm or on a majority of the partners, a partner will normally be entitled to expect that it will be exercised rationally and in good faith, and not arbitrarily or capriciously; and (d) the fiduciary who delegates or acts under dictation plainly fails to exercise the discretion entrusted to him or her. Applying the foregoing analysis to the facts of Mr. Ludwig's case, the conclusions were: (a) in its meeting on October 8, 2014, the Policy Board merely formalized a decision that had been made previously by someone other than the Policy Board itself, and there was no evidence as to what deliberations, if any, the Policy Board undertook at, or in advance of, that meeting; (b) expelling Mr. Ludwig was a mere rubber stamp to a decision that had been taken much earlier, and the Policy Board essentially abdicated its power of expulsion in this case, or at least acquiesced in the usurpation of that power by parties disentitled to wield it; (c) the evidence gave rise to a strong suspicion that the Policy Board acted to expel Mr. Ludwig at the dictation of the firm's CEO, and BDO gave no evidence in support of its assertion that the Edmonton office in general, and Mr. Ludwig in particular, were underperforming; (d) the Policy Board, therefore, did not make a valid determination within the meaning of article 17.4, so that the decision to expel Mr. Ludwig was simply invalid and amounted to a breach of contract and a breach of the partnership agreement; (e) BDO's argument that the Policy Board had an unfettered discretion when making a determination about the best interests of the partnership under article 17.4 of the partnership agreement could not be reconciled with the requirement that the discretion to expel a partner must be exercised rationally and in good faith, and not arbitrarily and capriciously; (f) Mr. Ludwig was not afforded an express opportunity to be heard by the Policy Board, but had he been given that opportunity, there would have been a strong indication of good faith on the part of the expelling partners that might have cured an otherwise defective procedure; and (g) in the end, BDO offered no evidence that the power to expel Mr. Ludwig was exercised scrupulously and in good faith. As a result of the foregoing analysis, the plaintiffs were entitled to: (a) damages of $1,233,739 for the lost profit allocation under the BDO profit-sharing arrangement to which Mr. Ludwig would have been entitled had he worked to his compulsory retirement date under the partnership agreement; (b) $61,198, reflecting an additional retirement benefit that would have accrued to Mr. Ludwig if he had retired on the compulsory retirement date; and (c) aggravated damages of $100,000 to reflect the embarrassment and reputational harm which Mr. Ludwig experienced as a result of his expulsion.

Tim Ludwig PC v. BDO Canada LLP,
2016 ACLG ¶ 79,719
2016 BCLG ¶ 79,143
2016 CCLR ¶ 201,300
2016 CCSG ¶ 51,580
2016 OCLG ¶ 51,956

Court Upholds OSC's Finding that Appellant Fund Managers Breached Their Fiduciary Duty by Using Fund Assets to Purchase Management Agreements Covering Other Funds for Their Own Benefit

Ontario Divisional Court, May 17, 2016

The corporate appellant, Crown Hill Capital Corp. ("Crown Hill"), was an investment company of which the individual appellant, Pushka, was the sole owner and directing mind. During 2008 and 2009, Pushka caused Crown Hill's predecessor investment fund, Crown Hill Dividend Fund ("CHDF"), with an asset base of $6.4 million, and an annual fee income of $44,000, to undergo three sets of merger transactions, at the end of which the merged fund, Crown Hill Fund ("CHF"), had an asset base of some $237 million. The first set of transactions was financed by Pushka and Crown Hill, and was approved by Crown Hill's board of directors and by all of the unitholders. At that time, the unitholders also approved the amendment of the fund's declaration of trust to permit the board of directors to amend the declaration of trust without unitholder approval to facilitate further unspecified fund mergers. The second and third sets of merger transactions, however, which were not approved by the unitholders, were financed by the funds' investors, in that Crown Hill and Pushka used monies entrusted to them for investment purposes to purchase further investment services management agreements relating to other funds which were then all merged into CHF. In other words, Crown Hill and Pushka loaned their investors' money to themselves to enable them to purchase management services agreements which accrued to their own very substantial benefit. In two decisions, i.e., the Merits Decision of August 23, 2013 and the Sanctions Decision of August 8, 2014, the Ontario Securities Commission ("OSC") found the following: (a) the appellants were liable for breaches of their fiduciary duties of good faith and loyalty to their investors, contrary to paragraph 116(a) of the *Securities Act*, RSO 1990, c. S.5; (b) that the appellants' conduct, which involved self-dealing, could not be saved by the business judgment rule, or by reliance on the board of directors, by recommendations of an independent review committee (the "IRC"), or by legal advice; (c) in any event, the independent directors and the IRC were not given the information needed to provide informed advice or make informed decisions; (d) the legal advice obtained was not directed to the central issues in this case, i.e., the self-interested nature of the transactions, and the disclosure and consent that would have to be obtained in such circumstances; and (e) the appellants obtained nearly $54 million in management and other fees as a result of their breaches of their fiduciary obligations, but should disgorge $18,237,047 of this, and should also pay administrative penalties of $1.875 million and costs of $300,000. On appeal, the appellants argued, in essence, that: (a) they had been supported by, and relied on, decisions of the board of directors (the majority of whom were independent persons of unquestioned integrity), on recommendations by the IRC (comprising three independent financial professionals of unquestioned integrity), and on legal advice from two of Canada's leading law firms; and (b) the impugned transactions were matters of business judgment which were protected from review by the "business judgment rule", which precludes a tribunal from second-guessing the decisions made by a board of directors in the course of managing the affairs of a corporation. During oral argument, the appellants also alleged that the OSC had committed breaches of procedural fairness and denials of natural justice.

The appeal was dismissed. The appellants were unable to show that the OSC reached its decisions relying upon matters which it expressly said it would not rely upon. Nor did the OSC err in concluding that the onus of proving that the board of directors and the IRC were fully informed of matters relating to the conflict of interest lay on the appellants. Reliance on board decisions and recommendations of the IRC were defences raised by the appellants, and as defence issues, it was for the defence to prove them on a balance of probabilities. In reviewing the OSC's decision, moreover, the applicable principles were: (a) a fiduciary acting in a conflict of interest *prima facie* breaches his or her duty of loyalty and good faith; (b) when intending to act in a conflict of interest, a fiduciary must "fully inform" those responsible for assessing and deciding whether or not to excuse that conflict; (c) the fiduciary must establish that the conflict has been managed appropriately before proceeding with that conflict; and (d) once a fiduciary has been shown to act in a conflict of interest, the onus is on the fiduciary to show, on a balance of probabilities, that he or she cleared the conflict before proceeding with it. In this case the OSC found, in essence, that: (a) the appellants' impugned transactions were self-interested and in breach of their duties to the funds which they were managing, as well as to their unitholders; (b) these transgressions were not saved by the business judgment rule, since the decision of whether or not to submit the proposed conflict of interest transactions to the unitholders for prior approval went well beyond business judgment and involved legal, fairness, and fiduciary considerations; (c) the board of directors and the IRC were not given the information they needed to provide informed advice or to make informed decisions, and in some respects they were misled; and (d) the legal advice obtained by the appellants was not directed to the self-interested nature of their proposals, nor to the concomitant need for prior disclosure to, and consent from, the unitholders before proceeding. All of these conclusions by the OSC were reasonable and firmly rooted in the evidence and in sound regulatory principle. The OSC also correctly stated and applied the law respecting disgorgement, and acted reasonably in arriving at a limited disgorgement remedy in this case.

Pushka v. Ontario Securities Commission,
2016 ACLG ¶ 79,720
2016 BCLG ¶ 79,144
2016 CCLR ¶ 201,301
2016 CCSG ¶ 51,581
2016 OCLG ¶ 51,957

CORPORATE BRIEF

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