Court File No. 32-2480036
Estate File No. 32-2480036

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE PROPOSAL OF FT ENE CANADA INC., OF THE CITY OF BRANTFORD, IN THE PROVINCE OF ONTARIO

BOOK OF AUTHORITIES

June 5, 2019

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Court File No. 32-2480036
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ONTARIO
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Ontario Judgments

Ontario Superior Court of Justice

Commercial List

G.A. Hainey J.

Heard: September 1, 2017.

Judgment: September 26, 2017.

Court File No.: CV-15-11169-00CL

[2017] O.J. No. 5000 | 2017 ONSC 5710

RE: IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF a Plan of Compromise or Arrangement of Essar Steel Algoma Inc., Essar Tech Algoma Inc., Algoma Holdings B.V., Essar Steel Algoma (Alberta ULC), Cannelton Iron Ore Company and Essar Steel Algoma Inc. USA, Applicants

(26 paras.)

Counsel

Ashley Taylor and *Sanja Sopic*, for the Applicants.

Jeffrey Levine, for Cliffs Mining Company.

Shawn Irving, for Certain Term Lenders and DIP Lenders.

Clifton Prophet and *Delna Contractor*, for the Monitor.

Jennifer Teskey, for the Board of Directors of Essar Algoma.

Jeremy Opolsky and *Davida Shiff*, for Essar Global Fund Limited.

Massimo Starnino, for the USW and Local 2724.

L. Joseph Latham, for the Ad Hoc Committee of Essar Algoma Noteholders.

ENDORSEMENT

G.A. HAINEY J.

Background

1 The Board of Directors of Essar Steel Algoma Inc. (the "Board") move for an order:

(a) directing Essar Steel Algoma Inc. (the "Company") to resume regular reporting to the Company's Board, composed of Kalyan Ghosh, Naresh Kothari, Jatinder Mehra, and Kishore Mirchandani (the "Directors"), and its committees, including the special committee of the Board, composed of Naresh Kishore and Kishore Mirchandani (the "Special Committee");

(b) directing the Company to resume the regular holding of meetings of the Board, and its committees, including the Special Committee, and to provide all support and information necessary for the Board or the Special Committee to perform their respective governance functions;

(c) directing the Company to pay outstanding arrears of Board and Special Committee fees to the independent members of the Board;

(d) directing the Company to include counsel for the Board in any discussions relating to environmental or other matters where liability issues have arisen or may arise;

(e) directing the Company to comply with prior orders of the court with respect to the payment of the fees and disbursements of independent counsel to the Board; and

(f) ancillary relief necessary to ensure that the Board and its committees, including the Special Committee, are once again able to provide corporate oversight and governance to the Company.

2 The grounds for the motion are as follows:

(a) The Company sought and obtained an initial order under the *Companies' Creditors Arrangement Act*, as amended (the "CCAA") on November 9, 2015 (the "Initial Order").

(b) Both prior to and immediately after the commencement of the CCAA proceedings, the Board was responsible for the management of the business and affairs of the Company.

(c) In October 2015, prior to the Company's filing under the CCAA, the Board approved the formation of the Special Committee, which was empowered to review, consider and evaluate any business or financial alternatives that might be available to the Company, including a potential CCAA filing, and to provide advice, guidance and approval with respect to the course of action ultimately determined by the Company.

(d) The Board and the Special Committee performed their respective functions for several months after the commencement of the CCAA proceedings.

(e) In mid-2016, the Monitor proposed an information sharing protocol (the "Information Sharing Protocol") to preserve the confidentiality of sensitive information, during the sale and investment solicitation process (the "SISP"). The Information Sharing Protocol was put in place due to the involvement of the parent of the Company (the "Parent") as a bidder for the Company.

(f) The Board and the Special Committee agreed to the Information Sharing Protocol. On July 19, 2016, Newbould J. made an endorsement (the "July Endorsement") indicating that it was no longer appropriate for confidential information to be provided to the Special Committee because of the Parent's intention to be a bidder for the Company.

(g) The Parent is no longer a bidder for the Company. The Company is proceeding with a transaction that contemplates a sale of the Company or its assets to the Company's term lenders.

(h) The Board maintains that the Company's management is in a conflict of interest.

(i) The Company has relied upon Newbould J.'s July Endorsement as a basis for not providing any information to the Board and the Special Committee, and has elected to discontinue all Board and Special Committee meetings and cease paying the normal fees due to the independent members of the Board.

(j) According to the Board, the Company's management's decision to usurp the Board and the Special Committee and therefore preclude the oversight that would normally come from those bodies is inappropriate, particularly given management's own conflicts of interest.

(k) The Company has also stopped paying the accounts of independent counsel to the Board.

(l) The Board alleges that its power and responsibility to control the affairs of the Company have been usurped in a manner contrary to the best interests of the Company and regular corporate governance practices.

Facts

3 Following the Initial Order, Newbould J. approved the Company's SISP on February 10, 2016. His order authorized the Company, with the assistance of the Monitor, the Chief Restructuring Advisor to the Company (the "CRA"), and the Company's Financial Advisor, to conduct the SISP. At the time the Monitor and the Company expressed concerns that leaks of confidential information might occur, particularly because the Parent was involved in the bidding process. As a result, the Monitor put in place the Information Sharing Protocol which was included in Newbould J.'s order dated May 16, 2016.

4 The Information Sharing Protocol suspended the sharing of substantive information concerning the SISP and transactional details with the Board and restricted the information provided on these matters from the CRA to the Special Committee although it continued to receive confidential information regarding the Company's business and operations including its financial statements.

5 In July 2016, the Parent signed a term sheet indicating its intention to submit a formal bid for the Company's assets.

6 In response to these developments, Newbould J. made the July Endorsement as follows:

> In light of the intention of the parent company of the applicants to be a bidder and buy the business, it is in my view no longer appropriate that any confidential information be given to the special committee.

7 Following the July Endorsement, the Company, in consultation with the Monitor and the CRA, put in place governance arrangements for the Company. These arrangements (the "Existing Governance Arrangements") were described in detail and reported to the Court, both in an affidavit sworn on August 17, 2016 by John Strek, the Senior Managing Director of the CRA, and in the Monitor's Fifteenth Report, which provides, in part, as follows:

> 35. In compliance with the July 19 Endorsement, with the Monitor's concurrence, the Special Committee was informed by counsel to Algoma and the CRA that there would no longer be meetings of the Board or the Special Committee and the Audit Committee was informed that there would no longer be meetings of that committee.
>
> 36. To ensure that there would be continuing oversight of Management's decisions, a modified form of corporate governance (described in the August Strek Affidavit) was discussed with the Monitor and the CRA and, with their concurrence, was implemented by Algoma.
>
> 37. On August 11, 2016, Mr. Mirchandani filed an affidavit seeking clarification from the Court of the July 19 Endorsement. He appears to take issue with the position stated by counsel to Algoma that 'it does not appear that there is an ongoing role for the Special Committee at this time and therefore the Company does not anticipate receiving any [legal] invoices for the time period commencing after July 19th'.
>
> 38. The Monitor supports the position of Algoma that, given the July 19 Endorsement, there should no longer be any meetings of the Board, the Special Committee or the Audit Committee.

8 In his affidavit sworn on August 14, 2017, in response to this motion, Mr. Strek testified as follows at paras. 3 and 30-35:

> 3. As detailed below, Algoma's operations and restructuring continue to be run by its senior management with assistance from the Court-appointed CRA and Evercore (as defined below) as overseen by the Monitor. The Board and the Special Committee have been effectively disengaged from their roles by orders of the then supervising CCAA judge, the Honourable Mr. Justice Newbould. The SISP has run its course, but the concerns that led to the disengagement of the Board and the Special Committee remain. I believe it is in Algoma's best interests to maintain the *status quo* ordered by Justice Newbould and to continue to exclude the Board and the Special Committee from receiving confidential information related to the company's operations or restructuring or from participating in any matters relating to Algoma's restructuring.
>
> ...
>
> 30. The July 19 Endorsement reduced the role of the Board and the Special Committee even further than the Information Sharing Protocol. In light of the July 19 Endorsement, Algoma suspended all meetings of the audit committee and other committees of the Board as the members of the Special Committee were also members of the other committees and would have access to confidential information through those committees.
>
> 31. Algoma ceased paying the fees due to the members of the Board and the Special Committee following the July 19 Endorsement. ...

32. In order to address corporate decision making where the board and the Special Committee could no longer receive confidential information, Algoma put in place the following corporate governance mechanism, with the approval and agreement of the CRA and the Monitor:

    In consideration of Justice Newbould's July 19, 2016 endorsement prohibiting the sharing of confidential information with the special committee (and also the Board) and stating that it is 'no longer appropriate that any confidential information be given to the special committee', where it is necessary from time to time to review various matters and issues with a third party that would otherwise have been subject to approval from the Board of Directors or other committees of the Board, the Company will meet and review with the CRA and the Monitor any and all such subject information, matters and issues which by definition would be or would incorporate confidential information subject to the Court's endorsement.

33. This corporate governance mechanism (the "Governance Arrangement") was disclosed to the Court and stakeholders in my affidavit sworn August 17, 2016...

34. As a result of these developments, the Board has been effectively disengaged from its role and from making any informed decisions for Algoma. Instead, decisions regarding Algoma's restructuring and business operations which would historically have been made by the Board are made by management with input from counsel, the CRA and Evercore and agreement with the Monitor. In light of the Governance Arrangement, I do not believe that there is any basis for the statements in the affidavit of Mr. Mirchandani sworn July 21, 2017 in support of the Board's within motion that Algoma's decision-making authority has been relegated to a single director, Mr. Gosh.

35. Since their disengagement, the Board and the Special Committee have taken no active steps in the restructuring and have not cooperated with requests for assistance in connection with certain administrative matters. ...

9 Following the filing of Mr. Strek's affidavit sworn August 17, 2016, the Monitor's Fifteenth Report and the affidavit of Mr. Mirchandani referenced above, Newbould J. made no directions or changes to the Existing Governance Arrangements. The Company has made and implemented all decisions in these CCAA proceedings since the July Endorsement in accordance with the Existing Governance Arrangements.

10 In the intervening time, the Parent's involvement in the Company's CCAA proceedings has continued, including its involvement in matters connected with the completion of a restructuring transaction. On March 6, 2017, Newbould J. heard motions by Local 2251 and by Essar Capital Limited ("ECL"), another subsidiary of the Parent. Local 2251 asked the Court for an order permitting it to engage in discussions with Ontario Steel Inc. and ECL asked the Court for an order reopening the SISP. In his endorsement dated March 6, 2017, dismissing both of these motions, Newbould J. held as follows at para. 24:

> [24] What is going on here is causing great difficulty in this CCAA process coming to a successful conclusion. This is made clear by the affidavit of Mr. Strek, the managing director of the CRA. Algoma needs to restructure itself in order to position its business to successfully manage the volatility of the steel industry. Among other things, the Applicants need to significantly deleverage their capital structure in order to reduce interest costs, decrease raw material costs, decrease annual pension costs, and revise labour costs to be competitive with the Applicants' direct competitors. The term sheet

> between Ontario Steel and Local 2251 that Local 2251 sought to promote through its motion in July, 2016 did not contemplate any amendments to Algoma's collective agreements or post-employment benefits. Mr. Strek is of the view that so long as Local 2251 thinks that Essar Global has a role to play in the restructuring proceedings, it is unlikely that it will engage in serious negotiations with the participating lenders who are behind the accepted bid. It is hard not to credit the CRA's view.

11 On May 23, 2017, Newbould J. heard Algoma's motion for an order approving an amendment to the DIP Agreement and an order directing the appointment of a restructuring committee. In dealing with Algoma's request for the creation of a restructuring committee, Newbould J. observed as follows at paras. 27 -- 32 of his May 30, 2017 endorsement:

> [27] Due to a prior order in this CCAA proceeding made on July 19, 2016, no confidential information is being given to the special committee of the board of directors of Algoma. Since then, no meetings of the audit committee have been held. Algoma also decided to cease holding board meetings or meetings of the special committee and to stop paying fees to the members.
>
> [28] Algoma is not proposing to appoint the members of the Restructuring Committee to its board of directors. Thus they will have no governance authority. It is said however that the establishment of the Restructuring Committee would restore a more typical governance structure to Algoma's decision making process to ensure that informed and prudent decisions are being made by Algoma through this part of the CCAA proceedings.
>
> [29] I have considerable difficulty with the request for a Restructuring Committee. Algoma has had a Chief Restructuring Advisor, CDG Group, from the outset of this CCAA proceeding. Mr. Strek was the person from CDG that fulfilled that role until last month when on April 17, 2017 Robert Del Genio, the managing member of CDG, was added to the team and the CDG monthly fees were increased from US$125,000 to US$200,000.
>
> [30] There would be considerable overlap of the duties of the Chief Restructuring Advisor and the Restructuring Committee. Included in the proposed duties of the Restructuring Committee are (i) analyzing and considering all alternatives that may be available to Algoma to successfully complete the restructuring and emerge from the CCAA proceedings as a going concern; (ii) establishing and overseeing such processes and work plans as it considers appropriate to effect the restructuring; and (iii) overseeing discussions and negotiations with Algoma's creditors, unions, retirees and other stakeholders.
>
> [31] A restructuring advisor is to advise on restructuring. The responsibilities of the Chief Restructuring Advisor in this case include the obligation to work collaboratively with the senior management and other Algoma professionals in evaluating and implementing strategic and tactical options through the restructuring process and to perform a number of management services including performing due diligence on Algoma, assist Algoma's management with any reporting to or negotiations with stakeholders, including the unions, customers, suppliers and the court approved representative counsel for the retirees.
>
> [32] I do not see how the proposed Restructuring Committee will alleviate the work of management ...

12 Newbould J. dismissed the request for the formation of a restructuring committee and left the Company's Existing Governance Arrangements unchanged.

13 The Monitor addressed this issue in its Thirty-Fourth Report dated August 11, 2017 as follows as para. 28:

> 28. The Existing Governance Arrangements have been acceptable to this Court to date. The Monitor is of the view that there have been no changes to the Applicants' circumstances which would merit changing those Arrangements. The Monitor is of the further view that based on the facts and for the reasons articulated in the Strek Board Affidavit, any reengagement of Algoma's Board of Directors at this juncture in the restructuring could create conflict, uncertainty, and disruption with corresponding detrimental effects on the completion of a restructuring transaction.

Issues

14 I must determine the following issues:

(a) Should the Company resume regular meetings of and regular reporting to the Company's Board and its committees and pay outstanding and future Board and committee fees to the Company's Directors?

(b) Should the Directors be entitled to representation and involvement in respect of any negotiation or settlement of claims or potential liabilities to which the Directors may be exposed, and should the Company continue to pay legal fees for the Board's legal representation in accordance with the Initial Order?

Positions of the Parties

15 The Board submits that its authority should not be usurped because the test for the removal of directors pursuant to s. 11.5 of the CCAA has not been met. Further, it submits that the July Endorsement does not provide the basis for either the removal of any of the Company's Directors or the suspension of the Board's normal governance activities. The Board also submits that its counsel should be paid its outstanding fees and disbursements and should be included in any discussions that may involve possible liability on the part of the Directors.

16 The Company and the Monitor submit that the July Endorsement and Newbould J.'s subsequent rulings make it clear that the Court has approved the Existing Governance Arrangements and there has been no change in circumstances justifying a change to those governance arrangements. They do not oppose paying the Board's counsel's fees and disbursements with respect to their potential environmental liability.

Analysis

17 Section 11 of the CCAA gives the court broad power to "as it may see fit, make any order that it considers appropriate in the circumstances". In my view, this allows me to make an order maintaining the *status quo* with respect to the Company's governance arrangement if I am satisfied that it is in the best interests of the Company and its stakeholders to do so. It is not necessary to remove any of the Directors pursuant to s. 11.5 of the CCAA to accomplish this.

18 I agree with the submissions of the Company and the Monitor that Newbould J. was well

aware that neither the Board nor the Special Committee had been operating since his July Endorsement. I interpret his endorsement dated May 30, 2017 as implicit approval of this governance arrangement. At paras. 27 -- 32 of his endorsement, Newbould J. made it clear that he was well aware of the Existing Governance Arrangements and that he did not consider the establishment of the proposed Restructuring Committee to be necessary to assist with the management of the Company.

19 In dismissing the motion to establish a Restructuring Committee Newbould J. concluded that "it makes little or no sense to create another body of restructuring advisors that will likely create disruption."

20 I have concluded from the wording of his endorsement that Newbould J. was satisfied with the Existing Governance Arrangements and that was the main reason that he declined to order the establishment of a Restructuring Committee.

21 Although the Parent is no longer a bidder for the Company and the Directors agree that the Board and the Special Committee will continue to have no involvement in the sale of the Company or its assets, I am concerned about the Monitor's view that "Any reengagement of Algoma's Board of Directors at this juncture in the restructuring could create conflict, uncertainty, and disruption with corresponding detrimental effects on the completion of a restructuring transaction". In my view, events have overtaken the time when the major concern was that the Parent was a bidder for the Company. The current state of the restructuring transaction and the Monitor's views persuade me that the *status quo* should be maintained and the Board and the Special Committee should not be reengaged as this could disrupt and jeopardize the successful completion of the Company's restructuring.

22 For these reasons I intend to follow the admonition of counsel to the Monitor, Mr. Prophet, who submitted that, "If it is not broken, don't fix it". It is clear from Newbould J.'s endorsement and the evidentiary record before me that the Company's Existing Governance Arrangements are not broken.

23 The Board's motion to reengage the Board and the Special Committee is therefore dismissed.

24 I do, however, agree with the Board's submission that its counsel should be paid its fees and disbursements for representing the Directors in connection with their potential liability as members of the Board. This is not to be confined to only potential environmental liability but to any type of potential liability the Directors might face. Section 42 of the Initial Order mandates this in any event. Board counsel is also to be included in any discussions relating to any potential liability on the part of the Directors. The Board's motion with respect to this issue is therefore granted.

Conclusion

25 The Board's motion to reengage the Board and Special Committee is dismissed and its motion to require payment of its counsel's fees and disbursements and to involve its counsel in discussions concerning the Directors' potential liability is granted

Costs

26 As there has been divided success on this motion, I make no order as to costs.

G.A. HAINEY J.

Moffat et al. v. Wetstein et al.[Indexed as: Moffat v. Wetstein], 29 O.R. (3d) 371

Ontario Reports

Ontario Court (General Division),

Granger J.

May 30, 1996

Court File No. 19435/94

29 O.R. (3d) 371 | *[1996] O.J. No. 1966*

Case Summary

Fiduciaries — Duties — Solicitor for plaintiffs being former partner in defendant accounting firm — No solicitor-client relationship existing between solicitor and accounting firm — Solicitor owing fiduciary duty to accounting firm — Fiduciary duties including duty to avoid actual or potential conflict of interest — Fiduciary responsibility of departing partner possibly enduring past date of withdrawal from partnership — Solicitor's representation of plaintiffs in action against accounting firm giving rise to appearance of potential breach of fiduciary duty sufficient to disqualify him from acting for plaintiffs.

Professions — Barristers and solicitors — Conflict of interest — Pecuniary interest — Former partner in accounting firm acting as solicitor for plaintiffs in action against accounting firm arising out of incidents which occurred while solicitor was partner in firm — Solicitor having financial interest in outcome of litigation adverse to that of plaintiffs — Plaintiffs aware of financial interest and waiving apparent conflict — Plaintiffs not having independent legal advice in waiving conflict — Impropriety in solicitor acting against himself not cured by waiver — Solicitor disqualified from acting for plaintiffs.

Professions — Barristers and solicitors — Conflict of interest — Access to confidential information — Law firm representing plaintiffs having acted in past for defendant — Defendant seeking to have law firm removed as solicitors of record for plaintiff on ground that law firm had access to defendant's partnership agreements and litigation philosophy — Defendant not demonstrating sufficient relationship between action and past retainers — Motion to remove law firm dismissed.

The plaintiffs brought an action against the defendants based on professional and taxation services allegedly provided by the defendants to the plaintiffs regarding certain investments. The plaintiffs were represented by the law firm of MT and by T, a former partner at that firm. T was also a former partner in the defendant accounting firm PMT. While he was a partner in PMT at the time the conduct complained of in this action took place, he was not involved in that conduct. However, T would be exposed to financial liability if the plaintiffs' action were successful. PMT had also been represented in the past by MT. PMT moved for an order removing MT as solicitors of record for the plaintiffs on the basis of an actual and/or apparent conflict of interest.

Held, the motion should be dismissed.

Clearly, a solicitor's pecuniary interest which is adverse to his client's interest can be a disqualifying conflict. This is true even when the client waives the apparent conflict. T had disclosed to the plaintiffs that he might have a financial interest in the outcome of the case, and the plaintiffs swore affidavits in which they waived that conflict. That fact was compelling and had to be taken into consideration. However, the plaintiffs' right to counsel of their choice was not absolute, and had to be tempered by the public interest in maintaining confidence in the administration of justice by having lawyers avoid the appearance of impropriety and by ensuring that justice is not only done, but is seen to be done. In this case, T had in effect sued himself. He had divided his loyalties between his duty to his client and his personal financial interest, and had created an actual conflict of interest. While the plaintiffs waived the conflict, there was no evidence that they were provided with independent legal advice with respect to the waiver, and it was questionable whether they fully comprehended the nature of the conflict. A reasonably informed person would not be satisfied that the impropriety in having T act, in essence, against himself was cured by the waiver of the plaintiffs in the absence of independent legal advice. T should be disqualified from acting for the plaintiffs. However, MT should not be disqualified from acting for the plaintiffs on this basis. The source of the conflict was personal to T, and left when he left. In the absence of T's financial conflict, MT was not at odds with the interests of its client, and the appearance of impropriety was no longer present.

Generally, before a disqualifying conflict of interest based on the potential misuse of confidential information can be found, a solicitor and client relationship must have existed between the solicitor sought to be removed, and a party presently adverse in interest to the position the solicitor has been retained to represent, and the relevant confidential information must have arisen in the context of that relationship. There was no solicitor and client relationship between T and PMT at the time he was a partner at PMT. It would, therefore, be inappropriate to remove him or MT as solicitors of record on that basis.

The lack of a solicitor-client relationship did not end the inquiry. As a partner of PMT, T was in a fiduciary relationship. Subsumed in a fiduciary's duties of good faith and loyalty is the duty to avoid a conflict of interest. The fiduciary must not only avoid a direct conflict of interest but must also avoid the appearance of a potential conflict. The fiduciary is barred from dividing loyalties between competing interests, including self-interest. The fiduciary responsibility of a departing partner may endure past the date of his or her withdrawal from the partnership. It would be wrong to allow T to advance a cause of action against his former partners for conduct during a period when he was a member of the partnership. Through his position as partner, T was privy to confidential information with respect to the partnership. Accordingly, his representation of the plaintiffs had the appearance of unfairness and created the possibility of an unfair use of confidential information. The appearance of a potential breach of a fiduciary duty by T was sufficient to restrain him and his present law firm from acting on behalf of the plaintiffs. As there was no evidence of a breach of fiduciary duty by T to date and as T had left MT, the appearance of the possibility of a potential breach did not disqualify MT.

PMT suggested that MT was in a conflict of interest because, in representing PMT in the past, MT had an opportunity to learn their internal financial structure, partnership agreements, insurance programs and litigation philosophy. In order to be relevant to a matter at hand, the confidential information gained through the solicitor and client relationship does not necessarily have to have a factual connection with the issues in the present retainer. Rather, legitimate concerns are raised when a solicitor has acquired confidential information with respect to a party's financial and business affairs and purports to conduct litigation adverse to that party. The onus was on PMT to establish that there existed a previous relationship which was sufficiently related to the retainer from which it was sought to remove the solicitor. The type of confidential information forming the basis of PMT's complaint can, in some cases, justify the removal of a solicitor. However, given the drastic nature of that remedy, there should be compelling and cogent evidence which provides a sufficient connection between the retainers. A party does not meet its onus of establishing that the prior relationship is sufficiently related to the present retainer merely by making a bald assertion that the past relationship has provided the solicitor with access to insurance policies, partnership agreements and litigation philosophy. Given the lack of strong evidence demonstrating how the past retainers were sufficiently related to the matter at hand, PMT failed to meet its onus of establishing the requisite connection. Accordingly, the removal of MT was not warranted.

Canadian Aero Service Ltd. v. O'Malley, *[1974] S.C.R. 592*, *40 D.L.R. (3d) 371*, *11 C.P.R. (2d) 206*; MacDonald Estate v. Martin, *[1990] 3 S.C.R. 1235*, *77 D.L.R. (4th) 249*, *70 Man. R. (2d) 241*, *121 N.R. 1*, *[1991] 1 W.W.R. 705*, 48 C.P.C. (2d) 113 sub nom. Martin v. Gray, apld

Alberts v. Mountjoy *(1977), 16 O.R. (2d) 682* (H.C.J.); Shaughnessy Brothers Investments Ltd. v. Lakehead Trailer Park (1985) *(1987), 63 O.R. (2d) 225*, 23 C.P.C. (2d) 194 (H.C.J.), folld

Other cases referred to

Baumgartner v. Baumgartner, *[1995] B.C.J. No. 313*, *122 D.L.R. (4th) 542*, *2 B.C.L.R. (3d) 126*, *[1995] 5 W.W.R. 289* (C.A.); Canada Trustco Mortgage Co. v. Corkum *(1991), 105 N.S.R. (2d) 230*, 284 A.P.R. 230, 49 C.P.C. (2d) 90 (S.C.); Chapman v. 3M Canada Inc. *(1995), 25 O.R. (3d) 658*, *24 C.C.L.T. (2d) 304*, 43 C.P.C. (3d) 142 (Gen. Div.); Crystal Heights Co-Operative Inc. v. Barban Builders Inc. (1987), 19 C.P.C. (2d) 212 (Ont. Dist. Ct.); Manville Canada Inc. v. Ladner Downs *(1992), 88 D.L.R. (4th) 208*, *63 B.C.L.R. (2d) 102*, *[1992] 2 W.W.R. 323* (S.C.) [affd *(1993), 100 D.L.R. (4th) 321*, *76 B.C.L.R. (2d) 273*, *[1993] 5 W.W.R. 36* (C.A.)]; Pielak v. Crown Forest Industries Ltd., *[1991] B.C.J. No. 3097* (S.C.); Ramsbottom v. Morning (1991), 48 C.P.C. (2d) 177 (Ont. Gen. Div.); Rayner v. Enright *(1993), 115 Sask. R. 159*, 20 C.P.C. (3d) 269 (Q.B.); Ross v. New Brunswick Teachers' Assn., *[1994] N.B.J. No. 578*, *156 N.B.R. (2d) 193*, 401 A.P.R. 193 (Q.B.); Sinclair v. Ridout, *[1955] O.R. 167*, *[1955] 4 D.L.R. 468* (H.C.J.); United Steelworkers of America, Locals 6874 & 4883 v. King, *[1993] N.S.J. No. 475*, *110 D.L.R. (4th) 150*, 355 A.P.R. 161, 22 C.P.C. (3d) 89 (N.S.S.C.)

Rules and regulations referred to

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, rule 8.01(1)

Authorities referred to

Manzer, A.R., A Practical Guide to Canadian Partnership Law (Aurora: Canada Law Book, 1995), pp. 8-47, 8-54

MOTION for an order removing a law firm as solicitors of record for the plaintiffs.

Claude Pensa, Q.C., and David B. Williams, for plaintiffs. James R. Caskey, Q.C., and Joaquim Ballès, for defendants, Peat Marwick Thorne. Frank A. Angeletti, for Sandy Wetstein and Davies, Wetstein & Co. Thomas J. Corbett, for Thompson, Corbett.

GRANGER J.: — The defendant seeks an order removing the law firm of McCarthy Tétrault as solicitors of record for the plaintiffs in this action on the basis of an actual and/or apparent conflict of interest.

Although they are not formally a party to the proceedings, nor are they presently solicitors of record for the plaintiffs, the law firm of Thompson Corbett filed materials prior to the hearing of this motion. Messrs. Thompson, Corbett is a recently formed law firm whose members are primarily former members of McCarthy Tétrault. The plaintiffs have expressed an intention to have Thompson Corbett represent them in this action.

It is agreed by all parties that the issues which are advanced by Peat Marwick in seeking to remove McCarthy Tétrault as solicitors of record for the plaintiff are also applicable to Thompson Corbett's proposed representation of the plaintiffs. Accordingly, it was agreed at the commencement of the hearing of this motion that Thompson Corbett would be permitted to make submissions and the issue of their potential representation of the plaintiffs would be disposed of in this motion.

NATURE OF MOTION

Peat Marwick's motion to remove McCarthy Tétrault as solicitor of record is based on the following:

(a) McCarthy Tétrault has in the past acted, and currently acts, for the defendant Peat Marwick Thorne, in various pieces of litigation and other matters of a commercial nature;

(b) David Thompson, a former partner at McCarthy Tétrault, and current member of Thompson Corbett was a member of Peat Marwick Thorne at relevant times outlined in the statement of claim and, consequently, has a financial interest in the outcome of this litigation if the plaintiffs are successful as against Peat Marwick Thorne.

THE PROCEEDINGS

The plaintiffs have been represented from the outset of the litigation by the law firm of McCarthy Tétrault, and in particular, by David Thompson, who was a former partner at that firm. This proceeding was initiated by statement of claim issued on December 23, 1994. The action arises out of professional and taxation services allegedly provided by the defendants to the plaintiffs, regarding certain investments. These investments were made over a period of approximately 11 years, from 1983 to 1994. The plaintiffs are claiming general and punitive damages against the defendants. Exclusive of prejudgment interest, post-judgment interest, and costs, the total general and punitive damages claimed are $2,200,000 and $600,000, respectively. Punitive damages are not covered by Peat Marwick's insurance policy. Furthermore, under its insurance policy, Peat Marwick had a deductible of $1.5 million U.S. (over $2 million Cdn.). Accordingly, those who were partners of Peat Marwick at the time the events giving rise to this action occurred, will be personally exposed in the event the plaintiffs are successful against Peat Marwick for the amounts claimed.

PEAT MARWICK THORNE AND RELEVANT HISTORY

On November 1, 1987, Peat Marwick merged with the accounting firm of Davies, Wetstein & Co. As a result of the merger, Sandy Wetstein became a partner of Peat Marwick. In September 1989, Peat Marwick merged with Thorne Ernst & Whinney by entering into a partnership agreement. The resulting partnership entity is known as Peat Marwick Thorne ("Peat Marwick").

Although the predecessor firms continued to exist as separate entities, the new partnership agreement binds all partners.

RELATIONSHIP -- DAVID THOMPSON AND PEAT MARWICK THORNE

In August 1986, David Thompson became a partner with Peat Marwick where he practised as a chartered accountant at Peat Marwick's Toronto office throughout his term as partner. John Thompson, presently managing partner of the Peat Marwick London office, also practised in Toronto at the time David Thompson was there. On August 31, 1991, David Thompson withdrew from the partnership to article and subsequently practise law with McCarthy Tétrault. David Thompson continued to receive his capital draw from Peat Marwick, up to and including February 1994. As a result of the merger between Peat Marwick and Davies, Wetstein & Co., David Thompson was a partner of Sandy Wetstein from November 1, 1987 to August 31, 1991. Sandy Wetstein is still a partner with Peat Marwick. David Thompson has a financial interest in the outcome of this litigation. As a former partner of Peat Marwick during the time the events giving rise to this action occurred, David Thompson will be jointly and severally liable for any damages awarded to the plaintiffs against Peat Marwick. During his term as partner, David Thompson had access to confidential information regarding the operation of Peat Marwick. He had access to partnership agreements, insurance documentation, financial statements, and annual reports and correspondence pertaining to such matters as management attitude toward litigation.

THE ACTION

The plaintiff, Dr. John Moffat, has been a client of McCarthy Tétrault since 1992. In January of 1994, David Thompson reviewed a syndication matter on behalf of Moffat. The details of the syndication are irrelevant for the purpose of this motion. Several of the investors in the syndication are plaintiffs in this action. At the time of their investments, which occurred in or about 1983-94, the investors were clients of Sandy Wetstein. After conducting his review of the syndication. David Thompson concluded that his client and the other investors had lost a significant amount of money, due to their reliance upon alleged misrepresentations by Wetstein and as a result of Wetstein's alleged failure to disclose to the investors the past history of the business in which they were investing, the obligations of the business and Wetstein's apparent self-dealing with respect to the investment. During the time of Wetstein's alleged misconduct, both Wetstein and David Thompson were partners of Peat Marwick, and each other. David Thompson completed his review of the syndicate and recorded his observations and conclusions in a memorandum dated February 16, 1994.

On February 15, 1994 David Thompson contacted Ross Batson, a senior partner in the London, Ontario office of Peat Marwick. David Thompson advised Batson of his investigation with respect to the syndication matter and also advised him of his concerns about Wetstein's actions with respect to the syndication. He requested a meeting with Batson to discuss these matters in further detail.

On February 16, 1994 David Thompson met with Ross Batson and John Thompson, the managing partner of the London, Ontario office of Peat Marwick. The purpose of the meeting was to discuss David Thompson's concerns with respect to the syndication. David Thompson left a copy of his memorandum dated February 16, 1994 with Batson and John Thompson. According to David Thompson, he was advised by John Thompson that Peat Marwick would put its legal counsel on notice of a potential claim and that if counsel was of the opinion that there

was a problem, Peat Marwick would deal with David Thompson and Moffat in a professional and co-operative manner.

John Thompson, on behalf of Peat Marwick, denies he mentioned that he would put legal counsel on notice. According to John Thompson, he had no idea that David Thompson was contemplating commencing an action. Rather, he was of the opinion that Peat Marwick and David Thompson were working together in a co-operative manner in the interests of a mutual client. On cross-examination on his affidavit, John Thompson indicated that he may have advised David Thompson that he would speak to Peter Sahagian, in-house counsel for Peat Marwick, as a matter of standard procedure. Ultimately, John Thompson did discuss the matter with Sahagian, who approved further discussions with David Thompson. A subsequent meeting between John Thompson and David Thompson was scheduled for March 10, 1994. In a letter to John Thompson, dated March 9, 1994, David Thompson confirmed the meeting and an understanding that discussions in the meeting would be treated as "off the record and without prejudice to the interests of all parties". Wetstein was present at the March 10, 1994 meeting and undertook to provide various documents relating to the syndication. Up to and including June 1994 there was continued communication and correspondence between Wetstein and David Thompson with respect to the syndication.

After reviewing all the relevant information provided by Wetstein, Daniel Ross, another member of McCarthy Tétrault, forwarded a lengthy letter to Wetstein dated July 26, 1994. In that letter, Ross outlined the concerns of McCarthy Tétrault, with respect to the syndication. The letter concludes with these words:

> The failure of a syndication, and possible loss arising therefrom, is a risk to be borne by the syndicators, not by those to whom you owed a fiduciary responsibility and who only agreed to participate based upon their complete reliance upon you.
>
> We have been instructed by Dr. Moffat to advise you of his intention to seek compensation from you, and your firm from time to time, in your capacity as accountant tax advisor and financial advisor to Dr. Moffat at all material times. Dr. Moffat will be seeking compensation for his entire involvement in Adventures L.P. from time to time, plus interest and legal costs. In addition, Dr. Moffat will be seeking an indemnification with respect to any liability which may arise as a consequence of the deduction by him of amounts to PAC Limited's operations in 1987 or 1988, or any other tax or related liability which may arise from Dr. Moffat's involvement in this matter at any time. Dr. Moffat will also be seeking compensation for losses sustained in connection with Westmount. Our review of Highview and Parkdale continues.
>
> Before proceeding further, we would be pleased to meet with you in order to discuss these matters with a view to resolving these issues. Naturally, any discussions will be without prejudice to the interests of any party. While Dr. Moffat is not anxious to institute formal proceedings, in the event we are unable to reach a satisfactory conclusion, we have been instructed to file a statement of claim in connection with these matters.

Wetstein responded to this letter by correspondence dated September 7, 1994 and October 14, 1994. The issue of a conflict of interest on the part of David Thompson or McCarthy Tétrault was not raised.

Apparently, the matter could not be satisfactorily resolved and in December of 1994, McCarthy Tétrault, on behalf on the plaintiffs, commenced an action against Peat Marwick and Sandy Wetstein claiming substantial damages arising from alleged breaches of contract, fiduciary duty, negligence and deceit.

By notice of motion, dated February 1, 1995, the defendant, Peat Marwick, sought to remove McCarthy Tétrault as solicitors of record for the plaintiffs, due to conflict of interests. This was the first time the conflict issued was raised by Peat Marwick. The motion was adjourned to permit cross-examinations on the affidavits filed by the parties.

THE ARGUMENTS

Peat Marwick is advancing two distinct arguments in support of their position; the first argument is based on the relationship between Peat Marwick and David Thompson, personally, the second results from the relationship between Peat Marwick and McCarthy Tétrault.

With respect to the first issue, Peat Marwick claims that David Thompson is precluded from acting against Peat Marwick, given his history as a partner of the firm. It is submitted that while he was a partner, David Thompson had access to confidential information with respect to Peat Marwick, and as such, he is precluded from acting against them. Further, it is submitted that Thompson may actually have a financial interest which is adverse to the plaintiffs, and as such, he should be disqualified from acting.

The second issue relates to the past and current relationship between McCarthy Tétrault and Peat Marwick. Apparently, there is a close working relationship between Peat Marwick's "in-house counsel", Peter Sahagian, and the Toronto office of McCarthy Tétrault. Through the course of this relationship, McCarthy Tétrault, like many other Toronto firms, has had occasion to act on behalf of Peat Marwick in a number of commercial and litigation matters.

Peat Marwick takes the position that as a result of this relationship, McCarthy Tétrault has gained access to a tremendous amount of confidential information including financial records, partnership agreements and general litigation philosophy. Accordingly, Peat Marwick submits that any time McCarthy Tétrault takes a position which is adverse in interest to Peat Marwick, a conflict of interest arises, and at the very least, McCarthy Tétrault requires Peat Marwick's approval before it can continue such representation.

McCarthy Tétrault submits that it conducted an in-house conflict search before commencing the action against Peat Marwick and did not find any retainer which they felt would disqualify them from acting on behalf of the plaintiffs herein.

DOES DAVID THOMPSON HAVE A DISQUALIFYING CONFLICT OF INTEREST?

David Thompson obtained the designation of chartered accountant in 1976. He subsequently enrolled in law school and obtained his law degree in 1980. After graduation, he commenced employment with Peat Marwick Mitchell & Co., and was admitted to the partnership of that firm in 1986. He withdrew from Peat Marwick on August 31, 1991, to commence articles with McCarthy Tétrault. He became a partner of McCarthy Tétrault on February 1, 1994. He continued to receive his capital draw from Peat Marwick, up to and including February 1994.

While a partner of Peat Marwick he practised out of its Toronto office, and at no time attended the London office of that firm. Interestingly, he was a partner of Sandy Wetstein, an individual defendant in this action, at the time that Wetstein is alleged to have engaged in the conduct giving rise to the action. Thompson does not recall meeting Wetstein while he was with Peat Marwick.

Peat Marwick raises two concerns with respect to Thompson's involvement as solicitor of record for the plaintiffs in this action:

1. David Thompson has a financial interest in the outcome of the litigation which is adverse to his clients;
2. David Thompson, as a former partner of Peat Marwick, had access to confidential information regarding the operations of Peat Marwick, including partnership agreements, insurance documentation, financial statements, and the litigation philosophy of the firm, which provides him with an unfair advantage in conducting this action.

THE FINANCIAL INTEREST

(i) Position of Peat Marwick

David Thompson was a member of Peat Marwick during the period it is alleged that Wetstein engaged in conduct forming the basis of the action, accordingly, and as a result he has a financial interest in the outcome of the action.

The plaintiffs are claiming damages as a result of deceit, misrepresentation and negligence, as well as punitive damages. Peat Marwick's insurance coverage for liability from such allegations, if proven at trial, is subject to a $1.5 million U.S. deductible. Given the amount of the plaintiffs' claim in this action, it is submitted that there is minimal or no insurance coverage for the claim, and the partners of Peat Marwick are essentially self-insurers in this matter. As a result, it was submitted that the former and current partners of Peat Marwick face personal exposure, should the plaintiffs succeed. In essence, David Thompson is prosecuting a claim against himself.

(ii) Position of McCarthy Tétrault

While David Thompson, in theory, may have a financial interest in the litigation, in reality, based on the structure of the Peat Marwick partnership, such an interest would be nominal at best. If the plaintiffs obtained a $1 million judgment against Peat Marwick, David Thompson's proportionate responsibility would be $1,635.

If there is any potential conflict arising out of the possibility that David Thompson could ultimately bear some liability with respect to a judgment in this matter, it would operate to the prejudice of the plaintiffs, not the defendant, Peat Marwick. David Thompson has disclosed to the plaintiffs that he might have a financial interest in the outcome of the case. The plaintiffs all swore affidavits acknowledging that disclosure and that they were content that McCarthy Tétrault would not be influenced by any consideration of Thompson's potential liability.

Peat Marwick, however, submitted that the quantum of the potential financial interest was irrelevant. The fact that Mr. Thompson had carriage of a matter contrary to his own interest was a conflict which was significant and warranted his removal.

(iii) Analysis

The fact that the plaintiffs have knowledge of Mr. Thompson's financial interest and swore affidavits in which they "waived" that conflict is compelling. If such a conflict does exist it is a conflict between the plaintiffs and not the defendants. Thompson Corbett submit that the plaintiffs are prepared to waive the conflict in order to keep Mr. Thompson as their solicitor, and that their right to counsel of their choice should not be interfered with.

In Shaughnessy Brothers Investments Ltd. v. Lakehead Trailer Park (1985) *(1987), 63 O.R. (2d) 225*, 23 C.P.C. (2d) 194 (H.C.J.), Sutherland J. came to a different conclusion. In that case, a defendant retained as counsel an associate in a law firm, some of whose partners were co-defendants in the action. The defendant appeared to be content to allow the associate to represent her, despite the apparent conflict. The solicitors for the plaintiffs moved to have the associate removed as solicitor of record. The plaintiffs argued that at the very least, the appearance of a conflict of interest was an impropriety and that the plaintiffs could be prejudiced by the associate's continued representation, as such representation might be a ground of appeal by the defendant that she did not receive independent legal advice. Master Donkin made an order removing the solicitor, and the solicitor appealed to the Supreme Court of Ontario.

The solicitor argued, among other things, that his appeal must succeed because:

1. The plaintiffs did not have standing to challenge his representation of the defendant because if there was a conflict it would enure to the prejudice of the defendant, not the plaintiffs;
2. the defendant was aware of the apparent conflict and nonetheless wanted the solicitor to represent her. It was submitted that a party's right to be represented by counsel of their choice overrides the public interest in maintaining a system where justice is not only done but seen to be done;
3. The majority of case-law relating to the removal of a solicitor of record dealt with the potential misuse of confidential information. As this case did not present that mischief, removal would be inappropriate.

Dealing with the standing issue, the court held that the plaintiffs' solicitors, as officers of the court, had the right to bring their motion. Sutherland J., at p. 233, stated:

> I accept as correct the submission of Mr. Morscher, for the respondents, that where there is a question of impropriety on the part of a solicitor, any other solicitor, as an officer of the court, has standing to bring the question before the court.

With respect to the right of a party to choose her own solicitor, Sutherland J. made the following observations at p. 232:

> I am unable to accept that, as repeatedly insisted by counsel for the appellant, the right of Anna Konsky to legal counsel of her own choice is a right which ought to override the public interest. Even if the level, quality and timing of the disclosures to Anna Konsky of the solicitor's conflict of interest had been much better than they actually were, her right to name the solicitor of her choice would not be an absolute one but would have to be balanced against the public interest in maintaining confidence in the administration of justice by having lawyers avoid the appearance of impropriety. In Flynn Developments Ltd., supra, at p. 60, Potts J. stated a prima facie right to the solicitor of his choice is displaced "if it creates even the semblance of a conflict of interest". We need not go that far here, as the conflict of interest is palpable. That there are limitations on a person's right to choose his or her own solicitor and to waive improprieties emerges clearly from the Divisional Court decision in Goldberg v. Goldberg *(1982), 141 D.L.R. (3d) 133*, *31 R.F.L. (2d) 453*, where Callaghan J., speaking for the court, stated at pp. 135-6 D.L.R., p. 456 R.F.L.:
>
> > Of more importance, however, is the fact that the principles involved herein are designed not only to protect the interests of the individual clients but they also protect the public confidence in the administration of justice. This is particularly so when the litigation

> involves a family dispute. Furthermore, when the public interest is involved, the appearance of impropriety overrides any private interest claimed by waiver.

The general rule stated in that excerpt was, by its terms, not confined to family disputes.

Finally, with respect to the submission that since the case did not involve the potential misuse of confidential information, Sutherland J. found it was inappropriate to remove the solicitor, stating at p. 231:

> 3. The appellant has referred to a number of decisions in cases where the solicitors sought to be removed from the record had, or their partners or associates had, previously acted for a party, or for both parties, in the same or a related matter and then had sought to act on such matter or related matter for an adverse party. Not surprisingly, the emphasis in such cases is on the mischief of the potential for the wrongful use of confidential information and on the appearance of conflict of interest in that regard. . . . On the basis of such cases the appellant has argued that the sole concern of the courts in respect of conflict of interest or the appearance of impropriety is that there may be a misuse of confidential information. That is a recurring concern but it clearly does not exhaust the subject. I am quite unable to accept the submissions of the appellant to the effect that the only concern is with the actual or possible misuse of confidential information or the appearance of such possible misuse. I would have thought it was quite obvious that there can be conflict of interest and impropriety where the moving party has imparted no confidential information to the solicitor in question and so where the solicitor cannot breach that sort of confidence. A solicitor who has no confidential information from a party may be in a position where it would nevertheless be improper for him to act for that party, for example, where he had an actual or an apparently possible financial interest (including an employment interest) in not pressing all her claims to the full.

(Emphasis in original)

(iv) Application of Shaughnessy

Clearly, a solicitor's pecuniary interest which is adverse to his client's interest can be a disqualifying conflict. This is true, even when the client waives the apparent conflict. In this case, there is a conflict between David Thompson's financial interest and that of the plaintiffs in their action. The fact that the plaintiffs have executed affidavits acknowledging and waiving the conflict is compelling and must be considered. However, the plaintiffs' right to counsel of their choice is not absolute, and must be tempered by the public interest in maintaining confidence in the administration of justice by having lawyers avoid the appearance of impropriety and by ensuring that justice is not only done, but is seen to be done.

In his affidavit, David Thompson deposes, at para. 10(i), as follows:

> If I have the potential for some obligation to Peat Marwick Thorne, in the event that this action is successful, I can say, with absolute certainty, that does not affect my undivided loyalty to the Plaintiffs, my clients;

Notwithstanding the self-serving nature of this evidence, David Thompson does not have to be disbelieved before it is justifiable to prevent him from acting. The justification does not lie in the confidential nature of the solicitor and client relationship, but in the fiduciary nature of that relationship. As a fiduciary, David Thompson must act and must be seen to act with undivided loyalty towards his client. An irreparable conflict is present once it is acknowledged that he will

potentially bear financial exposure as a member of the defendant at the time of the alleged wrongdoing, should he be successful in advancing the plaintiffs' cause.

Rule 8.01(1) of the Rules of Civil Procedure provide that "a proceeding by or against two or more persons as partners may be commenced using the firm name of the partnership". Further, pursuant to rule 8.02, the partnership must defend such an action in the name of the partnership and individual partners are precluded from entering separate defences.

By virtue of these rules, when David Thompson issued a statement of claim against Peat Marwick, he was suing all the partners of Peat Marwick at the time of the alleged wrongdoing. That time period includes the time in which David Thompson was a partner. Accordingly, Thompson has "sued" himself, as his liability as a partner of the defendant is subsumed in the action. Essentially, Thompson has divided his loyalties between his duty to his client and his personal financial interest or, in other words, he has created an actual conflict of interest.

In these circumstances, the public interest must prevail and Thompson should not be permitted to act. The fact that the plaintiffs' solicitor admitted on the cross-examination of his affidavit that it occurred to him that he was suing himself, is enough to create the impression of impropriety in the mind of a reasonably informed member of the public. While the plaintiffs have waived the conflict, there is no evidence which indicates they were provided with independent legal advice with respect to the waiver, and one must question if they fully comprehended the nature of the conflict.

The principles enunciated in MacDonald Estate v. Martin, *[1990] 3 S.C.R. 1235*, *77 D.L.R. (4th) 249*, have minimal applicability to the analysis of this particular issue, as the principles stated therein apply to the case where a conflict arises out of the potential misuse of confidential information. MacDonald Estate v. Martin does not address the situation where a conflict arises based on an adverse pecuniary interest between a party and his solicitor. In any event, a reasonably informed person would not be satisfied that the impropriety in having David Thompson act, in essence, against himself, is cured by the waiver of the plaintiffs, in the absence of independent legal advice.

(v) Thompson Tainting McCarthy Tétrault

Having found that David Thompson is precluded from acting for the plaintiffs because of his adverse financial interest in the subject-matter of the litigation, I must determine if McCarthy Tétrault can continue to act, since David Thompson is no longer affiliated with that firm and the source of the pecuniary conflict is removed from the firm. There no longer exists the appearance of impropriety that was once present.

If no other disqualifying conflict is found, it would be permissible in my opinion to allow McCarthy Tétrault to continue to act for the plaintiffs. The source of the conflict was "personal" to David Thompson, and left when he left. In the absence of Thompson's financial conflict, the firm is not at odds with the interests of its client, and the appearance of impropriety is no longer present.

The Impact of David Thompson's Former Partnership with Peat Marwick

(i) Position of Peat Marwick

Peat Marwick submits that both Thompson and McCarthy Tétrault should be prohibited from acting for the plaintiffs, as David Thompson is a former partner of Peat Marwick, and as such, had access to confidential information such as partnership agreements, financial statements,

and the litigation philosophy of the firm. As a result, it would be unfair to allow David Thompson to act for the plaintiffs as it would give them an unfair advantage since they would have access to the "family secrets" of Peat Marwick. Further, Thompson, as a former partner of McCarthy Tétrault, has tainted that firm and they can no longer act.

(ii) Position of McCarthy Tétrault

There is no allegation that David Thompson had direct knowledge of the matters in issue (i.e., the "Weststein affair") by virtue of his tenure at Peat Marwick. David Thompson is not aware of any confidential information, as a result of his position with Peat Marwick, that would have any bearing on the issues in this action. Upon withdrawing from the partnership of Peat Marwick, Mr. Thompson was required to and did divest himself of all confidential documents in his possession.

The onus is on Peat Marwick, as the party seeking to remove McCarthy Tétrault as solicitor of record, to demonstrate that David Thompson, the lawyer, received confidential information attributable to a solicitor and client relationship and relevant to a matter at hand, and that there is a risk that it will be used to the prejudice of Peat Marwick. The information that causes Peat Marwick concern, namely, partnership agreements, financial structure, and litigation philosophy, is not sufficiently related to the matter at hand to create a disqualifying conflict.

Perhaps, more importantly, any confidential information secured by David Thompson was gained qua accountant, as opposed to qua solicitor. Accordingly, if David Thompson is privy to confidential information concerning Peat Marwick, that information is not attributable to a solicitor and client relationship, and as such should not form the basis of an order removing McCarthy Tétrault (or David Thompson) as solicitors of record for the plaintiffs.

(iii) Analysis

The case-law addressed hereafter indicates that, generally, before a disqualifying conflict of interest based on the potential misuse of confidential information can be found, a solicitor and client relationship must have existed between the solicitor sought to be removed, and a party presently adverse in interest to the position the solicitor has been retained to represent, and that the relevant confidential information arose in the context of that relationship.

In Pielak v. Crown Forest Industries Ltd., *[1991] B.C.J. No. 3097* (S.C.), Prowse J. stated:

> In the case of Martin v. MacDonald Estate, the Supreme Court held that, although the legal profession as a self-governing profession has been entrusted by the legislature to develop and apply the appropriate standards by which lawyers shall conduct themselves, the court, in exercising its supervisory role, will disqualify a lawyer from continuing to act for a client if the court concludes that the lawyer received confidential information attributable to a solicitor and client relationship relevant to the matter at hand and that there is a possible risk that this confidential information will be used to the prejudice of the client.
> It is clear from the Martin case, in my view, that the concern of the court in dealing with this issue is to prevent the misuse of confidential information -- that is confidential information derived from a solicitor and client relationship.

The court went on to explain the rationale of protecting the confidential nature of information exchanged in a solicitor and client relationship. Specifically, Prowse J. stated:

> More particularly, in the Martin case, the court recognized that the legal profession has distinguished itself from the other professions by the sanctity with which these communications are treated. The law, too, perhaps unduly, has protected solicitor and client exchanges while denying the same protection to others. This tradition assumes particular importance when a client bares his or her soul in civil or criminal litigation.
>
> In this case, there was no solicitor and client relationship between Lawson Lundell and the plaintiffs. The only relationship that existed between the plaintiff and Lawson Lundell was a business relationship arising from the fact that the defendants had hired the plaintiffs as consultants and that Lawson Lundell had been retained by the defendants to act as counsel. The relationship with the plaintiffs and Lawson Lundell was not the type of relationship in which the exchange of information could be characterized as confidential.

A similar conclusion was reached in Ross v. New Brunswick Teachers' Assn., *[1994] N.B.J. No. 578*, *156 N.B.R. (2d) 193* (Q.B.). In that case, an order was sought to remove the defendant's solicitor of record on the ground that the solicitor had previously acted for the plaintiff's bargaining agent, the New Brunswick Teachers' Federation, in proceedings which related to an inquiry into the plaintiff's conduct under the provincial Human Rights Act. In dismissing the motion, Godin J. stated:

> The legal arguments put forward by the plaintiff in his brief to the court arise out of situations where a solicitor-client relationship exists. The court has not been referred to a single case where a solicitor who previously acted for a professional association or a bargaining agent was compelled to withdraw from acting against a member of the association or bargaining agent in a subsequent proceeding.
>
> The plaintiff relies on MacDonald Estate v. Martin, *[1990] 3 S.C.R. 1235*. That case involved a conflict arising out of a prior solicitor-client relationship. Mr. Justice Sopinka expressed the view of the majority of the Supreme Court of Canada as to a disqualifying conflict of interest, in such circumstances, in the following terms:
>
> > Is there a disqualifying conflict of interest? In this regard, it must be stressed that this conclusion is predicated on the fact that the client does not consent to but is objecting to the retainer which gives rise to the alleged conflict.
> >
> > Typically, these cases require two questions to be answered: (1) Did the lawyer receive confidential information attributable to a solicitor and client relationship relevant to the matter at hand? (2) Is there a risk that it will be used to the prejudice of the client?
>
> Since there never was a solicitor-client relationship between Mr. Ross and Mr. Mockler, and none is alleged, the case is of little assistance to the plaintiff.
>
> The real question that arises out of facts of this case is whether a solicitor who acquires confidential information from a person in a non solicitor-client relationship is ever prevented from acting against that person in a subsequent proceeding. In Titan Linkabit Corp. v. S.E.E. See Electronic Engineering Inc., Quick Law Federal Court Judgments *[1991] F.C.J. No. 326* the court concluded that there could be situations where removal of a solicitor could be ordered but only where there has been a communication of confidential information given under the clear understanding that it could not be used by the solicitor against the non-client. The burden of proof, however, is clearly on the person seeking the removal of the lawyer. This is how Mr. Justice Pinard expressed his views:
>
> > In my view, confidential information given to a solicitor by a non-client in a related matter could justify a removal such as the one requested by the plaintiffs only if the information was so given with the clear understanding, which is not the case here, that the

> information was indeed confidential and that it could not be used by the solicitor against the non-client.

I adopt the reasoning of Mr. Justice Pinard and find that to succeed in this matter, the plaintiff must establish that, first, confidential information was given, and secondly, the confidential information was given with the clear understanding that the information was confidential and that it could not be used by the solicitor against the non-client.

Similar comments were made by Gruchy J. when he was faced with a motion to remove the plaintiffs' solicitors of record, based on an alleged conflict in United Steelworkers of America, Locals 6874 & 4883 v. King, *[1993] N.S.J. No. 475*, *110 D.L.R. (4th) 150* (S.C.). Specifically, he stated at p. 7:

> In Martin v. Gray Mr. Justice Sopinka addressed the tests to be applied in determining whether there is a disqualifying conflict of interest requiring that a solicitor not be permitted to act for a particular client. He discarded the probability of mischief test as the question of the use of confidential information involves the examination of a matter not usually susceptible of proof. Rather, he said that the test ". . . must be such that the public represented by the reasonably informed person would be satisfied that no use of confidential information would occur. That, in my opinion, is the overriding policy that applies and must inform the court in answering the question: Is there a disqualifying conflict of interest?"
>
> Mr. Justice Sopinka continued:
>
> > Typically, these cases require two questions to be answered: (1) Did the lawyer receive confidential information attributable to a solicitor-and-client relationship relevant to the matter at hand? (2) Is there a risk that it will be used to the prejudice of the client?
>
> Mr. Justice Sopinka went on to explain the dilemma involved in the first question. That is, "in order to explore the matter in depth may require the very confidential information for which protection is sought to be revealed". Before dealing with that question, however, there is a preliminary point to be decided: Was there a solicitor and client relationship between Patterson Kitz and the applicants? It is only after that question has been answered that it is necessary to proceed to determine whether the information was relevant to the matter at hand. As Mr. Justice Sopinka went on to say,
>
> > . . . once it is shown by the client that there existed a previous relationship which is sufficiently related to the retainer from which it is sought to remove the solicitor, the court should infer that confidential information was imparted unless the solicitor satisfies the court that no information was imparted which could be relevant.
>
> It seems to me that the threshold question has to be whether the relationship existed.

(Gruchy J.'s emphasis)

In this case there was no solicitor and client relationship between David Thompson and Peat Marwick, at the time he was a partner at Peat Marwick. Accordingly, cases such as MacDonald Estate v. Martin are of little assistance in analyzing the applicable treatment of any confidential information that Thompson may have acquired vis-à-vis his relationship with Peat Marwick. Given the lack of a solicitor and client relationship between David Thompson and Peat Marwick, it would be inappropriate to remove him or McCarthy Tétrault as solicitors of record, based on any confidential information that Thompson may have gained through that relationship.

(iv) Fiduciary Relationship

The lack of a solicitor-client relationship does not necessarily end the inquiry. While David Thompson did not have a solicitor and client relationship with Peat Marwick, he was a partner of that firm, and accordingly was engaged in a fiduciary relationship vis-à-vis the accounting partnership. One must query whether David Thompson, when acting as a solicitor in a matter against Peat Marwick, may be in breach of a fiduciary duty he owes to the accounting partnership.

(v) Analysis

(a) The Law

A fiduciary owes a duty of loyalty unequalled elsewhere in the law. In Canadian Aero Service Ltd. v. O'Malley, *[1974] S.C.R. 592*, *40 D.L.R. (3d) 371*, Laskin J. reviewed the trust-like nature of the relationship and stated, at p. 607:

> An examination of the case law in this Court and in the Courts of other like jurisdictions on the fiduciary duties . . . shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.
>
> It is this fiduciary duty which is invoked by the appellant in this case and which is resisted by the respondents on the grounds that the duty as formulated is not nor should be part of our law and that, in any event, the facts of the present case do not fall within its scope.

Although Canadian Aero dealt with the duties of departing officers and directors of a corporation, the comments are applicable to all situations where a fiduciary concept is involved. A fiduciary is subject to a strict ethic to provide, among other things, the utmost good faith and loyalty to those to whom he acts in the capacity of fiduciary. Subsumed in the fiduciary's duties of good faith and loyalty is the duty to avoid a conflict of interest. The fiduciary must not only avoid a direct conflict of interest but must also avoid the appearance of a possible or potential conflict. The fiduciary is barred from dividing loyalties between competing interests, including self-interest.

Although the partnership relationship is contractual in nature and origin, the guise under which a partner operates vis-à-vis other partners is that of fiduciary. The individual partner owes a fiduciary duty to the partnership in general, as well as his fellow partners.

Obviously, had David Thompson been a partner at Peat Marwick at the time he became involved in pursuing the plaintiffs' cause herein, he would have committed a clear breach of his fiduciary duties to the partnership and the individual partners, including Wetstein. However, David Thompson was not a partner at the time he accepted the retainer from the plaintiffs. Accordingly, the central issue, with respect to the fiduciary concept, is whether David Thompson's fiduciary duties towards Peat Marwick and its partners extended past the date Thompson withdrew from the accounting partnership.

In the case of Sinclair v. Ridout, *[1955] O.R. 167* at pp. 187-88, *[1955] 4 D.L.R. 468* (H.C.J.), McRuer C.J. stated:

> While the partnership existed they were agents of a particular character for one another within the scope of the partnership. When the partnership was terminated the agency was terminated. I know of no law, and no law was cited to me, that would support a finding that, upon the dissolution of a partnership, in the absence of any agreement to the contrary, the partners cannot make use of information acquired by them in the course of the partnership in competition with each other with respect to matters for which the partnership was formed. Since the parties failed to have a written agreement relating to this matter to the contrary, I think they were both at liberty upon the termination of the relationship to compete with one and other for the purchase of Taylor-Forbes, Limited.

That case, however, dealt with the fiduciary duties which partners owe to each other when the partnership is terminated. In this case the partnership remains an ongoing concern.

Alison R. Manzer in A Practical Guide to Canadian Partnership Law (Aurora: Canada Law Book, 1995) states, at p. 8-54:

> Although the courts have clearly recognized that there are fiduciary duties owed between partners and that these fiduciary duties will impact upon the conduct of partners after dissolution, neither the statutory law nor the case law provides a definitive code as to expected conduct. The partnership agreement should clearly outline the intention among the parties as to entitlement to undertake activities which might otherwise be in breach of fiduciary duties and obligations. It would also be preferable to specify a code as to what is intended to be the ongoing fiduciary duties and responsibilities following termination of the partnership. If these matters are not effectively dealt with by contractual arrangements, they are likely to be the subject of dispute following dissolution. In addition, there are few effective forums for dealing with the resolution of these disputes, other than litigation proceedings.

> Manzer states at p. 8-47:
> Restrictive covenants generally will not be implied as a result of the application of law, other than relating directly to fiduciary responsibilities.

Accordingly, the fiduciary responsibility of a departing partner may endure past the date of his or her withdrawal from the partnership. Unfortunately, the parties did not file a copy of the partnership agreement in effect at the time David Thompson withdrew from the Peat Marwick partnership.

When evaluating the fiduciary duty owed by a departing partner to his or her remaining partners, the case-law relating to "departing employees" is useful by analogy. For example, in Alberts v. Mountjoy *(1977), 16 O.R. (2d) 682* (H.C.J.), Estey C.J.H.C. stated at pp. 689-90:

> . . . we have a principle within a principle to the effect that the ex-employee is not entitled to make "an unfair use" of information acquired in the course of his employment, nor may he use confidential information so acquired to advance his own business at the expense of that of his former employer.

. . . . .

> While the defendant Mountjoy, on the evidence, does not appear to have removed any documents from the premises of the plaintiff, he did leave with a substantial natural advantage which opened up to him the opportunity of taking over for his own profit a substantial trade asset of the plaintiff, that is, its relationship with its insurance clients.

(b) Application of the Law

David Thompson was, at one time, a partner of Peat Marwick, and stood in the role of fiduciary with respect to the other partners. His relationship with his partners was necessarily one which was governed by the principles of utmost good faith and loyalty. In my view, it would be inherently wrong to allow David Thompson to advance a cause of action against his former partners for conduct during a period when he was a member of the partnership.

Through his position as partner of the firm, David Thompson was privy to confidential information with respect to the partnership. The prior relationship leads to the appearance that David Thompson would enjoy an advantage over any other lawyer the plaintiffs might have retained in pursuing a claim against his former partnership. In a very real sense he knows or has the potential to know "the family secrets of Peat Marwick". Accordingly, his representation of the plaintiffs has the appearance of unfairness and creates the possibility of an unfair use of confidential information. In accordance with the principles set out in Alberts v. Mountjoy, such a situation could constitute a breach of fiduciary duties.

In assessing the impact of a potential breach of fiduciary duties by David Thompson, it is appropriate to look at the conduct of Peat Marwick, especially in terms of waiver and estoppel. While it may be arguable that David Thompson, by acting against Peat Marwick, breached a fiduciary duty or could potentially breach a fiduciary duty, Peat Marwick met and discussed the Wetstein issue with David Thompson several times knowing that Thompson was acting for Moffat, without raising the issue of conflict or breach of fiduciary duties. On the face of their dealings with him, Peat Marwick appears, by its conduct, to have accepted David Thompson as a proper advocate for Moffat's cause. Accordingly, it may be suggested that Peat Marwick waived its right to assert a breach of fiduciary duties, or is otherwise estopped by conduct from alleging that breach. However, I am not satisfied that such a waiver or estoppel has been created in this instance.

Although the issue of fiduciary duties was not canvassed at length by counsel and was not a ground alleged for the removal of McCarthy Tétrault and/or David Thompson, I am satisfied that the appearance of a potential breach of a fiduciary duty by David Thompson is sufficient to restrain him and Thompson Corbett from acting on behalf of the plaintiffs herein. As there was no evidence of a breach of a fiduciary duty by David Thompson to date and David Thompson has left McCarthy Tétrault, the appearance of the possibility of a potential breach would not disqualify McCarthy Tétrault.

PART II -- THE MCCARTHY TETRAULT ISSUES

The second main issue arising on this motion is whether the relationship between McCarthy Tétrault and Peat Marwick is of such a nature that it disqualifies McCarthy Tétrault from ever acting in a matter adverse in interest to Peat Marwick.

(i) Position of Peat Marwick

Peat Marwick submits that its head office in Toronto and the Toronto office of McCarthy Tétrault are in constant communication with respect to ongoing legal matters in which McCarthy Tétrault either acts for or provides advice to Peat Marwick. Peat Marwick further submits that McCarthy Tétrault has gained confidential information with respect to Peat Marwick's financing and business structure, and its general litigation philosophy through its past and present representation of Peat Marwick.

Peat Marwick submits that except for administrative proceedings or inactive litigation, McCarthy Tétrault does not act for any party adverse in interest to Peat Marwick, other than the plaintiffs in this case. Peat Marwick suggests that the appropriate course that McCarthy Tétrault should have followed in this instance and, indeed, in any instance in which they may potentially act adverse to Peat Marwick, is to seek permission to act from Peter Sahagian, in-house counsel for Peat Marwick.

(ii) Position of McCarthy Tétrault

David Thompson and McCarthy Tétrault take the position that there is no conflict of interest in their current representation of the plaintiffs, which arises from their past and current representation of Peat Marwick. David Thompson conducted two separate conflict searches, dated February 16, 1994 and October 4, 1994. Through his searches he concluded that:

1. McCarthy Tétrault did not act on the same matter for Peat Marwick; and
2. McCarthy Tétrault did not possess any confidential information which could directly relate to these claims; and
3. McCarthy Tétrault did not act for Peat Marwick on any related matter.

McCarthy Tétrault admits that it has been retained by Peat Marwick in the past, and continues to represent Peat Marwick on several matters. However, it takes the position that its other retainers with Peat Marwick involve separate and discrete matters which have no similarity, relevance or connectiveness with the Wetstein matter.

Further, there is no suggestion by Peat Marwick that McCarthy Tétrault is its main counsel or that there is any special retainer between the two entities. Rather, there is simply a good working relationship between Sahagian and the Toronto office of McCarthy Tétrault. In fact, the list of counsel that have represented Peat Marwick with respect to various matters since 1992 is lengthy and includes many of Toronto's "mega" law firms.

McCarthy Tétrault submits that Peat Marwick is in effect advancing the proposition that any law firm which has had significant contact with Peat Marwick in the past cannot commence an action against it without first securing the consent of Peat Marwick, even on discrete matters, totally unrelated to the law firm's prior retainers. This proposition falls short of the standard for removal set by the Supreme Court of Canada in MacDonald Estate v. Martin, supra. When the MacDonald Estate v. Martin standard is applied, there are insufficient grounds to remove McCarthy Tétrault as solicitors of record for the plaintiff as a result of past or other retainers from Peat Marwick.

(iii) The Howe Matter

At the present time, McCarthy Tétrault is representing the Institute of Chartered Accountants of Ontario ("I.C.A.O."), in an administrative discipline proceedings against Michael Howe, a partner at Peat Marwick.

McCarthy Tétrault, in the Howe matter, are acting adverse in interest to Peat Marwick, without having first secured the consent of Peat Marwick, nor has the issue of conflict of interest been raised by Peat Marwick. McCarthy Tétrault submits that, like the present action, Peat Marwick has a large potential liability arising out of the Howe matter. In support of this proposition, McCarthy Tétrault tendered an affidavit sworn by David Lawrence Knight, vice-chair,

professional standards, for Peat Marwick. The affidavit was originally used in support of a stay of the discipline proceedings against Howe.

In his affidavit, Knight deposes that the potential civil damage faced by Peat Marwick as a result of Howe's actions could be as high as $1.6 billion and if the claimants were totally successful, such damages would result in the financial collapse of the firm. Knight requested a stay of the discipline proceedings as a finding against Howe by the discipline committee could be admissible as prima facie evidence against Peat Marwick in the civil proceedings. Peat Marwick takes the position that the matter in which McCarthy Tétrault represents the I.C.A.O. against Peat Marwick and Howe is merely administrative in nature and is not of a similar nature as the current action in which they seek to represent the plaintiffs. It is on this distinction that Peat Marwick states that they do not object to McCarthy Tétrault acting adverse to their interests in an administrative proceeding.

Notwithstanding counsel's arguments, McCarthy Tétrault's representation of the I.C.A.O. in the Howe discipline matter has little relevance to the main issues on this motion, as does the issue of whether or not the Howe matter could have a financial impact on Peat Marwick. The issue on this motion is whether McCarthy Tétrault has a disqualifying conflict with respect to this matter.

(iv) The Law

The "governing" principles with respect to the removal of a solicitor of record based on a conflict of interest were enunciated by Sopinka J. in MacDonald Estate v. Martin, supra. Writing for the majority, Sopinka J. stated at p. 1243 S.C.R., pp. 254-55 D.L.R.:

> In resolving this issue, the Court is concerned with at least three competing values. There is first of all the concern to maintain the high standards of the legal profession and the integrity of our system of justice. Furthermore, there is the countervailing value that a litigant should not be deprived of his or her choice of counsel without good cause. Finally, there is the desirability of permitting reasonable mobility in the legal profession. The review of the cases which follows will show that the different standards have been adopted from time to time to resolve the issue. This reflects the different emphasis placed at different times and by different judges on the basic values outlined above.

In the present case, only the first two of these competing values are at issue. After reviewing a number of Canadian and international authorities Sopinka J. stated, at p. 1258 S.C.R., p. 266 D.L.R.:

> Nevertheless, it is evident from this review of authorities that the clear trend is in favour of a stricter test. This trend is the product of a strong policy in favour of ensuring not only that there be no actual conflict but that there be no appearance of conflict.

In formulating the appropriate "test" to be applied when considering the removal of a solicitor based on a conflict of interests, Sopinka J. stated at pp. 1259-60 S.C.R., p. 267 D.L.R.:

> What then should be the correct approach? Is the "probability of mischief" standard sufficiently high to satisfy the public requirement that there be an appearance of justice? In my opinion, it is not. This is borne out by the judicial statements to which I have referred and to the desire of the legal profession for strict rules of professional conduct, as its adoption of the Canadian Code of Professional Conduct demonstrates. The probability of mischief test is very much the same as the standard of proof in a civil case. We act on probabilities. This is

> the basis of Rakusen, supra. I am, however, driven to the conclusion that the public, and indeed lawyers and judges, have found that standard wanting. In dealing with the question of the use of confidential information, we are dealing with a matter that is usually not susceptible of proof. As pointed out by Fletcher Moulton L.J. in Rakusen (at p.841 [Ch.]), "that is a thing which you cannot prove." I would add: "or disprove". If it were otherwise, then no doubt the public would be satisfied upon proof that no prejudice would be occasioned. Since, however, it is not susceptible of proof, the test must be such that the public represented by the reasonably informed person would be satisfied that no use of confidential information would occur. That, in my opinion, is the overriding policy that applies, and must inform the court, in answering the question: Is there a disqualifying conflict of interest? In this regard, it must be stressed that this conclusion is predicated on the fact that the client does not consent to, but is objecting to, the retainer which gives rise to the alleged conflict. Typically, these cases require two questions to be answered: (1) Did the lawyer receive confidential information attributable to a solicitor-and-client relationship relevant to a matter at hand? (2) Is there a risk that it will be used to the prejudice of the client?

In describing the methodology for answering these questions, Sopinka J. stated, at p. 1260 S.C.R., p. 268 D.L.R.:

> In my opinion, once it is shown by the client that there existed a previous relationship which is sufficiently related to the retainer from which it is sought to remove the solicitor, the court should infer that confidential information was imparted unless the solicitor satisfies the court that no information was imparted which could be relevant. This will be a difficult burden to discharge. Not only must the court's degree of satisfaction be such that it would withstand the scrutiny of the reasonably informed member of the public that no such information passed, but the burden must be discharged without revealing the specifics of the privileged communication.

Clearly, the onus is on the client to establish that there existed a previous relationship which is sufficiently related to a matter at hand. Once this is done, there is a presumption that confidential information has been imparted, and a heavy onus to displace that presumption rests on the solicitor.

(1) Did the lawyer receive confidential information attributable to a solicitor and client relationship relevant to a matter at hand?

McCarthy Tétrault and Peat Marwick have, in the past, and continue to have a solicitor and client relationship from time to time. Clearly, McCarthy Tétrault has gained confidential information concerning Peat Marwick which is attributable to that relationship. The central issue is whether that information is relevant to a matter at hand.

There is no suggestion that McCarthy Tétrault has gained information concerning the Wetstein matter through its representation of Peat Marwick. Rather Peat Marwick suggests that a conflict exists in a broader sense, in that McCarthy Tétrault's representation of Peat Marwick has afforded McCarthy Tétrault the opportunity to learn their internal financial structure, partnership agreements, insurance programs and management attitudes towards litigation.

One of the most significant factual underpinnings of this argument is McCarthy Tétrault's involvement in the merger negotiations between Peat Marwick and Thorne Ernst & Whinney in 1989. McCarthy Tétrault acted for Thorne Ernst & Whinney and had access to the confidential information surrounding the merger. In essence, McCarthy Tétrault had a hand in creating the

entity against which it now purports to act.

(a) What Constitutes Confidential Information Relevant to a Matter at Hand?

The issue of whether "confidential information relevant to a matter at hand" requires a direct factual link between a previous retainer and the retainer from which the solicitor's removal is sought has been addressed in previous cases.

In Ramsbottom v. Morning (1991), 48 C.P.C. (2d) 177 (Ont. Gen. Div.), Hawkins J. stated, at p. 179:

> It seems to me axiomatic that Fireman & Co., during the course of its 5-year retainer with GO Transit handling all its bus litigation, would have acquired knowledge of its practices, procedures and defence strategies, which knowledge would give it an unfair advantage if acting against GO Transit. In a consideration of the "appearance of fairness" nice questions as to what portion of such knowledge might fit squarely into a "confidentiality" rubric, questions as to who knew what when, and which partners were actively engaged on the files and which not can never be precisely answered.
>
> The affidavits sworn in this matter and the cross-examinations on them leave one with a bad taste and are a shining example of the sort of thing that the rules of professional conduct are designed to avoid.
> The recent Supreme Court of Canada decision, McDonald Estate v. Martin, December 20, 1990 [since reported 48 C.P.C. (3d) 113, *[1991] 1 W.W.R. 705*, *70 Man. R. (2d) 241*, *121 N.R. 1*, *77 D.L.R. (4th) 249*], rejects the "probability of real mischief" test in favour of the higher standard of "possibility of real mischief". If there were no other considerations I would have no hesitation in granting the relief sought. However, there is another consideration and that is the question of delay. The third-party notice was delivered shortly after July 15, 1988. The present motion was launched July 9, 1990, almost 2 years later. There is no explanation for that delay. Even if the discovery by GO transit in June of 1989 of the possession by Fireman and Co. of the vehicle reports is taken as a starting point, there is no satisfactory explanation for the delay of over 1 year between that event and the bringing of the present motion. The interests of the defendant are entitled to some consideration and it would be unfair at this late date to require the defendant to give up the solicitors of its choice when the conflict has been apparent for all to see for over 2 years.

The court went on to dismiss the motion after considering the delay with which it was brought.

In Canada Trustco Mortgage Co. v. Corkum (1991), 49 C.P.C. (2d) 90, *105 N.S.R. (2d) 230* (S.C.), the plaintiff's solicitors had acted for the plaintiff in matters relating to the receivership and bankruptcy of two of the defendant's companies, in 1991. The defendant sought the removal of the solicitors on the grounds that they had intimate knowledge of his finances and businesses, arising from a previous solicitor and client relationship with the defendant.

The scope of the previous retainers included incorporating one of the defendant's companies, defending various traffic offences, acting on the purchase of his residential property, arranging commercial mortgages, selling one of his companies, drafting his will and acting on various pieces of litigation. The majority of the work was done 10 to 15 years before the plaintiff's retainer, and none of the members of the firm could recall the financial affairs of the defendant.

Nonetheless, the court removed the plaintiff's solicitors. At p. 103, Goodfellow J. stated:

> Mr. Tupper suggests the words "sufficiently related" require a direct factual link to the retainer from which it is sought to remove the solicitor. It was certainly clear in the Martin case that the factual information in the very file in question was known by the solicitor who had joined the respondent's firm.
>
> I do not think the words "sufficiently related" are restricted to an actual factual connection to the retainer in question. It seems to me that "sufficiently related" also encompasses the concerns expressed by Mr. Justice Cory when he said [at p. 36]:
>
> > [A] client will often be required to reveal to the lawyer retained highly confidential information. The client's most secret devices and desires, the client's most frightening fears will often, of necessity, be revealed. The client must be secure in the knowledge that the lawyer will neither disclose nor take advantage of these revelations.
>
> When one is dealing in litigation, an understanding of one's opponent, his strengths and weaknesses, is vitally important.
>
> Here, the plaintiff's law firm acted extensively for Eric J. Corkum in his personal, financial, and business endeavours over such a prolonged period that, in my view, a reasonably informed person would not be satisfied that no use of confidential information would occur. A reasonably informed person knowing the extent of the plaintiff's law firm's confidential knowledge of the personal, financial, and business affairs of Eric J. Corkum, which would have been imparted by him over a lengthy period of time on such a variety of matters, all in confidence, that sooner or later such knowledge would surface as a detriment to Eric J. Corkum. Any client, including Eric J. Corkum, must be secure in the knowledge that revelations made in confidence cannot, without waiver, come back to haunt him inadvertently or otherwise.

Accordingly, in order to be relevant to a matter at hand, the confidential information gained through the solicitor and client relationship does not necessarily have to have a factual connectiveness with the issues in the present retainer. Rather, legitimate concerns are raised when a solicitor has acquired confidential information with respect to a party's financial and business affairs and purports to conduct litigation adverse to that party.

In assessing whether the circumstances in this case are sufficient to conclude that McCarthy Tétrault's knowledge of Peat Marwick's financial structure and litigation philosophy is knowledge of a matter relevant to the one at hand, the evidence filed by the parties must be examined.

(b) Evidence of the Conflict

In his original affidavit, John Thompson of Peat Marwick lists six prior retainers through which he alleges that McCarthy Tétrault has acquired "an intimate knowledge of Peat Marwick's internal financial structure, partnership agreements, insurance programs, management attitude towards litigation and more".

The first two retainers deal with actions in which McCarthy Tétrault is currently defending Peat Marwick. The third retainer involves advice McCarthy Tétrault provided with respect to structuring an investment vehicle for the partners of Peat Marwick. The fourth retainer relates to McCarthy Tétrault's representation of Peat Marwick in a dispute it had with a former partner. The fifth retainer relates to advice that McCarthy Tétrault provided to Peat Marwick Stevenson & Kellog, management consultants associated with Peat Marwick, in the negotiations to bring the consultants into the KPMG Canada group as full partners. The sixth retainer relates to McCarthy Tétrault's involvement in the merger between Peat Marwick and Thorne Ernst & Whinney.

Applying the standard set out in Corkum, and based on the nature of the previous and current retainers between McCarthy Tétrault and Peat Marwick, as deposed to by John Thompson in his original affidavit, there is a concern with respect to McCarthy Tétrault's knowledge of Peat Marwick's business and financial structure which it has gained through their solicitor and client relationship. Of course, each case where a solicitor's removal is sought must be determined on its own merits and in the context of the particular circumstances surrounding the relationships between the parties. For example, in this case both the firm and client are much larger in size and scope than the firm and client in Corkum. Does this impact on the analysis? Does the fact that the solicitor-client relationship between McCarthy Tétrault and Peat Marwick is predominately centred in Toronto impact on the analysis? In my view, these types of considerations impact on the analysis of the conflict issue, to the extent that they affect the reasonably informed person's opinion with respect to whether confidential information would or would not be used.

Does this mean that a law firm can never act against a former client, even when it possesses confidential information with respect to that client's financial and business structures and affairs? If it is accepted that McCarthy Tétrault, through its past and present relationship with Peat Marwick does possess confidential information relevant to a matter at hand, the second part of the test in MacDonald Estate v. Martin must be considered, whether there is a risk that the confidential information will be used to the prejudice of the former client.

If, however, it is found that the prior and current solicitor-client relationship between Peat Marwick and McCarthy Tétrault has not accorded confidential information relevant to a matter at hand to McCarthy Tétrault, the second part of the MacDonald Estate v. Martin test need not be considered, as McCarthy Tétrault would not have a disqualifying conflict.

(c) Disposition

The client, Peat Marwick, bears the onus of establishing that there existed a previous relationship which is sufficiently related to the retainer from which it is sought to remove the solicitor. In general, the type of confidential information forming the basis of Peat Marwick's complaint can, in some cases, justify the removal of a solicitor. However, given the drastic nature of that remedy there should be compelling and cogent evidence which provides a sufficient connectiveness between the retainers.

In this case, based on the "evidence" filed by Peat Marwick in support of its motion, I am simply left to "guess" at the type of documents and information that McCarthy Tétrault may have been privy to in their past relationship with Peat Marwick. I am not suggesting that a client must disclose the exact specifics of the confidential information it seeks to protect, but some particulars are warranted, given the remedy sought. A party does not meet its onus of establishing that the prior relationship is sufficiently related to the present retainer, merely by making a bald assertion that the past relationship has provided the solicitor with access to insurance policies, partnership agreements, and litigation philosophy. At the very least, in order to discharge its onus, the client should describe how the solicitor gained that information, and why it is related to the matter at hand. It is also important to look at the dynamic of the past relationship. For example, who controlled the flow of information to McCarthy Tétrault? Was information provided to McCarthy Tétrault on an "as needed" basis or did McCarthy Tétrault have free and unlimited access to all of the information surrounding Peat Marwick's business?

In this case, given the lack of strong evidence demonstrating how the past retainers are sufficiently related to the matter at hand, Peat Marwick has failed to meet its onus of establishing the requisite connectiveness. Accordingly, in my opinion, the removal of McCarthy Tétrault is not

warranted on this branch of the MacDonald Estate v. Martin test. In the event I have erred in applying the test in MacDonald Estate v. Martin I intend to consider the second branch of the test and other factors which impact on the disposition in this matter.

(2) Is there a risk that confidential information will be used to the prejudice of the client?

There is no allegation that any of the McCarthy Tétrault lawyers involved in the advancement of the plaintiffs' claim have direct knowledge of the matters deposed to in the John Thompson affidavit, and therefore there is no direct conflict. Accordingly, in assessing whether McCarthy Tétrault should be removed, the concept of imputed knowledge must be examined.

In discussing the matter of imputed knowledge, Sopinka J., in MacDonald Estate v. Martin, stated at pp. 1261-62 S.C.R., pp. 268-69 D.L.R.:

> The second question is whether the confidential information will be misused. A lawyer who has relevant confidential information cannot act against his client or former client. In such a case the disqualification is automatic. No assurances or undertakings not to use the information will avail. The lawyer cannot compartmentalize his or her mind so as to screen out what has been gleaned from the client and what was acquired elsewhere. Furthermore, there would be a danger that the lawyer would avoid use of information acquired legitimately because it might be perceived to have come from the client. This would prevent the lawyer from adequately representing the new client. Moreover, the former client would feel at a disadvantage. Questions put in cross-examination about personal matters, for example, would create the uneasy feeling that they had their genesis in the previous relationship.
>
> The answer is less clear with respect to the partners or associates in the firm. Some courts have applied the concept of imputed knowledge. This assumes that knowledge of one member of the firm is the knowledge of all. If one lawyer cannot act, no member of the firm can act. This is a rule that has been applied by some law firms as their particular brand of ethics. While this is commendable and is to be encouraged, it is, in my opinion, an assumption which is unrealistic in the era of the mega-firm. Furthermore, if the presumption that the knowledge of one is the knowledge of all is to be applied, it must be applied with respect to both the former firm and the firm which the moving lawyer joins. Thus there is a conflict with respect to every matter handled by the old firm that has a substantial relationship with any matter handled by the new firm irrespective of whether the moving lawyer had any involvement with it. This is the "overkill" which has drawn so much criticism in the United States to which I have referred above.
> Moreover, I am not convinced that a reasonable member of the public would necessarily conclude that confidences are likely to be disclosed in every case despite institutional efforts to prevent it. There is, however, a strong inference that lawyers who work together share confidences. In answering this question, the court should therefore draw the inference, unless satisfied on the basis of clear and convincing evidence, that all reasonable measures have been taken to ensure that no disclosure will occur by the "tainted" lawyer to the member or members of the firm who are engaged against the former client.

An element of "reality" has been built into the test in the case-law subsequent to MacDonald Estate v. Martin. In Manville Canada Inc. v. Ladner Downs *(1992), 88 D.L.R. (4th) 208* at p. 222, *63 B.C.L.R. (2d) 102* (S.C.), Esson C.J.S.C. stated:

> The point on which the majority and minority in MacDonald Estate v. Martin divided was whether there should be an irrebuttable presumption of "imputed knowledge" amongst all lawyers in a firm. In finding the presumption to be irrebuttable, the minority gave overriding weight to the appearance of the thing. This approach is expressed in several passages in the reasons of Cory J. One such passage is at p. 272:
>
> > Our judicial system . . . cannot function properly if doubt or suspicion exists in the mind of the public that the confidential information disclosed by a client to a lawyer might be revealed.
>
> And at p. 273: "It is the appearance of fairness in the eyes of the public that is fundamentally important."
>
> The majority, in concluding that the presumption is rebuttable, gave some weight to the matter of appearance but with emphasis on the reality of the matter, i.e., to the question whether there is in fact a risk that confidential information will be used to the prejudice of the client.
> The language of the majority reasons does not, in my view, preclude the court, in deciding whether to grant the extraordinary and drastic remedy sought in applications of this kind, from having regard to the reality rather than to appearances or perceptions.

This approach was expressly approved of and adopted by Madam Justice Leitch in Chapman v. 3M Canada Inc., Ontario Court of Justice (General Division), released August 9, 1995 [now reported *25 O.R. (3d) 658*, 43 C.P.C. (3d) 142]. Leitch J. stated at p. 7 [p. 663 O.R.]:

> I concur with this reasoning of Chief Justice Esson in Manville Canada Inc. v. Ladner Downs and with his conclusions at p. 223 that when one litigant applies to deprive the opposing litigant of the services of a lawyer which it has chosen, there is necessarily some hardship imposed on the party deprived of its representative and
>
> > The imposition of such hardship and injustice can only be justified if it is inflicted to prevent the imposition of a more serious injustice on the party applying. It follows that the injunction should be granted only to relieve the applicant of the risk of "real mischief", not a mere perception.

If there are "tainted" lawyers in this instance they are the lawyers situate in Toronto who have acted and continue to act for Peat Marwick. The relevant question is whether McCarthy Tétrault has demonstrated on clear and convincing evidence that it has taken all reasonable measures to ensure that no disclosure will occur by the "tainted" lawyers. If so, the presumption that confidential information has been imparted is spent.

David Thompson of Thompson Corbett and McCarthy Tétrault take the position that neither the London office of McCarthy Tétrault, nor any of its members, has any knowledge concerning the financial structure of Peat Marwick which arises out of a solicitor and client relationship. However, the inquiry does not end with an examination of actual knowledge in determining whether confidential information will be used to prejudice the client.

The minority in MacDonald Estate v. Martin took the position that once it was demonstrated that the solicitor was in possession of confidential information relevant to a matter at hand which is attributable to a previous solicitor and client relationship an irrebuttable presumption that it would be used to the prejudice of the former client arises. The majority felt that the presumption was rebuttable, but to do so would be very onerous.

When examining the reality of the situation, it should be recognized that the "parties" involved are national entities, and if any conflict has developed it is "inter-municipality". That is, the

solicitor and client relationship between McCarthy Tétrault and Peat Marwick is predominately centred around the relationship between the Toronto branches of their respective firms. In this case, the London office of Peat Marwick is alleging wrongdoings originating in the London office of McCarthy Tétrault. This may affect the assessment of the reality that confidential information from the Toronto office will be shared with members of the London office.

If it is accepted that McCarthy Tétrault does possess confidential information relevant to a matter at hand, their argument that such information will not be used to the detriment of Peat Marwick is weakened by the lack of any pre-emptive measures taken to prevent the misuse of such information, such as the use of "Chinese walls". Given the availability of telecommunication devices such as faxes, modems, etc., branch offices located in different cities are not in and of themselves sufficient to meet the standard required by MacDonald Estate v. Martin to guard against the potential prejudicial use of the confidential information.

McCarthy Tétrault has taken no real steps to ensure that any confidential information in the possession of members of its Toronto office was not and will not be imparted to members of the London office. There are no screening processes, apart from geography, in place, and none are proposed. In other words, if it is accepted that McCarthy Tétrault is in possession of confidential information which is relevant to a matter at hand, they have taken no steps to rebut the presumption that the confidential information was imparted by members of the firm to the London office.

There are other factors which must be considered before McCarthy Tétrault could be removed as solicitors of record. These include a party's right to counsel of their choice, delay and the tactical nature of conflict motions.

Additional Principles

(i) A Party's Right to Counsel of Their Choice

Removing a party's solicitor of record is an extreme remedy as it necessarily deprives a party of the right to be represented by counsel of their choice in a litigious matter. This is one of the competing interests discussed by Sopinka J. in MacDonald Estate v. Martin. Justice Leitch, in Chapman, supra, commented on this issue, when adopting and approving of Chief Justice Esson's analysis in Manville Canada Inc., supra.

In this case, if it is accepted that McCarthy Tétrault is in possession of relevant confidential information, specifically knowledge of financial and business matters which would give it an unfair advantage in the conduct of the action on behalf of the plaintiffs, the "more serious injustice" to be prevented by their removal is the affront to the fundamental nature of the solicitor and client relationship and its confidential nature. Peat Marwick cannot be prejudiced by the disclosure of confidential information it has made to McCarthy Tétrault in the course of their relationship with that firm. If the only way to ensure that that mischief will not occur is to remove McCarthy Tétrault as solicitors of record that is what must be done in order to prevent the sanctity of the relationship notwithstanding the right of a client to retain counsel of his or her choice.

Another troubling aspect with respect to this case is the policy implications of "preemptive prevention of adverse representation". It has been shown that Peat Marwick has retained several large Toronto firms with respect to various matters since 1992. If Peat Marwick is successful in asserting that the confidential information which is relevant to a matter at hand was its financial structure, litigation philosophy and business practice of which McCarthy Tétrault has been privy given their relationship, it would lead to a practice where "large institutional" clients

such as Peat Marwick could retain a number of "mega-firms" and disclose information with respect to their financial structure, etc. in order to prevent that firm from acting on a matter adverse to the institutional client, in the future. Such a practice is undesirable because it frustrates the legitimate opportunity of parties who are adverse in interest to retain counsel to represent them in an action against the institutional client.

For example, in this case, Peat Marwick has, since 1992, retained over ten of the large and well-known firms in Toronto. If Peat Marwick can establish a conflict with each firm based on such matters as general knowledge of insurance policies, financial structure and litigation philosophy, the plaintiffs will be unable to avail themselves of any of the talent and resources of those firms, with respect to the prosecution of their claim against Peat Marwick.

(ii) Delay

It is submitted by both Mr. Pensa and Mr. Corbett that Peat Marwick has delayed in raising the issue of conflict of interest and that the delay is a factor which should properly be considered by the court when deciding whether to exercise its jurisdiction to remove McCarthy Tétrault as solicitors of record for the plaintiff.

Specifically, the plaintiffs allege that during the course of the meeting on February 16, 1994, between David Thompson, John Thompson and Ross Batson, Peat Marwick was put on notice of a potential claim in which David Thompson and McCarthy Tétrault would act as solicitors of record for the plaintiffs. David Thompson states that at the conclusion of the meeting, John Thompson stated that he would put counsel on notice of a potential claim. The plaintiffs contend that the fact that John Thompson consulted Peat Marwick's in-house counsel, Peter Sahagian, with respect to the February meeting supports this proposition.

Peat Marwick takes the position that they were never aware that the matter would become litigious and that they dealt amicably with David Thompson because he was a former partner and they were of the view that they were "assisting" him in servicing a mutual client, Dr. Moffat. Accordingly, the issue of a conflict did not occur to them. Peat Marwick claims that once they were served with the statement of claim in December 1994 they retained counsel and brought the motion to remove McCarthy Tétrault. The motion was originally returnable February 1, 1995 and was brought with reasonable promptness. Further, although McCarthy Tétrault had represented Dr. Moffat with respect to this matter since at least February of 1994, it did not commence its representation of the other plaintiffs until September 28, 1994.

The plaintiffs submit that if Peat Marwick was indeed unaware of the potential claim in February 1994 the latest that they could have been aware of the claim was July 1994 when Daniel Ross of McCarthy Tétrault sent the letter to Wetstein threatening legal action. The conflict issue was not raised at that time, and in fact was not raised until the plaintiffs were served with the notice of motion.

(a) The Law

The right of a party to be represented by counsel of his or her choice is one which is fundamental to the adversarial process, and, accordingly, must only be impaired in cases of clear necessity. The courts must act with great caution before they interfere with a party's choice of counsel, by removing that counsel as solicitor of record, and must consider all the circumstances surrounding the current and previous retainers.

Delay is a factor which can be considered by a court when it exercises its discretion to remove a solicitor of record. In Baumgartner v. Baumgartner, *[1995] B.C.J. No. 313*, *122 D.L.R. (4th)*

542 at p. 549 (C.A.), Southin J.A. stated:

> The import of those lacunae lies in this: as an application of this kind is, in effect, an application to the equitable jurisdiction of the court to protect the applicant from a loss of the confidentiality to which the solicitor/client relationship entitles him, it may well follow that the respondents to such an application, usually the opposing party and the solicitor in issue, may raise in answer, where the facts warrant it, the usual discretionary considerations, such as delay, which is relevant to equitable remedies.

In Ramsbottom v. Morning, supra, the solicitors for the defendant, who were formerly the solicitors for the third party in other proceedings, had knowledge of the third party's practices, procedures and defence strategies. Applying the test from McDonald Estate v. Martin, Justice Hawkins found that there was a disqualifying conflict and that the solicitors for the defendant should not have acted against the third party in the action. However, dealing with the issue of "delay", in bringing the motion, Hawkins J. stated, at p. 179:

> However, there is another consideration and that is the question of delay. The third-party notice was delivered shortly after July 15, 1988. The present motion was launched July 9, 1990, almost 2 years later. There is no explanation for that delay. Even if the discovery by GO Transit in June of 1989 of the possession by Fireman and Co. of the vehicle reports is taken as a starting point, there is no satisfactory explanation for the delay of over 1 year between that event and the bringing of the present motion. The interests of the defendant are entitled to some consideration and it would be unfair at this late date to require the defendant to give up the solicitors of its choice when the conflict has been apparent for all to see for over 2 years.

Accordingly, the motion was dismissed, and the defendant was entitled to retain his solicitor.

In Crystal Heights Co-Operative Inc. v. Barban Builders Inc. (1987), 19 C.P.C. (2d) 212 (Ont. Dist. Ct.), the solicitor whose removal was sought had acted for the third party for over two years before the motion to remove him was brought. In dismissing the motion, Vannini D.C.J. stated, at p. 217:

> The applicant has not offered a satisfactory and acceptable reason for not moving sooner than it did with this motion. It cannot now at this date justifiably complain about any apparent or possible conflict of interest.
>
> Nor has the applicant shown any reason to believe that Paciocco or any other member of the firm at the time could give evidence to rebut the evidence of the Barbans in support of their defence or that Bisceglia acquired any confidential information.
> Justice must not only be done but appear or be seen to be done to both parties. The prejudice to the Barbans if they should be denied the solicitor of their choice at this time and stage of the proceedings outweighs any possibility of prejudice to the applicant if their solicitor was allowed to continue. The unexplained delay also weighs in favour of the Barbans with the result that the scales of justice and the appearance of justice being done tip in favour of the Barbans.

While delay is a factor for the court to consider, it is not necessarily determinative of the issues on a motion such as this. In this instance, the plaintiffs allege that Peat Marwick delayed nearly a year before it raised the conflict issue, and as such, even if there is merit to the allegations of conflict, it would be unfair to remove the solicitor of their choice given the inordinate delay.

However, it is important to examine the delay in the context of the proceedings. The relief sought in the motion before the court is the removal of a solicitor of record. McCarthy Tétrault did not become the plaintiffs' solicitor of record until December of 1994, when it issued the statement of claim on their behalf. The solicitors retained by Peat Marwick appear to have acted promptly, from that date, in moving for the relief requested in this motion. This is not a case where the defendant delayed a year or two after the exchange of pleadings, before bringing its motion.

Further, while it is arguable that Peat Marwick should have raised the conflict issue on its own, it is significant to note that Mr. Caskey and the Siskind Cromarty firm were not involved in the "pre-statement of claim" negotiations and appear to have been retained in response to the issuance of the statement of claim. Mr. Caskey, once involved, appears to have proceeded promptly in raising the conflict issue and moving for the requested relief.

(b) The Tactical Nature of Conflict Motions

Although it may appear obvious, where a motion is brought which appeals to the court's equitable discretion to remove a solicitor of record, the relief should only be granted where the motion has proceeded on the basis of a genuine concern with respect to the merits of the alleged conflict. In other words, where a motion to remove a solicitor of record is brought for the purpose of frustrating or delaying one's opponent or to otherwise secure a tactical advantage in the course of litigation, the motion should be dismissed.

Again, while that may appear "obvious", recent cases have expressly endorsed that principle. For example, in Manville Canada Inc. v. Ladner Downs, supra, after concluding that there was no conflict of interest in the matter before him, Esson C.J.S.C. stated, at p. 224:

> Until very recently, applications to remove lawyers were so rare an event that, at least in this jurisdiction, few judges or lawyers seemed to be more than vaguely aware that such a remedy existed. Nor, so far as I am aware, was there any general feeling of discontent on the part of the public arising from the possibility of conflict. But there was and is a rising tide of discontent with the length, complexity and cost of proceedings. Since MacDonald Estate v. Martin, the application to disqualify has become a growth area as it began to do 20 or so years ago in the United States where it seems to have reached the stage of being a common feature of major litigation. No doubt, some of those applications are brought to prevent a risk of real mischief. But can there be any doubt that many are brought simply because an application to disqualify has become a weapon which can be used, amongst many others, to discomfit the opposite party by adding to the length, cost and agony of litigation. If that becomes a regular feature of our litigation it would not likely do much to improve the profession's standards in an area in which there seem to have been few serious problems. But it could do much to further reduce the court's ability to get judgment in a timely way.

In Rayner v. Enright (1993), 20 C.P.C. (3d) 269 (Sask. Q.B.), Kyle J. expressed a similar concern stating at p. 271:

> Concerns have been expressed that motions such as these have become a standard tactic in litigation in recent years. The courts must be vigilant to confine the principle to those cases where a litigant's interests are threatened or at least reasonably appear to be threatened as any expansion of the principle beyond the present guidelines will make the delivery of legal services to the public by law firms of large or medium size extremely difficult. Such is not a

> concern only for the lawyers, the expense and inconvenience to a litigant required to obtain new counsel cannot be overlooked in assessing the impact of judicial decisions in this area.

Essentially, commentary such as this reaffirms the fundamental principle that a party's choice of counsel should not be interfered with by the courts unless there is a compelling reason to do so. Certainly, the real possibility that the solicitor knows of relevant confidential information of an adverse party which was disclosed to him on a prior retainer is a compelling reason.

McCarthy Tétrault and David Thompson submit that the defendants may have an ulterior "tactical" motive for bringing this motion. Is there evidence of such a motive? On its face, the motion does seem to have some real merit. First, there is the compelling issue of David Thompson's actual conflict of interest, and second, there is the relationship between Peat Marwick and McCarthy Tétrault that gives rise to some legitimate concerns.

From a tactical perspective, there is some suggestion that Peter Sahagian is of the view that any time a firm which Peat Marwick has retained in the past seeks to represent a party adverse in interest to Peat Marwick the law firm must apply for and receive Peat Marwick's consent, whether the matters are related or not. This is a rather "high handed" attitude and does not reflect the state of the law, and is seemingly more a "business" practice. Perhaps, this motion may be viewed as an attempt to enforce the in-house business rule of Peat Marwick's legal department, as opposed to being motivated by a fear of disclosure of confidential information.

The Michael Howe, I.A.C.O. discipline matter may be relevant in assessing whether the present motion is tactically motivated. In the Howe matter, McCarthy Tétrault is acting for the I.A.C.O. in the prosecution of a professional discipline matter against Howe, an accountant at Peat Marwick. McCarthy Tétrault did not secure Peat Marwick's permission to act on that retainer. Peat Marwick takes the position that that matter is merely administrative, in which they have no pecuniary interest and, accordingly, they are not concerned over McCarthy Tétrault's representation of the I.A.C.O. McCarthy Tétrault asserts that the discipline matter against Howe could have a significant pecuniary impact on Peat Marwick, and has filed an affidavit made by David Knight, in the course of the Howe matter, to support this proposition. Accordingly, if the Howe matter does have a potential pecuniary impact on Peat Marwick, and they did not object to McCarthy Tétrault acting against them in that matter, it may call into question their motivation in seeking McCarthy Tétrault's removal in this matter.

There is also some interaction between the delay argument and the tactical argument. If McCarthy Tétrault and David Thompson's argument that the defendants knew of a potential claim approximately one year before the motion was brought with respect to delay is accepted, it strengthens the argument that the motion was only brought to frustrate and otherwise delay the plaintiffs in the prosecution of their claim.

If it is accepted that Peat Marwick's motivation for this motion was tactical it will certainly assist in balancing the competing interests in this motion is such a way as to favour support of the plaintiffs' right to counsel of their choice, i.e., McCarthy Tétrault. However, even if the motion is tactical, it is difficult to see how that would prevent Thompson from being removed, based on the direct and actual conflict of interest arising from his financial exposure, which is present in this case.

Tainting Thompson Through McCarthy Tétrault

If McCarthy Tétrault has a disqualifying conflict of interest, it would disqualify Thompson, Corbett from acting, as the members of that firm would be tainted by their previous involvement with McCarthy Tétrault. In order to disqualify McCarthy Tétrault knowledge of members from the Toronto office will have to be imputed to members of the London office. David Thompson is a

former member of the London office and was a member at the firm when the conflict, if found, arose, and accordingly, knowledge would be imputed to him as well.

If McCarthy Tétrault does not have a disqualifying conflict, Thompson would still be unable to act, given his actual conflict with respect to his financial interest in the litigation. However, since Thompson has left McCarthy Tétrault, his financial conflict should not taint or otherwise prevent McCarthy Tétrault from acting for the plaintiffs.

Accordingly, Thompson Corbett shall be restrained from acting on behalf of the plaintiffs in this matter. The motion to remove McCarthy Tétrault is dismissed.

Counsel may make written submissions on costs within 30 days.

Motion dismissed.

Canadian National Railway Co. v. McKercher LLP, [2013] 2 S.C.R. 649

Supreme Court Reports

Supreme Court of Canada

Present: McLachlin C.J. and LeBel, Fish, Abella, Rothstein, Cromwell, Moldaver, Karakatsanis and Wagner JJ.

Heard: January 24, 2013;

Judgment: July 5, 2013.

File No.: 34545.

[2013] 2 S.C.R. 649 | *[2013] 2 R.C.S. 649* | *[2013] S.C.J. No. 39* | *[2013] A.C.S. no 39* | *2013 SCC 39*

Canadian National Railway Company, Appellant; v. McKercher LLP and Gordon Wallace, Respondents, and Canadian Bar Association and Federation of Law Societies of Canada, Interveners.

(68 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR SASKATCHEWAN

Case Summary

Catchwords:

Law of professions — Barristers and solicitors — Duty of loyalty — Conflict of interest — Breach of confidence — Whether a law firm can accept a retainer to act against a current client on a matter unrelated to the client's existing files — Whether a law firm can bring a lawsuit against a current client on behalf of another client and if not, what remedies are available to the client.

Summary:

McKercher LLP was acting for CN on several matters when, without CN's consent or knowledge, it accepted a retainer to act for the plaintiff in a $1.75 billion class action against CN. CN first learned that McKercher was acting against it in the class action when it was served with the statement of claim. McKercher hastily terminated all retainers with CN, except for one which CN terminated. CN applied to strike McKercher as the solicitor of record in the class action due to an alleged conflict of interest. The motion judge granted the application and disqualified McKercher. The Court of Appeal overturned the motion judge's order.

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Held: The appeal should be allowed and the matter should be remitted to the Court of Queen's Bench for redetermination of a remedy.

A lawyer's duty of loyalty has three salient dimensions: a duty to avoid conflicting interests; a duty of commitment

to the client's cause; and a duty of candour. The duty to avoid conflicts is mainly concerned with protecting a former or current client's confidential information and with ensuring the effective representation of a current client. The duty of commitment entails that, subject to law society rules, a lawyer or law firm as a general rule should not summarily drop a client simply to avoid conflicts of interest. The duty of candour requires disclosure of any factors relevant to the ability to provide effective representation. A lawyer should advise an existing client before accepting a retainer that will require him to act against the client.

The present appeal concerns the risk to effective representation that arises when a lawyer acts concurrently in different matters for clients whose immediate interests in those matters are directly adverse. *R. v. Neil*, 2002 SCC 70, [2002] 3 S.C.R. 631, held that the general bright line rule is that a lawyer, and by extension a law firm, may not concurrently represent clients adverse in interest without first obtaining their consent. When the bright line rule is inapplicable, the question becomes whether the concurrent representation of clients creates a substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person. The bright line rule is based on the inescapable conflict of interest inherent in some situations of concurrent representation and it reflects the essence of a fiduciary's duty of loyalty. The rule cannot be rebutted or otherwise attenuated and it applies to concurrent representation in both related and unrelated matters. However, the rule is limited in scope. It applies only where the immediate interests of clients are directly adverse in the matters on which the lawyer is acting and it applies only to legal interests, as opposed to commercial or strategic interests. It cannot be raised tactically. It does not apply in circumstances where it is unreasonable for a client to expect that a law firm will not act against it in unrelated matters.

[page651]

McKercher's conduct fell squarely within the scope of the bright line rule. CN and the class suing CN are adverse in legal interest; CN did not tactically abuse the bright line rule; and it was reasonable in the circumstances for CN to have expected that McKercher would not concurrently represent a party suing it for $1.75 billion. McKercher's failure to obtain CN's consent before accepting the class action retainer breached the bright line rule. McKercher's termination of its retainers with CN breached its duty of commitment. Its failure to advise CN of its intention to represent the class breached its duty of candour. However, McKercher possessed no relevant confidential information that could be used to prejudice CN in the class action.

Disqualification may be required to avoid the risk of improper use of confidential information, to avoid the risk of impaired representation, or to maintain the repute of the administration of justice. In this case the only concern that would warrant disqualification is the protection of the repute of the administration of justice. While a breach of the bright line rule normally attracts the remedy of disqualification, factors that may militate against it must be considered. These factors may include: (i) behaviour disentitling the complaining party from seeking the removal of counsel, such as delay in bringing the motion for disqualification; (ii) significant prejudice to the new client's interest in retaining its counsel of choice, and that party's ability to retain new counsel; and (iii) the fact that the law firm accepted the conflicting retainer in good faith, reasonably believing that the concurrent representation fell beyond the scope of the bright line rule or applicable law society rules. As the motion judge did not have the benefit of these reasons, the matter should be remitted to the Queen's Bench for redetermination of the appropriate remedy.

Cases Cited

Referred to: *R. v. Neil*, 2002 SCC 70, [2002] 3 S.C.R. 631; *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235; *R. v. Cunningham*, 2010 SCC 10, [2010] 1 S.C.R. 331; *Cholmondeley v. Clinton* (1815), 19 Ves. Jun. 261, 34 E.R. 515; *Bricheno v. Thorp* (1821), Jacob 300, 37 E.R. 864; [page652] *Taylor v. Blacklow* (1836), 3 Bing. (N.C.) 235, 132 E.R. 401; *Rakusen v. Ellis*, [1912]

1 Ch. 831; *Strother v. 3464920 Canada Inc.*, 2007 SCC 24, [2007] 2 S.C.R. 177; *Bolkiah v. KPMG*, [1999] 2 A.C. 222; *Moffat v. Wetstein* (1996), 29 O.R. (3d) 371; *Canadian Pacific Railway v. Aikins, MacAulay & Thorvaldson* (1998), 23 C.P.C. (4th) 55; *De Beers Canada Inc. v. Shore Gold Inc.*, 2006 SKQB 101, 278 Sask. R. 171; *Toddglen Construction Ltd. v. Concord Adex Developments Corp.* (2004), 34 C.L.R. (3d) 111.

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History and Disposition:

APPEAL from a judgment of the Saskatchewan Court of Appeal (Lane, Ottenbreit and Caldwell JJ.A.), 2011 SKCA 108, 375 Sask. R. 218, 340 D.L.R. (4th) 402, [2012] 1 W.W.R. 251, 9 C.P.C. (7th) 292, 525 W.A.C. 218, [2011] S.J. No. 589 (QL), 2011 CarswellSask 625, setting aside a decision of Popescul J., 2009 SKQB 369, 344 Sask. R. 3, [2009] 12 W.W.R. 157, 77 C.P.C. (6th) 24, [2009] S.J. No. 549 (QL), 2009 CarswellSask 610 (*sub nom. Wallace v. Canadian Pacific Railway*). Appeal allowed.

[page653]

Counsel

Douglas C. Hodson, *Q.C.*, *Vanessa Monar Enweani* and *C. Ryan Lepage*, for the appellant.

Gavin MacKenzie and *Lauren Wihak*, for the respondents.

Malcolm M. Mercer, *Eric S. Block* and *Brendan Brammall*, for the intervener the Canadian Bar Association.

John J. L. Hunter, *Q.C.*, and *Stanley Martin*, for the intervener the Federation of Law Societies of Canada.

The judgment of the Court was delivered by

McLACHLIN C.J.

1 Can a law firm accept a retainer to act against a current client on a matter unrelated to the client's existing files? More specifically, can a firm bring a lawsuit against a current client on behalf of another client? If not, what remedies are available to the client whose lawyer has brought suit against it? These are the questions raised by this appeal.

I. Background

2 McKercher LLP ("McKercher") is a large law firm in Saskatchewan. The Canadian National Railway Company ("CN") retained McKercher to act for it on a variety of matters. In late 2008, McKercher was acting for CN on three ongoing matters: a personal injury claim concerning a rail yard incident in which children had been injured; the purchase of real estate; and the representation of CN's interests as a creditor in a receivership. As well, two of its partners held power of attorney from CN for service of process in Saskatchewan.

3 At the same time, the McKercher firm accepted a retainer from Gordon Wallace ("Wallace") to act against CN in a $1.75 billion class action based on allegations that CN had illegally overcharged Western Canadian farmers for grain transportation. It is not contested on appeal that the Wallace action [page654] was legally and factually unrelated to the ongoing CN retainers.

4 The McKercher firm did not advise CN that it intended to accept the Wallace retainer. CN learned this only when it was served with the statement of claim on January 9, 2009. Between December 5, 2008, and January 15, 2009, various McKercher partners hastily terminated their retainers with CN, except on the real estate file, which was terminated by CN.

5 Following receipt of the statement of claim, CN applied for an order removing McKercher as solicitor of record for Wallace in the class action against it, on the grounds that the McKercher firm had breached its duty of loyalty to CN by placing itself in a conflict of interest, had improperly terminated its existing CN retainers, and might misuse confidential information gained in the course of the solicitor-client relationship.

6 The motion judge granted the application, and disqualified McKercher from acting on the Wallace litigation: *2009 SKQB 369*, *344 Sask. R. 3*. He found that the firm had breached the duty of loyalty it owed CN, placing itself in a conflict of interest by accepting the Wallace retainer while acting for CN on other matters. In his view, CN felt an understandable sense of betrayal, which substantially impaired the McKercher firm's ability to represent CN in the ongoing retainers. Moreover, McKercher had received a unique understanding of the litigation strengths, weaknesses and attitudes of CN; this understanding constituted relevant confidential information. The motion judge concluded that McKercher's violation of the duty of loyalty, in addition to the possession of relevant confidential information, made disqualification of McKercher as counsel on the Wallace action an appropriate remedy.

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7 The Court of Appeal overturned the motion judge's order disqualifying McKercher: *2011 SKCA 108*, *375 Sask. R. 218*. The Court of Appeal found that a general understanding of CN's litigation strengths and weaknesses did not constitute relevant confidential information warranting disqualification. Moreover, it found that McKercher had not breached its duty of loyalty by accepting to act concurrently for Wallace. CN was a large corporate client that was not in a position of vulnerability or dependency with respect to McKercher. As such, its implied consent to McKercher acting for an opposing party in unrelated legal matters could be inferred. However, the Court of Appeal found that McKercher had breached its duty of loyalty towards CN by peremptorily terminating the solicitor-client relationship on its existing files for CN. Nevertheless, disqualification was not an appropriate remedy in this case, since McKercher's continued representation of Wallace created no risk of prejudice to CN. Indeed, the termination of the lawyer-client relationship had effectively put an end to any possibility of prejudice.

8 The case at hand requires this Court to examine the lawyer's duty of loyalty to his client, and in particular the requirement that a lawyer avoid conflicts of interest. As we held in *R. v. Neil*, *2002 SCC 70*, *[2002] 3 S.C.R. 631*, the general "bright line" rule is that a lawyer, and by extension a law firm, may not concurrently represent clients adverse in interest without obtaining their consent - regardless of whether the client matters are related or unrelated: para. 29. However, when the bright line rule is inapplicable, the question becomes whether the concurrent representation of clients creates a "substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person": *Neil*, at para. 31. This appeal turns on the scope of the bright line rule: Did it apply to McKercher's concurrent representation [page656] of CN and Wallace? Or is the applicable test instead whether the concurrent representation of CN and Wallace created a substantial risk of impaired representation?

9 In these reasons, I conclude that McKercher's concurrent representation of CN and Wallace fell squarely within the scope of the bright line rule. The bright line rule was engaged by the facts of this case: CN and Wallace were adverse in legal interests; CN has not attempted to tactically abuse the bright line rule; and it was reasonable in the circumstances for CN to expect that McKercher would not concurrently represent a party suing it for $1.75 billion. McKercher failed to obtain CN's consent to the concurrent representation of Wallace, and consequently breached the bright line rule when it accepted the Wallace retainer.

10 In addition to its duty to avoid conflicts of interest, a law firm is under a duty of commitment to the client's cause which prevents it from summarily and unexpectedly dropping a client in

order to circumvent conflict of interest rules, and a duty of candour which requires the law firm to advise its existing client of all matters relevant to the retainer. I conclude that McKercher's termination of its existing retainers with CN breached its duty of commitment to its client's cause, and its failure to advise CN of its intention to accept the Wallace retainer breached its duty of candour to its client. However, McKercher possessed no relevant confidential information that could be used to prejudice CN.

11 As regards the appropriate remedy to McKercher's breaches, I conclude that the only concern that would warrant disqualification in this case is the protection of the repute of the administration of justice. A breach of the bright line rule normally attracts the remedy of disqualification. This remains [page657] true even if the lawyer-client relationship is terminated subsequent to the breach. However, certain factors may militate against disqualification, and they must be taken into consideration. As the motion judge did not have the benefit of these reasons, I would remit the matter to the Queen's Bench for redetermination in accordance with them.

II. Issues

12 The appeal raises the following issues:

A. The Role of the Courts in Resolving Conflicts Issues

B. The Governing Principles

C. Application of the Principles

D. The Appropriate Remedy

III. Analysis

A. *The Role of the Courts in Resolving Conflicts Issues*

13 Courts of inherent jurisdiction have supervisory power over litigation brought before them. Lawyers are officers of the court and are bound to conduct their business as the court directs. When issues arise as to whether a lawyer may act for a particular client in litigation, it falls to the court to resolve those issues. The courts' purpose in exercising their supervisory powers over lawyers has traditionally been to protect clients from prejudice and to preserve the repute of the administration of justice, not to discipline or punish lawyers.

14 In addition to their supervisory role over court proceedings, courts develop the fiduciary principles that govern lawyers in their duties to [page658] clients. Solicitor-client privilege has been a frequent subject of court consideration, for example.

15 The inherent power of courts to resolve issues of conflicts in cases that may come before them is not to be confused with the powers that the legislatures confer on law societies to establish regulations for their members, who form a self-governing profession: *MacDonald Estate v. Martin*, *[1990] 3 S.C.R. 1235*, at p. 1244. The purpose of law society regulation is to establish general rules applicable to all members to ensure ethical conduct, protect the public and discipline lawyers who breach the rules - in short, the good governance of the profession.

16 Both the courts and law societies are involved in resolving issues relating to conflicts of interest - the courts from the perspective of the proper administration of justice, the law societies

from the perspective of good governance of the profession: see *R. v. Cunningham*, 2010 SCC 10, [2010] 1 S.C.R. 331. In exercising their respective powers, each may properly have regard for the other's views. Yet each must discharge its unique role. Law societies are not prevented from adopting stricter rules than those applied by the courts in their supervisory role. Nor are courts in their supervisory role bound by the letter of law society rules, although "an expression of a professional standard in a code of ethics ... should be considered an important statement of public policy": *Martin*, at p. 1246.

17 In recent years the Canadian Bar Association and the Federation of Law Societies of Canada have worked toward common conflict rules applicable across Canada. However, they have been unable to agree on their precise form: see, for example, A. Dodek, "Conflicted Identities: The Battle over the Duty of Loyalty in Canada" (2011), 14 *Legal Ethics* 193. That debate was transported into the proceedings before us, each of these interveners asking [page659] this Court to endorse their approach. While the court is properly informed by views put forward, the role of this Court is not to mediate the debate. Ours is the more modest task of determining which principles should apply in a case such as this, from the perspective of what is required for the proper administration of justice.

18 Against this backdrop, I now turn to examine the principles that govern this appeal.

B. *The Governing Principles*

19 A lawyer, and by extension a law firm, owes a duty of loyalty to clients. This duty has three salient dimensions: (1) a duty to avoid conflicting interests; (2) a duty of commitment to the client's cause; and (3) a duty of candour: *Neil*, at para. 19. I will consider each in turn.

1. Avoiding Conflicts of Interest

(a) *English Origins*

20 Canada's law of conflicts as administered by the courts is based on precedents rooted in the English jurisprudence. Traditionally, the main concern was that clients not suffer prejudice from a lawyer's representation - at the same time or sequentially - of parties adverse in interest. Disqualification of a lawyer from a case was reserved for situations where there was a real risk of harm to the client, as opposed to a theoretical possibility of harm: see, for example, *Cholmondeley v. Clinton* (1815), 19 Ves. Jun. 261, 34 E.R. 515; *Bricheno v. Thorp* (1821), Jacob 300, 37 E.R. 864; *Taylor v. Blacklow* (1836), 3 Bing. (N.C.) 235, 132 E.R. 401. The rule was not absolute or "bright line", but pragmatic. Courts looked to the circumstances of each case and sought to determine whether it was realistic to conclude that the client would suffer some form of harm. Fletcher Moulton L.J.'s statement in *Rakusen v. Ellis*, [1912] 1 Ch. 831 [page660] (C.A.), catches the flavour of the English common law approach:

> As a general rule the Court will not interfere unless there be a case where mischief is rightly anticipated... . [W]here there is such a probability of mischief that the Court feels that, in its duty as holding the balance between the high standard of behaviour which it requires of its officers and the practical necessities of life, it ought to interfere and say that a solicitor shall not act. Now in the present case there is an absolute absence of any reasonable probability of any mischief whatever. [p. 841]

(b) *The Martin Test: A Focus on Risk of Prejudice and Balancing of Values*

21 In the *Martin* case, this Court (*per* Sopinka J.) adopted the English common law's focus on protecting the client from real risks of harm, although it diverged from some of the English case law with respect to the exact level of risk that should attract the conflicts rule. The issue in *Martin* was whether a law firm should be disqualified from acting against a party because a lawyer in the firm had received relevant confidential information in the course of her prior work for that party. As will be discussed further below, the Court held that a firm cannot be disqualified unless there is a risk of prejudice to the client, although in some cases the client benefits from a presumption of risk of prejudice: pp. 1260-61.

22 In addition to retaining an emphasis on risk of prejudice to the client, the Court concluded in *Martin* that an effective and fair conflicts rule must strike an appropriate balance between conflicting values. On the one hand stands the high repute of the legal profession and the administration of justice. On the other hand stand the values of allowing the client's choice of counsel and permitting reasonable mobility in the legal profession. The realities of large [page661] law firms and litigants who pick and choose between them must be factored into the balance. As was the case in the English common law, the Court declined to endorse broad rules that are not context-sensitive.

(c) *Types of Prejudice Addressed by Conflict of Interest Rules*

23 The law of conflicts is mainly concerned with two types of prejudice: prejudice as a result of the lawyer's misuse of confidential information obtained from a client; and prejudice arising where the lawyer "soft peddles" his representation of a client in order to serve his own interests, those of another client, or those of a third person. As regards these concerns, the law distinguishes between former clients and current clients. The lawyer's main duty to a former client is to refrain from misusing confidential information. With respect to a current client, for whom representation is ongoing, the lawyer must neither misuse confidential information, nor place himself in a situation that jeopardizes effective representation. I will examine each of these aspects of the conflicts rule in turn.

(d) *Confidential Information*

24 The first major concern addressed by the duty to avoid conflicting interests is the misuse of confidential information. The duty to avoid conflicts reinforces the lawyer's duty of confidentiality - which is a distinct duty - by preventing situations that carry a heightened risk of a breach of confidentiality. A lawyer cannot act in a matter where he may use confidential information obtained from a former or current client to the detriment of that client. A two-part test is applied to determine whether the new matter will place the lawyer in a conflict of interest: (1) Did the lawyer receive confidential information attributable to a solicitor and client relationship relevant to the matter at hand? (2) Is there a risk that it will be used to the prejudice of that client?: *Martin*, at p. 1260. If the lawyer's new retainer is "sufficiently related" to the matters [page662] on which he or she worked for the former client, a rebuttable presumption arises that the lawyer possesses confidential information that raises a risk of prejudice: p. 1260.

(e) *Effective Representation*

25 The second main concern, which arises with respect to current clients, is that the lawyer be

an effective representative - that he serve as a zealous advocate for the interests of his client. The lawyer must refrain "from being in a position where it will be systematically unclear whether he performed his fiduciary duty to act in what he perceived to be the best interests" of his client: D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (4th ed. 2012), at p. 968. As the oft-cited Lord Brougham said, "an advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client": *Trial of Queen Caroline* (1821), by J. Nightingale, vol. II, The Defence, Part I, at p. 8.

26 Effective representation may be threatened in situations where the lawyer is tempted to prefer other interests over those of his client: the lawyer's own interests, those of a current client, of a former client, or of a third person: *Neil*, at para. 31. This appeal concerns the risk to effective representation that arises when a lawyer acts concurrently in different matters for clients whose immediate interests in those matters are directly adverse. This Court has held that concurrent representation of clients directly adverse in interest attracts a clear prohibition: the bright line rule.

(f) *The Bright Line Rule*

27 In *Neil*, this Court (*per* Binnie J.) stated that a lawyer may not represent a client in one matter while representing that client's adversary in another matter, unless both clients provide their informed consent. Binnie J. articulated the rule thus:

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> The bright line is provided by the general rule that a lawyer may not represent one client whose interests are directly adverse to the immediate interests of another current client - *even if the two mandates are unrelated* - unless both clients consent after receiving full disclosure (and preferably independent legal advice), and the lawyer reasonably believes that he or she is able to represent each client without adversely affecting the other. [Emphasis in original; para. 29]

28 The rule expressly applies to both related *and* unrelated matters. It is possible to argue that a blanket prohibition against concurrent representation is not warranted with respect to unrelated matters, where the concrete duties owed by the lawyer to each client may not actually enter into conflict. However, the rule provides a number of advantages. It is clear. It recognizes that it is difficult - often impossible - for a lawyer or law firm to neatly compartmentalize the interests of different clients when those interests are fundamentally adverse. Finally, it reflects the fact that the lawyer-client relationship is a relationship based on trust. The reality is that "the client's faith in the lawyer's loyalty to the client's interests will be severely tried whenever the lawyer must be loyal to another client whose interests are materially adverse": *Restatement of the Law, Third: The Law Governing Lawyers* (2000), vol. 2, s. 128(2), at p. 339.

29 The parties and interveners to this appeal disagreed over the substance of the bright line rule. It was variously suggested that the bright line rule is only a rebuttable presumption of conflict, that it does not apply to unrelated matters, and that it attracts a balancing of various circumstantial factors that may give rise to a conflict. These suggestions must be rejected. Where applicable, the bright line rule prohibits concurrent representation. It does not invite further considerations. As Binnie J. stated in *Strother v. 3464920 Canada Inc.*, *2007 SCC 24*, *[2007] 2 S.C.R. 177*, "[t]he 'bright line' rule is the product of the balancing of interests not the

gateway to further internal balancing": para. 51. To turn [page664] the rule into a rebuttable presumption or a balancing exercise would be tantamount to overruling *Neil* and *Strother*. I am not persuaded that it would be appropriate here to depart from the rule of precedent.

30 However, the bright line rule is not a rule of unlimited application. The real issue raised by this appeal is the scope of the rule. I now turn to this issue.

(g) *The Scope of the Bright Line Rule*

31 The bright line rule holds that a law firm cannot act for a client whose interests are adverse to those of another existing client, unless both clients consent. It applies regardless of whether the client matters are related or unrelated. The rule is based on "the inescapable conflict of interest which is inherent" in some situations of concurrent representation: *Bolkiah v. KPMG*, [1999] 2 A.C. 222 (H.L.), at p. 235, cited in *Neil*, at para. 27. It reflects the essence of the fiduciary's duty of loyalty: "... a fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position": *Bolkiah*, at p. 234.

32 However, *Neil* and *Strother* make it clear that the scope of the rule is not unlimited. The rule applies where the *immediate legal* interests of clients are *directly* adverse. It does not apply to condone tactical abuses. And it does not apply in circumstances where it is unreasonable to expect that the lawyer will not concurrently represent adverse parties in unrelated legal matters. The limited scope of application of the rule is illustrated by *Neil* and *Strother*. This Court found the bright line rule to be inapplicable to the facts of both of those cases, and instead examined whether there [page665] was a substantial risk of impaired representation: *Neil*, at para. 31; *Strother*, at para. 54.

33 First, the bright line rule applies only where the *immediate* interests of clients are *directly* adverse in the matters on which the lawyer is acting. In *Neil*, a law firm was concurrently representing Mr. Neil in criminal proceedings and Ms. Lambert in divorce proceedings, when it was foreseeable that Lambert would eventually become Neil's co-accused in the criminal proceedings. The lawyer representing Lambert in the divorce proceedings began to gather information that he could eventually use against Neil. The law firm also encouraged another one of its clients, Mr. Doblanko, to report criminal actions by Neil to the police. The goal was to mount a "cut-throat" defence for Lambert in the criminal case, painting her as an innocent dupe who had been manipulated by Neil.

34 This Court did not apply the bright line rule to the facts in *Neil*, because of the nature of the conflict. Neither Neil and Lambert, nor Neil and Doblanko, were *directly* adverse to one another in the legal matters on which the law firm represented them. Neil was not a party to Lambert's divorce, nor to any action in which Doblanko was involved. The adversity of interests was *indirect*: it stemmed from the strategic linkage between the matters, rather than from Neil being directly pitted against Lambert or Doblanko in either of the matters.

35 Second, the bright line rule applies only when clients are adverse in *legal* interest. The main area of application of the bright line rule is in civil and criminal proceedings. *Neil* and *Strother* illustrate this limitation. The interests in *Neil* were not legal, but rather strategic. In *Strother*, they were commercial:

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> ... the conflict of interest principles do not generally preclude a law firm or lawyer from acting concurrently for different clients who are in the same line of business, or who compete with each other for business... .
>
> The clients' respective "interests" that require the protection of the duty of loyalty have to do with the practice of law, not commercial prosperity. Here the alleged "adversity" between concurrent clients related to business matters. [paras. 54-55, *per* Binnie J.]

36 Third, the bright line rule cannot be successfully raised by a party who seeks to abuse it. In some circumstances, a party may seek to rely on the bright line rule in a manner that is "tactical rather than principled": *Neil*, at para. 28. The possibility of tactical abuse is especially high in the case of institutional clients dealing with large national law firms. Indeed, institutional clients have the resources to retain a significant number of firms, and the retention of a single partner in any Canadian city can disqualify all other lawyers within the firm nation-wide from acting against that client. As Binnie J. remarked,

> [i]n an era of national firms and a rising turnover of lawyers, especially at the less senior levels, the imposition of exaggerated and unnecessary client loyalty demands, spread across many offices and lawyers who in fact have no knowledge whatsoever of the client or its particular affairs, may promote form at the expense of substance, and tactical advantage instead of legitimate protection. [Emphasis added; para. 15.]

Thus, clients who intentionally create situations that will engage the bright line rule, as a means of depriving adversaries of their choice of counsel, forfeit the benefit of the rule. Indeed, institutional clients should not spread their retainers among scores of leading law firms in a purposeful attempt to create potential conflicts.

[page667]

37 Finally, the bright line rule does not apply in circumstances where it is unreasonable for a client to expect that its law firm will not act against it in unrelated matters. In *Neil*, Binnie J. gave the example of "professional litigants" whose consent to concurrent representation of adverse legal interests can be inferred:

> In exceptional cases, consent of the client may be inferred. For example, governments generally accept that private practitioners who do their civil or criminal work will act against them in unrelated matters, and a contrary position in a particular case may, depending on the circumstances, be seen as tactical rather than principled. Chartered banks and entities that could be described as professional litigants may have a similarly broad-minded attitude where the matters are sufficiently unrelated that there is no danger of confidential information being abused. These exceptional cases are explained by the notion of informed consent, express or implied. [para. 28]

In some cases, it is simply not reasonable for a client to claim that it expected a law firm to owe it exclusive loyalty and to refrain from acting against it in unrelated matters. As Binnie J. stated in *Neil*, these cases are the exception, rather than the norm. Factors such as the nature of the relationship between the law firm and the client, the terms of the retainer, as well as the types of

matters involved, may be relevant to consider when determining whether there was a reasonable expectation that the law firm would not act against the client in unrelated matters. Ultimately, courts must conduct a case-by-case assessment, and set aside the bright line rule when it appears that a client could not reasonably expect its application.

[page668]

(h) *The Substantial Risk Principle*

38 When a situation falls outside the scope of the bright line rule for any of the reasons discussed above, the question becomes whether the concurrent representation of clients creates a substantial risk that the lawyer's representation of the client would be materially and adversely affected. The determination of whether there exists a conflict becomes more contextual, and looks to whether the situation is "liable to create conflicting pressures on judgment" as a result of "the presence of factors which may reasonably be perceived as affecting judgment": Waters, Gillen and Smith, at p. 968. In addition, the onus falls upon the client to establish, on a balance of probabilities, the existence of a conflict - there is only a deemed conflict of interest if the bright line rule applies.

(i) *Practical Implications*

39 When a law firm is asked to act against an existing client on an unrelated matter, it must determine whether accepting the retainer will breach the bright line rule. It must ask itself whether (i) the immediate *legal* interests of the new client are directly adverse to those of the existing client, (ii) the existing client has sought to exploit the bright line rule in a tactical manner; and (iii) the existing client can reasonably expect that the law firm will not act against it in unrelated matters. In most cases, simultaneously acting for and against a client in legal matters will result in a breach of the bright line rule, with the result that the law firm cannot accept the new retainer unless the clients involved grant their informed consent.

40 If the law firm concludes that the bright line rule is inapplicable, it must then ask itself whether accepting the new retainer will create a substantial risk of impaired representation. If the answer is no, then the law firm may accept the retainer. In the [page669] event that the existing client disagrees with the law firm's assessment, the client may bring a motion before the courts to prevent the firm from continuing to represent the adverse party. In this manner, the courts will be called upon to further develop the contours of the bright line rule, and to ensure that lawyers do not act in matters where they cannot exercise their professional judgment free of conflicting pressures.

(j) *Summary*

41 The bright line rule is precisely what its name implies: a bright line rule. It cannot be rebutted or otherwise attenuated. It applies to concurrent representation in both related *and* unrelated matters. However, the rule is limited in scope. It applies only where the *immediate* interests of clients are *directly* adverse in the matters on which the lawyer is acting. It applies only to legal - as opposed to commercial or strategic - interests. It cannot be raised tactically. And it does not apply in circumstances where it is unreasonable for a client to expect that a law firm will not act against it in unrelated matters. If a situation falls outside the scope of the rule, the applicable test

is whether there is a substantial risk that the lawyer's representation of the client would be materially and adversely affected.

42 I now turn to the other dimensions of the duty of loyalty which are relevant to the present appeal.

2. The Duty of Commitment to the Client's Cause

43 The duty of commitment is closely related to the duty to avoid conflicting interests. In fact, the lawyer must avoid conflicting interests precisely so that he can remain committed to the client. Together, these duties ensure "that a divided loyalty does not cause the lawyer to 'soft peddle' his or her [representation] of a client out of concern for another client": *Neil*, at para. 19.

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44 The duty of commitment prevents the lawyer from undermining the lawyer-client relationship. As a general rule, a lawyer or law firm should not summarily and unexpectedly drop a client simply in order to avoid conflicts of interest with existing or future clients. This is subject to law society rules, which may, for example, allow law firms to end their involvement in a case under the terms of a limited scope retainer: see, for example, Law Society of Upper Canada, *Rules of Professional Conduct* (online), r. 2.02(6.1) and (6.2); Law Society of Alberta, *Code of Conduct* (online), Commentary to r. 2.01(2); Nova Scotia Barristers' Society, *Code of Professional Conduct* (online), rr. 3.2-1A and 7.2-6A.

3. The Duty of Candour

45 A lawyer or law firm owes a duty of candour to the client. This requires the law firm to disclose any factors relevant to the lawyer's ability to provide effective representation. As Binnie J. stated in *Strother*, at para. 55: "The thing the lawyer must not do is keep the client in the dark about matters he or she knows to be relevant to the retainer" (emphasis deleted).

46 It follows that as a general rule a lawyer should advise an existing client before accepting a retainer that will require him to act against the client, even if he considers the situation to fall outside the scope of the bright line rule. At the very least, the existing client may feel that the personal relationship with the lawyer has been damaged and may wish to take its business elsewhere.

47 I add this. The lawyer's duty of candour towards the existing client must be reconciled with the lawyer's obligation of confidentiality towards his new client. In order to provide full disclosure to the existing client, the lawyer must first obtain the consent of the new client to disclose the existence, nature and scope of the new retainer. If the new client refuses to grant this consent, the lawyer will be unable to fulfill his duty of candour and, consequently, must decline to act for the new client.

[page671]

C. *Application of the Principles*

48 All three of the duties that flow from the lawyer's duty of loyalty are engaged in this case: the

duty to avoid conflicting interests; the duty of commitment to the client's cause; and the duty of candour to the client. I will deal with each in turn.

1. The Duty to Avoid Conflicting Interests

49 The question here is whether McKercher's concurrent representation of CN and Wallace fell within the scope of the bright line rule. I conclude that it did.

50 The bright line rule prevents the concurrent representation of clients whose immediate legal interests are directly adverse, subject to the limitations discussed in these reasons. The fact that the Wallace and CN retainers were legally and factually unrelated does not prevent the application of the bright line rule.

51 Here, the bright line rule is applicable. The immediate interests of CN and Wallace were directly adverse, and those interests were legal in nature. Indeed, McKercher helped Wallace bring a class action directly against CN. In addition, there is no evidence on the record that CN is seeking to use the bright line rule tactically. Nothing suggests that CN has been purposefully spreading out its legal work across Saskatchewan law firms in an attempt to prevent Wallace or other litigants from retaining effective legal counsel. The motion judge accepted the testimony of CN's general counsel and concluded that CN was acting "on a principled basis, and not merely for tactical reasons": para. 62. I find no palpable and overriding error in this conclusion.

52 Finally, it was reasonable in these circumstances for CN to expect that McKercher would [page672] not act for Wallace. I agree with the motion judge's findings on this point:

> The solicitor and client had a longstanding relationship. CN used the McKercher Firm as the "go to" firm. Although there were at least two other firms in Saskatchewan that also did CN's legal work, I accept the testimony of Mr. Chouc, that the McKercher Firm was its primary firm within this province... . The lawsuit commenced seeks huge damages against CN and alleges both aggravated and punitive damages, which connote a degree of moral turpitude on the part of CN. Simply put, it is hard to imagine a situation that would strike more deeply at the loyalty component of the solicitor-client relationship. [para. 56]

In other words, it was reasonable for CN to be surprised and dismayed when its primary legal counsel in the province of Saskatchewan sued it for $1.75 billion.

53 Consequently, the facts of this appeal fall within the scope of the bright line rule. McKercher breached the rule, and by extension its duty to avoid conflicting interests, when it accepted to represent Wallace without first obtaining CN's informed consent.

54 However, I cannot agree that this is a situation where there also exists a risk of misuse of confidential information. CN's contention that McKercher obtained confidential information that might assist it on the Wallace matter - namely, a general understanding of CN's litigation philosophy - does not withstand scrutiny. "[M]erely ... making a bald assertion that the past relationship has provided the solicitor with access to ... litigation philosophy" does not suffice: *Moffat v. Wetstein* (1996), 29 O.R. (3d) 371 (Gen. Div.), at p. 401. "There is a distinction between possessing information that is relevant to the matter at issue and having an understanding of the corporate philosophy" of a previous client: *Canadian Pacific Railway v.*

Aikins, MacAulay & Thorvaldson (1998), 23 C.P.C. (4th) 55 (Man. C.A.), at para. 26. The information must be capable of being used against the client in some tangible manner. In the present case, the real estate, [page673] insolvency, and personal injury files on which McKercher worked were entirely unrelated to the Wallace action, and CN has failed to show how they or other matters on which McKercher acted could have yielded *relevant* confidential information that could be used against it.

2. The Duty of Commitment to the Client's Cause

55 The duty of commitment to the client's cause suggests that a law firm should not summarily and unexpectedly terminate a retainer as a means of circumventing conflict of interest rules. The McKercher firm had committed itself to act loyally for CN on the personal injury, real estate and receivership matters. McKercher was bound to complete those retainers, unless the client discharged it or acted in a way that gave McKercher cause to terminate the retainers. McKercher breached its duty of commitment to CN's causes when it terminated its retainer with CN on two of these files. It is clear that a law firm cannot terminate a client relationship purely in an attempt to circumvent its duty of loyalty to that client: *De Beers Canada Inc. v. Shore Gold Inc.*, 2006 SKQB 101, 278 Sask. R. 171, at para. 17; *Toddglen Construction Ltd. v. Concord Adex Developments Corp.* (2004), 34 C.L.R. (3d) 111 (Ont. S.C.J., *per* Master Sandler).

56 The conclusion on this point is supported by the obligation imposed on McKercher by its Law Society that it not withdraw its services from a client without good cause and appropriate notice: see the ethical rules applicable at the relevant time, Law Society of Saskatchewan, *Code of Professional Conduct* (1991), c. XII, at p. 47. The desire to accept a new, potentially lucrative client did not provide good cause to withdraw services from CN.

[page674]

3. The Duty of Candour

57 The McKercher firm breached its duty of candour to CN by failing to disclose to CN its intention to accept the Wallace retainer.

58 It bears repeating: a lawyer must not "keep the client in the dark about matters he or she knows to be relevant to the retainer": *Strother*, at para. 55. As discussed, this rule must be broadly construed to give the client an opportunity to judge for itself whether the proposed concurrent representation risks prejudicing its interests and if so, to take appropriate action.

59 CN should have been given the opportunity to assess McKercher's intention to represent Wallace and to make an appropriate decision in response - whether to terminate its existing retainers, continue those retainers, or take other action. Instead, CN only learned that it was being sued by its own lawyer when it received a statement of claim. This is precisely the type of situation that the duty of candour is meant to prevent.

D. *The Appropriate Remedy*

60 I have concluded that accepting the Wallace retainer placed McKercher in a conflict of interest, and that McKercher breached its duties of commitment and candour to CN. The

question is whether McKercher should be disqualified from representing the Wallace plaintiffs because its acceptance of the Wallace retainer breached the duty of loyalty it owed CN.

61 As discussed, the courts in the exercise of their supervisory jurisdiction over the administration of justice in the courts have inherent jurisdiction to remove law firms from pending litigation. Disqualification may be required: (1) to avoid the risk of improper use of confidential information; (2) to avoid the risk of impaired representation; and/or (3) to maintain the repute of the administration of justice.

[page675]

62 Where there is a need to prevent misuse of confidential information, as set out in *Martin*, disqualification is generally the only appropriate remedy, subject to the use of mechanisms that alleviate this risk as permitted by law society rules. Similarly, where the concern is risk of impaired representation as set out in these reasons, disqualification will normally be required if the law firm continues to concurrently act for both clients.

63 The third purpose that may be served by disqualification is to protect the integrity and repute of the administration of justice. Disqualification may be required to send a message that the disloyal conduct involved in the law firm's breach is not condoned by the courts, thereby protecting public confidence in lawyers and deterring other law firms from similar practices.

64 In assessing whether disqualification is required on this ground alone, all relevant circumstances should be considered. On the one hand, acting for a client in breach of the bright line rule is always a serious matter that on its face supports disqualification. The termination of the client retainers - whether through lawyer withdrawal or through a client firing his lawyer after learning of a breach - does not necessarily suffice to remove all concerns that the lawyer's conduct has harmed the repute of the administration of justice.

65 On the other hand, it must be acknowledged that in circumstances where the lawyer-client relationship has been terminated and there is no risk of misuse of confidential information, there is generally no longer a concern of ongoing prejudice to the complaining party. In light of this reality, courts faced with a motion for disqualification on this third ground should consider certain factors that may point the other way. Such factors may include: (i) behaviour disentitling the complaining party from [page676] seeking the removal of counsel, such as delay in bringing the motion for disqualification; (ii) significant prejudice to the new client's interest in retaining its counsel of choice, and that party's ability to retain new counsel; and (iii) the fact that the law firm accepted the conflicting retainer in good faith, reasonably believing that the concurrent representation fell beyond the scope of the bright line rule and applicable law society restrictions.

66 Against this background, I return to this appeal. The motion judge concluded that the appropriate remedy was to disqualify McKercher from the Wallace action. He based this conclusion on a variety of factors - in particular, he focused on what he perceived to be CN's justified sense of betrayal, the impairment of McKercher's ability to continue to represent CN on the ongoing retainers, and the risk of misuse of confidential information. Some of these considerations were not relevant. Here, disqualification is not required to prevent the misuse of confidential information. Nor is it required to avoid the risk of impaired representation. Indeed, the termination of the CN retainers that McKercher was working on ended the representation.

The only question, therefore, is whether disqualification is required to maintain public confidence in the justice system.

67 As discussed, a violation of the bright line rule on its face supports disqualification, even where the lawyer-client relationship has been terminated as a result of the breach. However, it is also necessary to weigh the factors identified above, which may suggest that disqualification is inappropriate in the circumstances. The motion judge did not have the benefit of these reasons, and obviously could not consider all of the factors just discussed that are relevant to the issue of disqualification. [page677] These reasons recast the legal framework for judging McKercher's conduct and determining the appropriate remedy. Fairness suggests that the issue of remedy should be remitted to the court for consideration in accordance with them.

IV. Conclusion

68 I would allow the appeal and remit the matter to the Queen's Bench to be decided in accordance with these reasons. I would award costs to the appellant, CN.

Appeal allowed with costs.

Solicitors:

Solicitors for the appellant: MacPherson Leslie & Tyerman, Saskatoon.

Solicitors for the respondents: Heenan Blaikie, Toronto.

Solicitors for the intervener the Canadian Bar Association: McCarthy Tétrault, Toronto.

Solicitors for the intervener the Federation of Law Societies of Canada: Hunter Litigation Chambers, Vancouver; Fasken Martineau DuMoulin, Vancouver.

Rice v. Smith, [2013] O.J. No. 784

Ontario Judgments

Ontario Superior Court of Justice

I.F. Leach J.

Heard: January 30, 2013.

Judgment: February 25, 2013.

Court File No. 6873/12

[2013] O.J. No. 784 | 2013 ONSC 1200

Between James Rice, Applicant, and Barry Smith, Chung-Lie Ting and BLS Textiles Inc., Respondents

(66 paras.)

Case Summary

Civil litigation — Civil procedure — Parties — Representation of parties — Disqualification or removal of counsel — Application by applicant for oppression remedy for removal of counsel of record for majority shareholders and corporation allowed — Counsel had been involved in ouster of applicant from company and was probable witness in oppression proceeding — Counsel could not act for both majority shareholders and corporation, as this was conflict of interests — Corporation ordered to retain new counsel separate from that of majority shareholders.

Corporations, partnerships and associations law — Corporations — Oppression remedy — Application by applicant for oppression remedy for removal of counsel of record for majority shareholders and corporation allowed — Counsel had been involved in ouster of applicant from company and was probable witness in oppression proceeding — Counsel could not act for both majority shareholders and corporation, as this was conflict of interests — Corporation ordered to retain new counsel separate from that of majority shareholders.

Legal profession — Barristers and solicitors — Retention of counsel — Representation — Application for removal of counsel — Counsel as witness — Relationship with client — Conflict of interest — Lawyer acting for more than one party — Application by applicant for oppression remedy for removal of counsel of record for majority shareholders and corporation allowed — Counsel had been involved in ouster of applicant from company and was probable witness in oppression proceeding — Counsel could not act for both majority shareholders and corporation, as this was conflict of interests — Corporation ordered to retain new counsel separate from that of majority shareholders — Law Society of Upper Canada Rules of Professional Conduct, Rules 2.02, 2.04, 4.02.

Professional responsibility — Self-governing professions — Independence — Conflicts of

interest — Professions — Legal — Barristers and solicitors — Application by applicant for oppression remedy for removal of counsel of record for majority shareholders and corporation allowed — Counsel had been involved in ouster of applicant from company and was probable witness in oppression proceeding — Counsel could not act for both majority shareholders and corporation, as this was conflict of interests — Corporation ordered to retain new counsel separate from that of majority shareholders.

Motion by Rice for an order removing McDonald as counsel of record for Smith, Ting and BLS Textiles, or alternatively, to remove McDonald as counsel for BLS only. Rice, Smith and Ting acted as shareholders, officers and directors of BLS until disputes between the individual parties arose. At one point, Ting had BLS valued and McDonald, then corporate counsel for BLS, met with Rice and Smith to discuss Rice buying out Smith. Unable to reach an agreement, the dispute continued until Rice's rights as a shareholder, officer and director were removed through the actions of Smith and Ting. McDonald was the person who actually terminated Rice from his position with BLS, alleging Rice had shared confidential BLS information with outsiders. Rice commenced the present proceeding as an application for a remedy from oppression, naming BLS as a defendant because it would be impacted by any decision. McDonald admitted to being involved in the meeting with Rice and Smith, but claimed he never acted for Rice, and admitted he dismissed Rice from employment. He nonetheless took the position he could act for Smith, Ting and BLS in the oppression proceedings because there was no reason to call him as a witness and because he was not in a conflict position.

HELD: Motion allowed.

McDonald was removed as solicitor of record for all the respondents. BLS was to retain counsel separate from that retained by Smith and Ting. McDonald could not act as a solicitor for any of the parties in the litigation. His evidence about the circumstances surrounding Rice's termination was necessary for the case. There was a legitimate probability Rice would call McDonald as a witness, even if Smith, Ting and BLS did not do so. McDonald's joint representation of BLS and its majority shareholders and directors also represented an impermissible conflict of interest.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, *R.S.C. 1985, c. C-44, s. 214*, s. 241

Law Society of Upper Canada Rules of Professional Conduct, Rule 2.02(1.1), Rule 2.04, Rule 2.04(1), Rule 2.04(2), Rule 2.04(3), Rule 2.04(6), Rule 4.02

Ontario Rules of Civil Procedure, Rule 15.01

Counsel

Mavis J. Butkus, for the Applicant.

John W. Findlay, for the Defendants.

I.F. LEACH J.

1 Before me is a motion by the Applicant for an order removing John W. McDonald ("McDonald") as lawyer of record for all of the Respondents.

2 In the alternative, the Applicant seeks an order removing McDonald as lawyer of record for the corporate Respondent, BLS Textiles Inc. ("BLS").

Background

3 The motion is brought within the larger context of an application to address and resolve various issues stemming from a serious dispute between the only three shareholders and directors of BLS: the Applicant James Rice ("Rice"), and the individual Respondents Barry Smith ("Smith") and Chung-Lie Ting ("Ting").

4 Litigation of the application has not yet progressed to examinations in relation to the extended affidavit and documentary evidence filed by the parties, and the substantive merits of the application, (including underlying factual disputes), are not before me for resolution. These reasons accordingly should not be taken as any binding determination in that regard.

5 However, by way of background:

* BLS is incorporated federally, pursuant to the laws of Canada, and is based in Cambridge, Ontario. It apparently was founded by Smith in late 2005 or early 2006, and initially focused on the sale and marketing of textiles, including high performance fabrics like Kevlar.
* Ting joined BLS at some point between 2006 and 2008, during which time the company's operations included, to some extent at least, production of body armour components.
* Rice joined BLS in 2008, after spending many years with the Canadian Armed Forces and in private business acquiring and developing experience and expertise relating to terminal ballistics and armour protection for personnel and vehicles.
* The formal corporate arrangements put in place in 2008, (by way of a share purchase agreement, a unanimous shareholders' agreement, director election by the shareholders, and corporate by-law enactment), resulted in the following BLS shareholdings: Smith 37.5 percent; Ting 37.5 percent; and Rice 25 percent. All three individuals were directors of BLS. All three individuals also continued to work for the company in various officer and employee capacities.
* The business of BLS grew rapidly through extensive production and supply of products used by police for vehicle and personnel protection, and it now annually generates many millions of dollars in sales. However, relations between the shareholders deteriorated over the course of 2010 and 2011. The reasons for this are disputed. In broad terms:

    * The Applicant contends that the shareholders' respective efforts and involvement in the operations of BLS were disproportionate and inequitable, resulting in friction that was compounded by disagreements concerning corporate financing and future business plans. All of this is said to have prompted unsuccessful discussions and proposals, (explored and developed with appropriate professional assistance), concerning further share sale and purchase arrangements. These included efforts by Ting to obtain a business valuation, (as a prelude to overall sale of BLS or a sale of Ting's interest in the company), and efforts by Rice to investigate and propose his purchase of the shares held by Smith and Ting; a possibility discussed at a meeting or meetings between Rice, Smith and McDonald in November of 2011. When these various discussions and proposals failed, and relations became acrimonious, Smith and Ting allegedly abused their majority shareholding to exclude Rice and effectively appropriate his interest in BLS, relying on various baseless allegations of misconduct.

    * The Respondents contend that Rice wrongly breached his fiduciary duties owed to BLS, breached corporate confidence and/or otherwise misappropriated confidential information of BLS, violated BLS rights of intellectual property (including patent rights), and interfered with the contractual relations of BLS. These allegations are based, in part, on Rice's sharing of otherwise confidential BLS information, (such as financial statements and plans), with his banker, accountant and lawyers.

* In any case, it is common ground that, during a meeting on March 12, 2012, (attended by Rice, Smith, Ting and McDonald), Rice's employment by BLS was terminated, in circumstances addressed in more detail below. Although apparently excluded thereafter from any involvement in the business operations of BLS, or any formal director or shareholder communications or meetings, Rice formally remains a director and shareholder of the company.

* The application herein was commenced by Rice on May 9, 2012. It seeks minority shareholder oppression remedies pursuant to sections 214 and 241 of the *Canada Business Corporations Act*, *R.S.C. 1985, c.C-44*., ("CBCA"), because the majority shareholders (Smith and Ting) allegedly have conducted the business affairs of BLS in a manner that is oppressive, unfairly prejudicial to and unfairly disregards the interest of Rice. In essence, Rice alleges that Smith and Ting have abused their majority shareholding interest to wrongfully terminate and exclude Rice from the operations of BLS, while simultaneously refusing any further financial compensation for his termination or financial interest in the company, (e.g., by way of repayment of his outstanding shareholder loans and/or purchase of his shares). The notice of application formally names Smith, Ting and BLS as respondents. However, a review of the notice of application and supporting affidavit makes it clear, I think, that Rice's formal complaints of misconduct really are directed at Smith and Ting alone, and that the company has been added as a named respondent only because it obviously would be a party affected by a number of oppression remedies permitted by the CBCA and sought by Rice; (e.g., appointment of a liquidator or receiver/manager to wind up the company's affairs, sell its assets, and distribute its property).

* Shortly after service of the application record, McDonald delivered a notice of appearance on behalf of Smith, Ting and BLS. This was followed by delivery of a

responding motion record on or about June 4, 2012. These documents made it clear that McDonald was intending to act as lawyer of record for all three of the Respondents.

* Active litigation of the matter then was delayed for a time pending attempts to mediate a resolution. However, a mediation carried out on August 21, 2012, was unsuccessful.
* By way of a letter dated August 28, 2012, (prior to the next formal return of the application following the failed mediation), McDonald was advised that Rice would be taking steps to restrain McDonald's further formal representation of the Respondents in the litigation, based on his involvement in "critical meetings" between the parties in November of 2011 and March of 2012, and McDonald's "direct participation in the events leading to Mr Rice's ouster from the company". The letter apparently failed to prompt any steps by the Respondents to secure new legal representation.
* On September 17, 2012, Rice initiated the motion now before me, seeking McDonald's removal as lawyer of record.
* On October 18, 2012, the Respondents served their responding motion record, which contains an affidavit sworn by McDonald the day before. McDonald was cross-examined on that affidavit on January 8, 2013.

6 It is also important to note that, at some unspecified point during the above chronology, the parties came to agree that proper resolution of this matter will require the documentary and oral discovery procedures normally associated with an action, as well as a trial. McDonald currently intends to represent all of the Respondents at that trial.

McDonald Involvement

7 Affidavits sworn by Rice in support of his application and present motion detail McDonald's involvement in events leading to the present litigation, and that evidence is not contradicted by the Respondents or McDonald. (To the contrary, the Respondents and McDonald emphasize their agreement with that evidence as a suggested reason why it is unnecessary to remove McDonald as the Respondents' lawyer of record.)

8 McDonald himself nevertheless supplemented Rice's evidence during the course of cross-examination on his affidavit.

9 In the result, the largely undisputed evidence before me includes the following:

i. McDonald attended and actively participated in a dinner meeting between Rice and Smith in Cambridge on November 28, 2011, at which there were extended discussions concerning the possibility of Rice purchasing Smith's shares in BLS. This included review of how the shares would be valued, (by reference to the business valuation previously commissioned by Ting), how the transaction might be structured, (upfront cash payment and a form of vendor take-back financing, coupled with further post-sale compensation to Smith through consulting arrangements), and how it generally might be financed by Rice. During the course of these conversations:

a. McDonald's comments made it clear that he already was privy to certain confidential information, (such as the business valuation obtained by Ting).

b. It also clearly was understood that Rice would need to investigate the feasibility of the contemplated proposal by consultation with his professional advisors and prospective lenders. Indeed, McDonald went so far as to expressly indicate to Rice that this should be done. Smith and McDonald knew, at the time of the meeting, that Rice necessarily would provide his advisors and prospective lenders with information such as the BLS financial statements, business plan and business valuation.

c. McDonald also expressly opined to Smith that the contemplated buyout "was exactly what Smith should be seeking". This comment and the nature of the discussions strongly suggest that McDonald was there to advise Smith personally, (which was the perception of Rice at the time). However, McDonald took the position during his subsequent cross-examination that he had attended the meeting in question only as BLS corporate counsel, and was not yet acting for Smith personally.

ii. McDonald also attended and actively participated in the meeting on March 12, 2012, during which Rice was formally terminated as an officer and employee of BLS. Although the meeting also was attended by Smith and Ting, there is no dispute that McDonald immediately "took charge of the meeting"; e.g., informing Rice of his termination for cause, articulating the alleged grounds for termination, taking possession of Rice's keys, and indicating what Rice then should do regarding removal of his personal effects and further contact. (It seems that Smith and Ting said little or nothing at the meeting.) McDonald also then sent Rice a letter later that day, confirming what had been done.

iii. McDonald had known Smith for years prior to his retention as corporate counsel by Smith and Ting. However, McDonald indicates that his only solicitor-client relationship has been with BLS, (at least prior to his going on record as lawyer for all three Respondents in this litigation). McDonald also has confirmed that his related legal services, (including those provided in relation to Rice's termination and all subsequent efforts to oppose Rice's application), have been and are being paid entirely by BLS. McDonald has "never submitted a legal bill to Mr Smith or Mr Ting".

iv. In his professed role as BLS corporate counsel, McDonald freely acknowledges that he did not and has not consulted with or taken instructions in whole or in part from Rice, (e.g., about suggestions or suspicion of misconduct by Rice), despite his awareness that Rice was and is a director and shareholder of the company. In McDonald's opinion, there was "no requirement to consult with him", and "no reason to" do so. McDonald similarly was of the "opinion that it was unnecessary" to attend any formal shareholder or director meetings to consider Rice's termination. Generally, McDonald has confirmed that he saw and sees no conflict as corporate counsel in accepting instructions from only two of the three directors and officers to terminate the third. More generally, it seems that, throughout his involvement with BLS, his opinions and advice to the corporation and its directors normally have been verbal and undocumented, and delivered only to two of the corporation's three directors and shareholders.

v. McDonald took an active role in personally investigating Rice's alleged misconduct, and McDonald actually was the one who made the decision to terminate Rice. In that regard, McDonald generally described the decision making and execution process in the following terms: "I said, 'We will terminate him.' They didn't want to be involved in it. I said, 'No problem. I'll do it."

10 It is also noteworthy that, during cross-examination on McDonald's affidavit, various requests by the applicant's counsel for disclosure from the Respondents and their current lawyer of record were met with assertions of confidentiality and privilege.

Overview of positions

11 Rice takes issue with McDonald's continued representation of the Respondents on two grounds:

i. McDonald's involvement in key events and communications underlying the litigation inherently prevents his taking the matter to trial. Doing so inevitably would trigger longstanding policy concerns of fairness and propriety associated with a lawyer assuming the dual role of counsel and witness.

ii. In disputes of this nature, (between majority and minority shareholders of a corporation), a lawyer may not properly represent both the corporation and one group of shareholders, to the exclusion of the other group of shareholders. Doing so inherently and unavoidably raises conflict of interest concerns already manifest in this case.

12 The Respondents and McDonald emphasize the importance of protecting and preserving the right of litigants to select their own representation, and the need to restrain assaults on that right through challenges that may be motivated by adversarial tactics rather than principle. In that regard, they argue in particular that "the timing of this motion is questionable and entirely too late". They also argue that the applicant's stated concerns are baseless, for reasons that include the following:

i. At this point, they say, the applicant has failed to establish any likelihood of McDonald being a witness at trial. The Respondents and McDonald are not challenging the applicant's evidence as to what occurred during the meetings in November of 2011 and March of 2012. Moreover, Smith and/or Ting can and will be called as witnesses, available for cross-examination, in relation to those events and/or the investigation that was relied upon before and after Rice's termination to justify his exclusion from the corporation, (even if that investigation was carried out by McDonald). Given such considerations, and what they view as the unsettled nature of the issues in dispute, the Respondents contend that the current motion is, at the very least, premature.

ii. The Respondents deny the existence of any actual or prospective conflict of interest. In that regard, they emphasize that McDonald has "never acted for Rice", and consistently has avoided any interaction with Rice, (e.g., by retainer agreements, emails, reporting letters, accounts or meetings with Rice or his advisors), that would suggest otherwise. At all times, McDonald has instead taken his advice from, and reported to, the majority shareholders who effectively control

> the corporation. As those shareholders have the ability to select legal representation and determine legal instructions in any event, regardless of what Rice may think as a minority shareholder, the Respondents say that forcing BLS and the majority shareholders to obtain separate legal representation would create nothing but unnecessary complication and expense.

13 For the reasons that follow, I believe the concerns raised by Rice are significant and have merit, and that they necessitate McDonald's removal as lawyer of record for any respondent in this litigation.

Conflict of Interest and Lawyer Removal - General Principles

14 Our courts repeatedly have emphasized the right of litigants not to be deprived of their counsel of choice without good cause.

15 In particular, deprivation of preferred counsel imposes inherent hardship on a litigant, and such relief therefore should be ordered only where it is necessary to prevent the imposition of a more serious injustice, and the risk of real mischief.[1]

16 However, the courts' respect for preferred representation is tempered by ongoing concern to maintain the high standards of the legal profession and the integrity of the justice system, and this includes the courts' inherent jurisdiction to remove from the record lawyers who have a conflict of interest.[2]

17 In the exercise of that jurisdiction, courts are not bound by the codes of professional conduct to which lawyers must adhere. However, those codes reflect centuries of experience, are persuasive, and their importance has been recognized by the Supreme Court of Canada.[3]

18 One specific conflict of interest concern, (identified by almost identical provisions and commentaries in the codes of professional conduct adopted by the Canadian Bar Association and the Law Society of Upper Canada), is addressed by the long-established prohibition on a lawyer simultaneously acting as counsel and witness. In particular, a "lawyer must not in effect become an unsworn witness or put the lawyer's credibility in issue", and the "lawyer who is a necessary witness should testify and entrust the conduct of the case to someone else".[4]

19 The particular conflict of interest prohibition dealing with "lawyer as witness" is intended to prevent the inevitable conflict of interest a lawyer otherwise would have between the duty owed to his or her client, and duties of independence otherwise owed to others, especially the Court.[5] In particular, lawyers are independent officers of the court, and a trial judge must be able to rely upon counsel for a high degree of objectivity and detachment. That fundamental relationship is compromised, and the administration of justice and integrity of the system accordingly are undermined, where the objectivity and credibility of counsel necessarily are subjected to challenge in the course of determining the substantive merits of an underlying dispute.[6]

20 However, rather than approach the general "lawyer as witness" conflict of interest concern and prohibition as an absolute rule, our courts adopt a flexible approach and consider each case on its own merits, having regard to a variety of factors that, according to the circumstances of the case, may include the following:

a. the stage of the proceedings;
b. the likelihood that the witness will be called;
c. the good faith (or otherwise) of the party making the application;
d. the significance of the evidence to be led;
e. the impact of removing counsel on the party's right to be represented by counsel of choice;
f. whether trial is by judge or jury;
g. the likelihood of a real conflict arising or that the evidence will be "tainted";
h. who will call the witness; and i. the connection or relationship between counsel, the prospective witness and the parties involved in the litigation.[7]

21 The above principles focus on "lawyer as witness" conflict of interest concerns.

22 More generally, however, lawyers must not place themselves in any situation, or act or continue to act in a matter, where there is or is likely to be a conflicting interest. This includes situations where a lawyer owes conflicting duties of representation and confidentiality to parties on both sides of a legal dispute.[8]

23 Of course, there are many varied circumstances in which such concerns might arise.

24 However, authorities repeatedly have identified corporate shareholder disputes as situations involving inherent conflicts of interest that effectively restrict a lawyer's ability to extend joint representation.

25 In particular, as emphasized by the professional codes of conduct, a lawyer representing a corporate organization must remember at all times that the corporation has a legal personality distinct from its individual directors and shareholders, and that those interests may very well diverge, thereby preventing a lawyer's continued involvement in an internal corporate dispute.[9]

26 In matters of legal representation, it accordingly is a fundamental error to regard a corporation as being synonymous with its majority directors and shareholders.

27 Doing so almost inevitably leads to a corporate lawyer's disregard of obligations owed to the corporate body and structure as a whole, in favour of a particular corporate faction. Most notably, the corporate lawyer effectively may ignore his or her obligation to seek litigation instructions from the corporation's entire board of directors, and/or the lawyer's corresponding obligation to share otherwise confidential and privileged litigation information with all of the corporation's directors.

28 It also ignores possible and probable distinctions between the interests of the corporation and such a majority. For example, where conduct of the director or shareholder majority is the real focus of a litigation dispute with a director or shareholding minority, (rather than any conduct of the corporation *per se*), corporate payment of the majority's legal representation benefits the majority directors and shareholders but not the corporation. It also results in a situation where the minority shareholders effectively are being compelled to pay, at least in part, the legal fees of opposing legal counsel.

29 The above concerns have been highlighted in numerous cases emphasizing a lawyer's inability to jointly represent both a corporation and individual majority directors and shareholders in litigation focused on an internal corporate dispute. See, for example: *Mottershead v. Burdwood Bay Settlement Co.*, *[1991] B.C.J. No. 2554* (B.C.S.C.), ("*Mottershead*"); *Alles v. Maurice*, *[1992] O.J. No. 331* (S.C.J.); *Edwards-MacLeod Properties Ltd. v. 1037661 Ontario Ltd.*, *[2001] O.J. No. 145* (S.C.J.); and *Canadian Arctic Trading House Ltd. v. Bronstein*, *[2007] O.J. No. 3278* (S.C.J.).

30 The following comments from *Mottershead* case, at paragraphs 8-10, (expressly cited with approval by a number of the Ontario authorities noted above)[10], exemplify the underlying concerns and conflict of interest rationale for restricting and preventing such joint representation:

> In my view, it is clear that Mr Davies and his law firm are in a conflict of interest. As corporate solicitor and counsel for the Company, Mr Davies' duty is to the Company; as counsel for the three personal defendants, who are also the majority shareholders, his duty is to those individuals. *The best interests of the Company are not necessarily those of the majority shareholders and directors*. The Company is a separate legal entity and it is *no answer for Mr Davies to say that his instructions are from the individual majority shareholders as personal defendants are one and the same as those instructions which they provide as majority directors of the Company*. The duty of the solicitor for the Company is to advise *all* of the directors so that they may make an informed decision *as a board* with respect to the interests of the Company.
>
> In shareholder litigation, there exists a potential conflict of interest between the personal interests of the individual parties both plaintiffs and defendants as shareholders and their fiduciary duties as directors of the Company. *A solicitor acting both for the majority shareholders and for the Company on the sole basis of the instructions of that same majority personifies that conflict*.
>
> Moreover, a solicitor owes a duty of confidentiality to his or her client and information received from the majority shareholders in their capacity as personal defendants would be privileged. Sure a conflict arises when that solicitor receives privileged information in his capacity as solicitor for the majority shareholder defendants and declines to advise the board of directors *which includes the minority shareholders* of that information notwithstanding his role as corporate solicitor and counsel for the defendant Company.
>
> [Emphasis added.]

31 In the same case, the court expressly noted, in paragraph 14, the following examples of "an actual conflict of interest, and not simply the appearance of a conflict", arising from such joint representation:

a. payment of the majority shareholders' legal costs as a corporate expense effectively then assessed against all of the corporation's shares;
b. provision of legal opinions to the majority shareholders and not to the minority shareholders, who are also directors; and c. refusal to disclose litigation-related documents and information to minority directors and shareholders of the corporation, on the basis of purported solicitor-client privilege.

32 Where such conflict of interest concerns arise, the proper course is to require legal representation for the corporation, (if such representation is required), that is separate and distinct from the legal representation of the majority directors and shareholders. Ideally, such representation should be chosen independently of the litigating individuals. However, if no agreement in that regard is possible, and no acceptable means is found to make such an appointment, any shareholder should be given leave to make an appropriate application to the court. Similarly, if no means is found whereby corporate counsel may be properly instructed, the lawyer or lawyers in question may apply to the court for instructions.[11]

Application - McDonald as "Lawyer and Witness"

33 Should McDonald's involvement in the events underlying this litigation prevent his continued representation of the Respondents as lawyer of record, on the basis he is a potential witness?

34 Parties regularly act on the recommendations and advice of lawyers, who frequently communicate decisions made and positions adopted by their clients. Lawyer involvement in that limited sense should not necessarily disqualify continued lawyer involvement if a dispute evolves into formal litigation. Otherwise, a great many litigants automatically would be deprived of their preferred legal representation, in which they have invested considerable time and expense.

35 In this particular case, however, I think McDonald's involvement clearly transcends any status as advisor or communicator of decisions taken by clients. Nor was he merely a passive witness to the actions of others.

36 To the contrary, the evidence and McDonald's own admissions indicate the following:

a. McDonald was an active and major participant in at least two meetings of critical importance to this litigation; i.e., the meeting in November of 2011, (during which Rice arguably was given authority to share otherwise confidential information with third parties for a limited purpose), and the meeting in March of 2012, (during which Rice was terminated for reasons that are very much in dispute);[12]
b. McDonald was not only the principal actor but also the effective decision maker, as far as termination of Rice was concerned; and c. The Respondents justify their actions by reliance on the investigation personally carried out by McDonald into the activities of Rice.

37 I agree with the Applicant's submission that these are all critical events and matters that go to the heart of the substantive dispute between the parties.

38 The litigation realistically cannot be addressed and resolved without detailed examination of the circumstances in which Rice's sharing of information with others outside BLS may have been anticipated and expressly authorized, and reasonable inferences that might be drawn from any similar disclosure to others already made by Ting and/or Smith. In that regard, whether such disclosure was made to McDonald prior to his retention as lawyer for BLS is also relevant and important. Matters relating to the nature and timing of that representation therefore may be of critical importance.

39 Similarly, the litigation requires fulsome exploration of the suggestion that Rice's termination

for cause was motivated by bad faith and ulterior motives; an inference that may be supported by the termination having been undertaken prior to any adequate investigation of alleged misconduct.

40 McDonald is a participant and witness whose evidence would be significant in relation to all these matters.

41 In that regard, it is not a sufficient answer to the identified "lawyer as witness" concerns to say:

a. that the Respondents do not dispute the particular description of events set forth in Rice's affidavit evidence;

b. that the events of the termination meeting are confirmed by McDonald's letter sent later that day; or

c. that McDonald is an unnecessary witness because Smith and/or Ting can be called and cross-examined at trial to say what they observed on the relevant occasions, or simply confirm their reliance on information and documents stemming from McDonald's investigation, communications and/or decisions.

42 The parties now agree that the matter necessarily must move *beyond* affidavit evidence, and on to a full trial.

43 Moreover, this fundamentally is a case where both sides allege that things are not what the other side professes them to be. (For example, Rice contends that his supposed termination for cause is really a baseless attempt, through abuse of majority shareholding status, to appropriate his interest in the company without compensation. The Respondents contend that Rice's sharing of information and documentation with third parties was not part of any authorized or *bona fide* effort to investigate a share purchase, but a component of deliberate attempts by Rice to undermine the integrity of BLS for personal gain.)

44 In such circumstances, it is not enough to suggest that the parties may agree on what was said or done on a particular occasion without giving each party full opportunity to go beyond statements and conduct; i.e., by way of fulsome cross-examination to explore and test context, authority, motive and credibility.

45 In my opinion, McDonald is a material witness, and I am satisfied that there is a legitimate and real probability of his being called as such at trial by Rice, if not by the Respondents.

46 I see no evidence before me of any bad faith in that regard, but a legitimate recognition of the issues in dispute, and the inevitable need of Rice to properly explore and challenge the basis of the Respondents' conduct and position in the litigation.

47 In that regard, McDonald cannot be shielded from cross-examination by the Respondents' reliance on McDonald's own confirming letter, and/or a suggestion that Smith and/or Ting alone should be presented as witnesses to provide evidence of the conduct or statements of McDonald on which the Respondents relied.

48 Rice and his counsel should be permitted to cross-examine a material witness and participant directly.

49 If McDonald continues to represent the Respondents at trial, (which is his stated intention), and he is called as a witness, (which seems extremely likely), that would place counsel for Rice in the invidious position of having to cross-examine the counsel who is making the Respondents' primary case.

50 Moreover, the court effectively would be confronted with the inappropriate task of having to consider and assess the conduct and motives of an active participant in underlying events who also then appears as counsel at trial.

51 Contrary to the suggestions of the Respondents, I also think the above concerns actually are being raised at a very early stage of the formal litigation, at a time when any detrimental impact on the Respondents of requiring new representation will be relatively modest.

52 Apart from an unsuccessful attempt at mediation and steps taken in relation to this motion, the parties' actions in relation to the formal litigation have not progressed beyond the initial exchange of written application records.

53 The matter accordingly is at the threshold of the many additional steps required to ready the matter for trial now that the parties agree an action is required; (e.g., further pleadings, documentary production, oral discovery examinations, and trial preparation). It certainly is not nearly as far along the litigation track as other matters where the court necessarily has intervened, (sometimes on the eve of trial), to address and remedy obvious "lawyer as witness" concerns.[13]

54 For all these reasons, the "lawyer as witness" matters raised by Rice are valid and serious, and present sufficient justification to compel McDonald's withdrawal as lawyer of record in this litigation, for any of the Respondents.

Application - McDonald Joint Representation of Respondents

55 The above analysis is sufficient to warrant McDonald's removal as lawyer of record.

56 However, for the sake of completeness, and because it has relevance to the retention of new Respondent counsel, I find that McDonald's joint representation of BLS and the majority shareholders/directors also represents an impermissible conflict of interest.

57 In that regard, the situation before me manifests most if not all of the concerns highlighted in the *Mottershead* case and similar authorities.

58 In particular, while the Respondents put forward McDonald's lack of interaction with Rice as a positive consideration, his fundamental approach to the parties and the dispute actually underscores precisely the sort of impermissible conflict of interest problems identified by the authorities in relation to disputes of this nature.

59 For example:

a. On what basis has McDonald, in his professed role as lawyer for BLS, consistently and deliberately failed to consult in any manner whatsoever with Rice, as one of the corporation's directors and shareholders?

b. On what basis can McDonald, in his professed role as lawyer for BLS, refuse to provide Rice, one of the corporation's directors and shareholders, with prompt and complete disclosure of any and all litigation-related information and discussions McDonald has or will have via his interaction with Smith and Ting?

c. On what basis does McDonald, in his professed role as lawyer for BLS, justify billing the corporation for legal work done to defend the personal interests of Smith and Ting?

60 In my view, the real and only basis effectively relied upon by McDonald for his conduct is the one rejected by the authorities as inadequate and improper: the corporation's solicitor has paid insufficient regard to the distinct legal personality of the corporation, (which should guide the corporate lawyer's conduct), and has treated the corporation and its majority shareholders as being one and the same.

61 For the reasons outlined above, the authorities mandate that, in an internal corporate dispute such as the one now before the court, the corporation and the majority shareholders must have legal representation that is separate and distinct.

62 The circumstances demonstrate an actual conflict of interest in that regard, which also warrants McDonald's removal as lawyer of record.

63 When the corporation retains new counsel, for purposes of this litigation, the lawyer in question therefore should not also represent Smith and/or Ting.

Conclusion

64 An order therefore shall go as follows:

a. McDonald shall withdraw as lawyer of record for any respondent.

b. The corporate Respondent, (which requires representation by a lawyer pursuant to Rule 15.01 unless and until leave is sought and obtained to do otherwise), henceforth must be represented by counsel separate from counsel retained by Smith and/or Ting, (assuming they choose to retain new counsel in preference to self-representation).

c. Appointment of a new lawyer of record for BLS may be made either by agreement of the parties or by the court on the motion of any shareholder.

d. If new lawyers are appointed for BLS in one manner or another and no means is found whereby they can be properly instructed, (having regard to the obligation of corporate counsel to consult with and consider the views of all directors or, in appropriate cases, all shareholders), those lawyers may apply to the court for directions.

Costs

65 Because my decision was reserved, the parties were unable to make any submissions regarding costs of the Applicant's motion. If the parties are unable to reach an agreement on costs in that regard:

a. the Applicant may serve and file written cost submissions, not to exceed four pages in length, (not including any bill of costs), within two weeks of the release of this decision;

b. the Respondents then may serve and file responding written cost submissions, also not to exceed four pages in length, within two weeks of service of the Applicant's written cost submissions; and c. the Applicant then may serve and file, within one week of receiving any responding cost submissions from the Respondents, reply cost submissions not exceeding two pages in length.

66 If no written cost submissions are received within two weeks of the release of this decision, there shall be no costs of the motion.

I.F. LEACH J.

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1 See, for example, *MacDonald Estate v. Martin*, *[1990] 3 S.C.R. 1235*, at paragraphs 16 and 47; *Manville Canada Inc. v. Ladner Downs (1992), 88 D.L.R. (4th) 208* at p.233; and *Chapman v. 3M Canada Inc. (1995), 25 O.R. (3d) 658* at paragraphs 19-20.

2 *MacDonald Estate v. Martin*, *supra*, at paragraphs 16, 53 and 58.

3 *MacDonald Estate v. Martin, supra*, at paragraph 21; *Stevens v. Salt*, *[1995] O.J. No. 813* (Gen.Div.), at paragraphs 5-6 and 22; *Urquhart v. Allen Estate*, *[1999] O.J. No. 4816* (S.C.J.), at paragraph 16.

4 Commentary to Rule 4.02 of The Law Society of Upper Canada *Rules of Professional Conduct*, ("The Lawyer as Witness"). See also The Canadian Bar Association *Code of Professional Conduct*, Chapter IX, ("The Lawyer as Advocate"), Commentary 5.

5 *Stevens v. Salt*, *supra*, at paragraphs 8-9.

6 *Urquhart v. Allen Estate*, *supra*, at paragraphs 27-28.

7 *Essa (Township) v. Guergis* and *Heck v. Royal Bank (1993), 15 O.R. (3d) 573* (Div. Ct.), at paragraph 48.

8 See Rule 2.04 of The Law Society of Upper Canada *Rules of Professional Conduct*, ("Avoidance of Conflicts of Interest"), and in particular, sub-rules 2.04(1), (2), (3) and (6), and the Commentaries thereto. See also The Canadian Bar Association *Code of Professional Conduct*, Chapter V, ("Impartiality and Conflict of Interest Between Clients"), and in particular, Commentaries 1, 3, 4 and 8 in particular.

9 See, for example, Rule 2.02(1.1) of The Law Society of Upper Canada *Rules of Professional Conduct*, ("Quality of Service - When Client an Organization"), and Commentary thereto. See also The Canadian Bar Association *Code of Professional Conduct*, Chapter V, ("Impartiality and Conflict of Interest Between Clients", *supra*), and in particular, Commentary 16.

10 See *Edwards-MacLeod Properties Ltd. v. 1037661 Ontario Ltd., supra*, at paragraph 36, and *Canadian Arctic Trading House Ltd. v. Bronstein, supra*, at paragraph 12. *Alles v. Maurice, supra*, also cites *Motterhead* with apparent approval, at paragraph 26.

11 See the comments of Austin J., (as he then was), in *Alles v. Maurice*, *[1992] O.J. No. 331* (Gen.Div.), at paragraphs 11, 17, 19, and 21-23. See also *Algonquin Mercantile Corp. v. Cockwell*, *[1996] O.J. No. 1727* (Gen. Div.), at paragraphs 9, 28 and 36.

12 In their responding application record, the Respondents themselves clearly identify the propriety of Rice's sharing of confidential information with his advisors and prospective lenders, and the circumstances of his termination, as major issues to be resolved by the litigation. (In particular, they were identified by the Respondents as issues requiring resolution by trial, rather than by a paper application.) I accordingly reject the suggestion that Rice's motion is premature because the underlying issues have not yet been sufficiently identified.

13 Compare, for example, *Edwards-MacLeod Properties Ltd. v. 1037661 Ontario Ltd., supra*, at paragraph 49, and *Urquhart v. Allen Estate, supra*, at paragraph 21.

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Bulloch-MacIntosh v. Browne, [2015] O.J. No. 1292

Ontario Judgments

Ontario Superior Court of Justice

S.E. Firestone J.

Heard: March 2, 2015.

Judgment: March 18, 2015.

Court File No.: 96-CU-114450CM

[2015] O.J. No. 1292 | 2015 ONSC 1622

Between Wendy Margaret Bulloch-MacIntosh and Wendy Margaret Bulloch-MacIntosh, Estate Trustee For the Estate of James MacIntosh, Plaintiffs (Moving Parties), and Graeme Browne and Richard Emery, Defendants (Respondents)

(36 paras.)

Case Summary

Legal profession — Barristers and solicitors — Disqualification or removal — Relationship with client — Conflict of interest — Duty to former client — Relationship with others — Relationship with opposite party — Motion by plaintiff for order removing current solicitors of record for defendant E on basis of conflict of interest for prior representation of co-defendant B allowed — Solicitor was initially retained by both defendants in medical malpractice action, but B consented to solicitor's withdrawal — B's waiver of conflict of interest was overridden by solicitor's later agreement not to act in manner adverse to B — Liability and causation were at issue and so simply providing full and complete defence to E potentially increased B's liability exposure — Removal necessary to ensure fair trial and confidence in administration of justice.

Professional responsibility — Self-governing professions — Independence — Conflicts of interest — Client consent — Duties — Loyalty — Interests of client — Professions — Legal — Barristers and solicitors — Motion by plaintiff for order removing current solicitors of record for defendant E on basis of conflict of interest for prior representation of co-defendant B allowed — Solicitor was initially retained by both defendants in medical malpractice action, but B consented to solicitor's withdrawal — B's waiver of conflict of interest was overridden by solicitor's later agreement not to act in manner adverse to B — Liability and causation were at issue and so simply providing full and complete defence to E potentially increased B's liability exposure — Removal necessary to ensure fair trial and confidence in administration of justice.

Motion by the plaintiff for an order removing the current solicitors of record for the defendant E on the basis of a conflict of interest arising from prior representation of the co-defendant B. This was a medical malpractice action against two oral surgeons who respectively provided the surgery and subsequent care for the plaintiff. B retained the firm that later merged with the solicitor and firm that continued to represent E. The solicitor had been

removed from record as counsel for B, who lived in the U.S. and now represented himself with help from his U.S attorney. B had previously consented to the solicitor's withdrawal and continued representation of E and waived any potential conflict that may arise. However, when the solicitor removed himself, he agreed not to act in a manner adverse to B, which overrode the previous waiver of conflict. B alleged he first learned of the potential adversity between him and E at discovery, and then he filed an amended statement of defence and cross-claim, in which he adopted the plaintiff's allegations against E. B complained the solicitor should have advanced a limitation defence on his behalf and that there was financial conflict. The plaintiffs argued they had repeatedly raised the potential conflict in 1999 and would be prejudiced by the likelihood of a mistrial. E argued the motion was tactical.

HELD: Motion allowed.

The solicitor initially obtained clear consent and waiver of conflict from B, but it was modified by the solicitor's later agreement not to act in a manner adverse to B's immediate interests. Notwithstanding S's good faith interests, it would be very difficult to comply with the agreement while still conducting the trial in a fair manner. Not defending B's cross-claim would not be sufficient given B remained a defendant in the main action. Liability and causation were at issue and the very exercise of providing a full and complete defence to E potentially increased B's liability exposure. There was no order that could be crafted that would fairly and justly alleviate the concerns without unduly restricting E and B in their defences. Removal of the solicitor and firm was necessary to ensure fair trial and the public's confidence in the administration of justice. While not timely, the motion was not brought for tactical reasons and, in light of the unique factual matrix, prejudice to E due to the delay did not outweigh the benefits and necessity of a removal order. There was no prejudice to E that could not be compensated for by costs and/or an adjournment.

Counsel

John Legge and David Steeves, for the Plaintiffs.

Jamie Macdonald, for the Defendant Richard Emery.

James Newland and Neil Wilson for the Ontario Health Insurance Program.

Graeme Browne, In Person.

Craig O'Brien, for Norton Rose.

REASONS FOR DECISION

S.E. FIRESTONE J

1 The trial of this matter was scheduled for March 2, 2015. Prior to the commencement of trial I heard the plaintiff's motion for an order that, among other things, Norton Rose Fulbright ("Norton"), the current solicitors of record for Dr. Emery ("Emery"), be removed as a result of a

disqualifying conflict of interest arising from their prior representation of the co-defendant Dr. Graeme Browne ("Browne"). On this motion, I heard oral submissions and in addition requested and received subsequent written submissions.

BACKGROUND

2 On November 19, 1996, the plaintiffs commenced a lawsuit in which they alleged negligence against a number of defendants which included the two defendant oral surgeons, Browne and Emery. The action has been dismissed or discontinued against all defendants except Browne and Emery. Both doctors performed surgeries in 1977 and 1978 in which the plaintiff Wendy Margaret Bulloch-MacIntosh was implanted with bilateral silastic temporomandibular joint devices. After performing the original surgery, Browne left Canada in 1977 and ceased to be involved in the plaintiff's care. Emery continued to care for the plaintiff from 1978 until 1996. The plaintiffs allege negligence with regard to the initial surgical procedure performed by Browne as well as the subsequent care provided by Emery from 1978 to 1996.

3 Ogilvy Renault LLP ("Ogilvy"), which merged with Norton in June 2011, was retained by Browne in 1999 to defend him in the action. Ogilvy also jointly represented and continues to represent Emery. On June 2, 2011, after representing Browne for 12 years, Norton obtained an order removing the firm as lawyers of record for Browne. Browne resides in the U.S. He did not retain new Ontario counsel. He continues to represent himself with the assistance of his U.S. attorney, Mr. Strothman ("Strothman") who has been assisting him from the outset.

4 At the outset of this litigation, Strothman advised Ogilvy in correspondence dated March 25, 1999 that Browne understands there could be a future conflict with Emery and that if such a conflict arises such that Ogilvy could no longer act for him, he consents in advance to their withdrawal from representation of him and accepts that they may continue to act for Emery. Strothman stated as follows:

> Dr. Browne understands that there may be a potential future conflict with Dr. Emery should evidence arrive somewhere, somehow that suggests there is such a conflict. He will rely on your determination in that regard which can be made at any time. If you do ascertain such a conflict exists such that you can no longer represent Dr. Browne, he is consenting in advance to your withdrawing at that time from representation of him and accepts that you can continue to act for Dr. Emery. He also understands that conceptually, you might obtain information during your representation of him which could be used against him. He places no constraints upon you in that regard. (As I have indicated, he doesn't have any files or records so such information is going to come from another source, if it exists, and therefore, your representation of Dr. Browne should not lead to its discovery).

5 In that correspondence Browne through Strothman gave his consent in advance for his former solicitors to act against him in the same matter in which confidential information was obtained.

6 This agreement changed in or around the time Norton removed itself as lawyers of record in 2011. An email from Strothman to Norton dated October 31, 2014 states in part:

> Dr. Browne has requested that I remind your firm at the time of its withdrawal from representing Dr. Browne it assured Dr. Browne that it could not and would not in any way be adverse to him in the Bulloch litigation. If Dr. Browne's summary judgment motion

> does not result in his full and final dismissal from this litigation, Dr. Brown's cross-claim will remain if leave to amend in that fashion is granted. If leave is not granted the claim of Dr. Browne does not go away. He assumes that Norton Rose will not defend Dr. Emery against Dr. Browne's claim since that would be acting adverse to Dr. Browne. Please confirm that Norton Rose will not act in any way adverse to Dr. Browne.

7 Norton acknowledges in its factum that, at the time it was removed as lawyers of record for Browne in 2011, it agreed that it could not, and would not, act in a manner adverse to Browne's immediate interests. This agreement in my view modifies and/or overrides the initial waiver of any conflict arising from Norton's joint representation of both doctors as contained in Strothman letter dated March 25, 1999.

8 Browne alleges he learned for the first time at his discovery in September 2014 of the potential adversity of interest between himself and Emery. Following this revelation, in October 2014 Browne obtained leave to file an amended Statement of Defence and Cross-claim against Emery. In this Cross-claim, Browne specifically states that:

> For the purposes of this Cross claim only, Dr. Browne adopts and repeats the allegations asserted by the Plaintiffs against the Defendant Richard Emery as set out in their Fresh as Amended Statement of Claim to the extent as may be supported by the Plaintiff Bulloch in this litigation.

9 At the preliminary pre-trial motion before me on March 2, 2015, Browne was called on consent to give *viva voce* evidence. He testified that he did not impart any relevant verbal or documentary confidential information to Ogilvy or Norton which has not yet been produced in this litigation. In a later memorandum to the Court, Browne clarified that he did not believe any of the information in Norton's possession was confidential such that it should be held back from the Court or himself.

10 It appears that Browne misunderstood the question when he was asked whether Norton possessed any relevant confidential information. The basis of Brown's alleged conflict was that Norton should have advanced a defense on his behalf on the basis of the Statute of Limitations; that other doctors were released from the action but he was not; and that there was a financial conflict because Norton had requested an additional $10,000 retainer in 2011. Browne's concerns seem primarily directed at events during Norton's representation of him.

ISSUE FOR DETERMINATION

11 The issue on this motion is whether Norton should be removed due to a conflict given the agreement that Norton could not and would not act in a manner adverse to Browne.

POSITIONS OF THE PARTIES

12 The moving party plaintiffs ask that Norton be disqualified from representing Emery. The plaintiffs contend they are not raising the conflict issue tactically but that they have repeatedly raised the potential conflict since the plaintiffs say it first manifested in August 1999. At that time, the plaintiffs could and did not know what consents or waivers were in place between Norton and the doctors. There is nothing before me to suggest a conflict then in any event. When the potential conflict crystallized in October 2014, the plaintiffs amplified their objection. The

plaintiffs also contend that they are substantively and irretrievably prejudiced by the conflict because of the likelihood of a mistrial.

13 OHIP, whose subrogated claim is being advanced, takes the position that Emery and Browne are adverse in interest and the continued representation of Emery by Norton would compromise the fairness of the trial and risk bringing the administration of justice into disrepute. Any procedural orders that may attempt to regulate the trial to avoid the adversity between Browne and Emery would be difficult to implement.

14 The defendant Emery and Norton argue that the motion to remove Norton as counsel of record for Emery is an attempt by the plaintiffs to gain an undeserved tactical advantage on false pretenses. Removing Norton as counsel would prejudice Emery and have significant adverse cost consequences to him as new counsel are brought up to speed. Moreover, Norton can continue to represent Emery because, as Emery is not defending the cross-claim, Emery is not taking a position adverse in interest to Browne.

ANALYSIS

Conflicts of Interest and the Duty of Loyalty

Rules of Professional Conduct

15 The Law Society of Upper Canada's *Rules of Professional Conduct* provide guidance for the courts on the question of disqualifying conflicts of interest. As the Supreme Court of Canada recognized in *Canadian National Railway Co. v. McKercher LLP*, *2013 SCC 39*, *[2013] 2 S.C.R. 649*, at para. 16, courts and law societies are both involved in resolving issues relating to conflicts of interest and may have regard to each other's views. Courts are not "bound by the letter of law society rules, although 'an expression of a professional standard in a code of ethics ... should be considered an important statement of public policy': *Martin*, at p. 1246."

16 The *Rules of Professional Conduct* are clear that, absent consent, a lawyer shall not act against a former client in the same or a related matter. Rule 3.4-10 states:

> Unless the former client consents, a lawyer shall not act against a former client in
>
> (a) the same matter,
>
> (b) any related matter, or
>
> (c) save as provided by rule 3.4-11, any other matter if the lawyer has relevant confidential information arising from the representation of their former client that may prejudice the client.

17 In its Commentary on this section, the Law Society writes:

> [R]ules 3.4.10 and 3.4-11 address conflicts where the lawyer acts against a former client. Rule 3.4-10 guards against the misuse of confidential information from a previous retainer and ensures that a lawyer does not attack the legal work done during a previous retainer or undermine the client's position on a matter that was central to a previous retainer.

18 The *Rules of Professional Conduct* also allow that parties may consent to be jointly

represented or may waive any conflict that could arise between them. Rule 3.4-2 reads:

> A lawyer shall not represent a client in a matter when there is a conflict of interest unless there is an express or implied consent from all clients and it is reasonable for the lawyer to conclude that he or she is able to represent each client without having a material adverse effect upon the representation of or loyalty to the other client.

19 As noted above, Norton did initially obtain Browne's clear consent and waiver of the conflict of interest and the litigation proceeded on that basis. However, this agreement was modified by Browne in Strothman's email dated October 31, 2014 and confirmed by Norton's later statement that it "could not, and would not, act in a manner adverse to Dr. Browne's immediate interests." The primary issue is whether, realistically, such adversity can be avoided given the factual matrix of this case. Norton's position is that such adversity can be avoided given the following: Emery has not defended Browns cross-claim for contribution and indemnity; Emery has not cross-claimed against Browne; and Emery's overall position that the action should be dismissed against Browne.

20 Historically, the law on disqualifying conflicts of interest has focused on the use and misuse of confidential information a lawyer may have obtained from his former client. In *Martin v. Macdonald Estate (Gray)*, *[1990] 3 S.C.R. 1235*, at para. 48, Sopinka J. articulated the test for determining whether there is a disqualifying conflict of interest in acting against a former client: (1) Did the lawyer receive confidential information attributable to a solicitor and client relationship relevant to the matter at hand? (2) Is there a risk that it will be used to the prejudice of the client?

21 In the present case, there remain some issues between Browne and Norton concerning whether any confidential information was received by Norton from Browne and if so whether it has been disclosed. Norton says it is not in possession of any confidential information from Browne. Browne suggests that there is confusion as to what records were withheld from him.

22 In any event, it is well established that an important element of a lawyer's obligation to avoid conflicts of interest is the duty of loyalty, which goes beyond the duty not to disclose confidential information. In *R. v. Neil, 2002 SCC 70*, *[2002] 3 S.C.R. 631*, the Court wrote in the context of current clients at para. 17:

> While the Court is most often preoccupied with uses and abuses of confidential information in cases where it is sought to disqualify a lawyer from further acting in a matter, as in *Macdonald Estates*, *supra*, the duty of loyalty to current clients includes a much broader principle of avoidance of conflicts of interest, in which confidential information may or may not play a role.

23 In *R. v. Neil,* the Court explained the basis for the duty of loyalty by quoting Wilson J.A.'s judgment in *Davey v. Wooley, Hames, Dale & Dingwall (1982), 35 O.R. (2d) 599* (C.A.), at p. 602:

> Human nature being what it is, the solicitor cannot give his exclusive, undivided attention to the interests of his client if he is torn between his client's interests and his own or his client's interests and those of another client to whom he owes the self-same duty of loyalty, dedication, and good faith.

24 *R. v. Neil* was concerned with the duty of loyalty owed by a lawyer to his or her "current clients," which would prohibit that lawyer from representing two current clients in matters where they may be adverse in immediate legal interest. However, the courts also have recognized a duty of loyalty owed to "former clients." According to Justice D.M. Brown (as he then was) in *Hames v. Greenberg*, *2013 ONSC 4410*, at para. 10: "provincial appellate court jurisprudence has concluded that a lawyer may be disqualified from acting against a former client even when the new retainer does not put at risk the former client's confidences." This "second dimension of the duty of loyalty to clients" involves the public's confidence in the administration of justice.

25 The Ontario Court of Appeal in *Consulate Ventures Inc. v. Amico Contracting & Engineering (1992) Inc*., *2010 ONCA 788*, at paras. 30-31, stated it this way, quoting with approval Cromwell J.A.'s words in *Brookville Carriers Flat Bed GP Inc. v. Blackjack Transport Ltd. (2008), 263 N.S.R. (2d) 272* (C.A.):

> Cromwell J.A. reviewed the case law, including *Speid* and the authoritative texts at length. He concluded that lawyers had a duty of loyalty to former clients that was rooted both in confidentiality concerns and the need to foster and maintain public confidence in the client/solicitor relationship and the due administration of justice. He said at para. 51:
>
> > This broader continuing duty of loyalty to former clients is based on the need to protect and promote public confidence in the legal profession and the administration of justice. What is of concern is the specter of a lawyer attacking or undermining in a subsequent retainer the legal work which the lawyer did for the former client or of a lawyer effectively changing sides by taking an adversarial position against a former client with respect to a matter that was central to the previous retainer.

26 In the result, the Court of Appeal in *Consulate Ventures* concluded at para. 36:

> I agree with the priority given to the preservation of the integrity of the process. In my view, that goal finds expression in the *Rules of Professional Conduct* cited above and in the controlling jurisprudence. A lawyer's obligation, whether described as a duty of loyalty owed to a former client, or as a professional obligation to promote public confidence in the legal profession and the administration of justice dictates that Mr. Lenczner cannot act on this appeal against the respondent, his former client.

27 If, in defending Emery at trial, Norton acts in a manner that is "adverse" to Browne's interests, then Norton would be prevented both by its agreement with Browne as well as by its duty of loyalty to Browne and Emery from continuing to act for Emery. Even if no confidential information is at stake, public confidence in the legal profession and the administration of justice requires that the duty of loyalty to Norton's former and current clients not be compromised. The issue is whether this can be accomplished at trial given that Norton is not defending the cross-claim and will not directly be attacking Browne's actions.

28 Notwithstanding Norton's unequivocal good faith intentions to comply with the agreement not to act in a manner adverse to Browne, in my view it would be difficult, if not impossible, to actually conduct this trial in a fair manner without a substantial risk of a compromised trial process and possible mistrial resulting from disagreements over whether Norton, in defending Emery's interests, has acted in a manner adverse to Browne's interests. This is a real risk which exists notwithstanding Norton's best intentions and good faith efforts to avoid it. Not defending

the cross-claim is not, with respect, sufficient to accomplish this goal given that Browne remains a defendant in this action.

29 In this medical malpractice lawsuit there are liability issues, including both the standard of care and causation, being advanced by the plaintiffs against Emery and Browne. Browne in his cross-claim repeats and relies upon the allegations of negligence by the plaintiffs against Emery. At trial, in addition to the parties, various liability experts will be called. Norton will invariably conduct an examination or cross-examination of some or all of these witnesses. The practical reality is that Court could not fairly police the proceedings and determine at what point such examinations crosses the line from a compliant examination to one that is adverse to Browne. This is especially so given that Browne is self-represented. Can Norton realistically be expected to avoid such adversity if it cross-examines Browne or the other witness called on the issue of liability? Does not the very exercise of providing a full and complete defence to Emery potentially increase Brown's liability exposure?

30 There is no order that could be crafted which would fairly and justly alleviate these concerns and which would not unduly restrict both Emery and Browne in their defence of this action. There is no procedural order which would prevent or safeguard against such adversity which would be fair to all parties given the complex nature of the liability issues in this case.

31 While it is absolutely clear that Norton has acted in good faith and with the best intentions, the reality is that, in light of the agreement and duty of loyalty to both Emery and Browne, Norton must be removed as solicitors of record for Emery in order to ensure a fair trial to all parties and public confidence in the administration of justice.

32 I am cognizant a litigant should not be deprived of counsel of its choice without good cause. In *Best v. Cox, 2013 ONCA 695*, at para. 8, Feldman J.A. reiterated the principle that the court will grant a removal motion only in rare cases, citing Cronk J.A. in *Kaiser, Re, 2011 ONCA 713*, at para. 21 as follows:

> As the motion judge properly noted, "A litigant should not be deprived of counsel of his choice without good cause." ... For this reason, Canadian courts exercise the highest level of restraint before interfering with a party's choice of counsel. Where such discretionary, equitable relief is involved, there must be a possibility of real mischief should a removal order be refused. The test is whether a fair-minded and reasonably informed member of the public would conclude that council's removal is necessary for the proper administration of justice...

33 For the reasons given, there is in my view a possibility of real mischief which requires removal in order to ensure the proper administration of justice.

34 This motion was not brought in a timely way. I am, however, not satisfied that this motion was brought for tactical reasons despite the fact that plaintiff's counsel raised a potential conflict issue long ago but did nothing about it until now. Based on the unique factual matrix of this case the delay and prejudice to Emery do not outweigh the benefits and necessity of granting the removal order. There is no prejudice that cannot be compensated for by costs and/or an adjournment.

DISPOSITION

35 I order that Norton be removed as lawyers of record for Emery. Emery is to appoint new counsel within the next 60 days following which a new trial date is to be fixed. A trial management conference is to be arranged with me to take place on an expedited basis immediately following the appointment of new counsel.

36 If the parties are unable to agree on the costs of this motion, I may be contacted in order to set a timetable for the delivery of cost submissions.

S.E. FIRESTONE J.

Reciprocal Opportunities Inc. v. Sikh Lehar International Organization, [2018] O.J. No. 4472

Ontario Judgments

Ontario Court of Appeal

A. Hoy A.C.J.O., K.M. van Rensburg and G.I. Pardu JJ.A.

Heard: July 18, 2018.

Judgment: August 31, 2018.

Docket: C65109

[2018] O.J. No. 4472 | 2018 ONCA 713 | 296 A.C.W.S. (3d) 100 | 63 C.B.R. (6th) 169 | 426 D.L.R. (4th) 273 | 2018 CarswellOnt 14182

Between Reciprocal Opportunities Incorporated, Plaintiff (Respondent), and Sikh Lehar International Organization, Narinderjit Singh Mattu, Rajwant Kaur Nijjar, Manjit Singh Mangat, Kamaljit Kaur Mangat, Suchet Singh Saini, Kamaljit Kaur Saini, Gurdev Singh Gill, Kanwaljit Kaur Gill, Inderjeet Singh Saini, Jatinder Kaur Saini, Harjeet Singh Thabal, Jaswinder Thabal, Hardeep Singh Dhoot, Raminder Dhoot, Daljit Singh Jammu, Parnpal Jammu, Harkanwal Singh, Kanwaljit Singh, Ramandeep Singh Athwal, Harnish Mangat, Sikanderjit Singh Dhaliwal, Sukhinder Dhaliwal, Gurdish Singh Mangat, Satinderjit Kaur Mangat and Guru Nanak Property Management Ltd., Defendants (Respondent)

(77 paras.)

Case Summary

Creditors and debtors law — Receivers — Court appointed receivers — Sales by receiver — Duties — To debtor — Appeal by Sandhu from order of motion judge that declined to approve sale of property by court-appointed receiver to him allowed — New hearing ordered — Motion judge found receiver had been prepared to accept payout of first mortgage and assign mortgage to third party and only unresolved issue was proper payout — He found manner in which receiver conducted process resulted in unfairness to debtor and prospective assignee of first mortgage — Motion judge failed to properly consider and give sufficient weight to interests of creditors — He further failed to consider interests of appellant, qua purchaser.

Appeal by Sandhu from an order of a motion judge that declined to approve the sale of property by the court-appointed receiver to him. Sikh Lehar International Organization ("SLIO") became insolvent in 2014. In 2017, a receiver was appointed. The order authorized the receiver to sell SLIO's property, subject to court approval. The receiver received three offers to purchase the property and entered an agreement to sell the property to the appellant. Throughout the sale process, the receiver was aware SLIO was attempting to arrange an assignment of the first mortgage on the property. The motion judge declined to approve the sale of the property to the appellant and instead established a process to permit the assignment of the first mortgage. He found the receiver had been prepared to accept payment of the outstanding balance of the first mortgage and assign the mortgage to a third party and that the only issue that had not been established was the proper payout. He found the

manner in which the receiver conducted the process resulted in unfairness to SLIO and the prospective assignee of the first mortgage.

HELD: Appeal allowed and a new hearing was ordered.

The motion judge failed to properly consider and give sufficient weight to the interests of the creditors. He further failed to consider the interests of the appellant, qua purchaser. He did not consider the potential prejudice that would result to the appellant's interests if the sale was not approved. The assignment of the first mortgage would not permit SLIO to repay its other substantial debts. It was not clear SLIO was in a position to service the first mortgage, if assigned to a new mortgagee. A rehearing would permit the motion judge to obtain clarity on the receiver's position and would permit the receiver to provide a further report to assist the motion judge in balancing the interests of the creditors, the appellant, SLIO, and the proposed assignee. There were several factual findings that needed to be made to resolve the motion.

Appeal From:

On appeal from the order of Justice R.J. Harper of the Superior Court of Justice, dated February 28, 2018.

Counsel

Paul J. Pape, for the appellant Sukhinder Sandhu.

Dennis Touesnard, for the receiver JP Graci & Associates Ltd.

Ted R. Laan, for the respondent Sikh Lehar International Organization.

Jonathan Piccin, for the respondent Community Trust Company and 2283435 Ontario Inc.

The judgment of the Court was delivered by

A. HOY A.C.J.O.

1 The appellant, Sukhinder Sandhu, appeals the February 28, 2018 order of the motion judge, declining to approve the sale by a court-appointed receiver of the property known as 79 Bramsteele Road, Brampton, Ontario (the "Property") to him.

2 For the following reasons, I would allow the appeal, set aside the order of the motion judge, and direct a new hearing.

Background

3 Sikh Lehar International Organization ("SLIO") was established as a religious, private charitable organization to buy the Property and establish, manage and operate a Gurdwara (a Sikh temple). The Gurdwara is a tenant, but not the sole tenant, of the Property.

4 By 2014, SLIO was insolvent.

5 The Property has been the subject of litigation. The trustees of SLIO all wanted to sell the Property, and purported to sell it to different purchasers. Disagreements about selling the Property led to the departure of some of the trustees and litigation about the amounts owing to the departing trustees: see *Sikh Lehar International Organization v. Saini*, *2018 ONSC 2839*. It also gave rise to litigation between SLIO, its two remaining trustees, Manjit Mangat and Harkanwal Singh, and the appellant, who had sought to purchase the Property: see *Sandhu v. Sikh Lehar International Organization*, *2017 ONSC 5680*.[1] Further, Canadian Convention Centre Inc. ("CCC"), a tenant of the Property, is seeking damages for alleged breaches of its lease in the amount of $2 million.[2]

6 On September 1, 2017, at the instance of the first mortgagee of the Property,[3] Reciprocal Opportunities Incorporated ("ROI"), the motion judge granted an order appointing J.P. Graci and Associates Ltd. (the "Receiver") as receiver of all the assets, undertakings and property of SLIO. The order authorized the Receiver to sell the Property, subject to the approval of the court.

7 The Receiver proceeded to have the Property appraised on September 15, 2017 and contacted persons who had expressed an interest in purchasing the Property.

8 However, in an email on October 4, 2017, SLIO advised the Receiver that it had a firm commitment from a lender to take an assignment of "your mortgage" (presumably referring to the first mortgage), with the transaction to close in the next two weeks. The Receiver responded by email on October 5, 2017. It advised that the payout on the first mortgage was $4,092,745.31, the per diem rate was $1,114.51, and the Receiver's fees and legal fees were $80,000. The Receiver further advised that if the mortgage amount and outstanding expenses were paid, it would apply to the court to approve the assignment of the mortgage and to be discharged. The Receiver also stated it anticipated having the information necessary to begin marketing the Property by November 1, 2017. The Receiver copied its counsel and SLIO's real estate counsel with its response, and separately forwarded its response (together with SLIO's October 4, 2017 email) to, among others, counsel for the appellant.

9 There is no indication in the record that SLIO -- or the proposed assignee -- was in funds and prepared to close within two weeks of its October 4, 2017 email to the Receiver.

10 The Receiver retained the services of a commercial real estate broker, who listed the Property for sale and put it on MLS as of October 31, 2017. The real estate broker also opined that the current value of the Property was significantly less than the appraised value, as the appraisal obtained by the Receiver assumed that the Property's roof structures were in good working order, but in fact a significant portion of the roof required immediate replacement.

11 By letter dated October 31, 2017 to real estate counsel for SLIO, counsel for the Receiver confirmed that "provided [SLIO] buys out the first mortgage on the property on or before November 14, 2017, then the Receiver will move for an Order having itself discharged." He advised that, as of that date, the payout of the first mortgage was in the amount of

$4,121,722.50, with a per diem rate of $1,114.51. He further advised that provided payment was made before November 14, 2017, the Receiver's fees and legal fees would be capped at $80,000 plus HST.

12 The Receiver received three offers to purchase the Property. It entered into an agreement (the "Agreement") to sell the Property to the appellant on November 2, 2017.[4]

13 Under the Agreement, the appellant agrees to purchase the Property on an "as is where is" basis, and to complete the transaction 15 business days after the Receiver obtains an approval and vesting order. With the exception of the requirement for an approval and vesting order, the appellant's obligation to complete the purchase is essentially unconditional. The Agreement provides for a purchase price that exceeds the current value of the Property as assessed by the commercial real estate broker retained by the Receiver, and that approximates the appraised value of the Property.

14 In an affidavit sworn December 22, 2017, Mr. Mangat, one of the remaining trustees of SLIO, deposed that the appellant was "aware of the Receiver's intention to assign the first mortgage upon payment of the amounts owing." Mr. Mangat was not cross-examined on his affidavit.

15 The "buy out" of the first mortgage did not proceed by November 14, 2017.

16 In an email to the Receiver on November 23, 2017, real estate counsel for SLIO confirmed that SLIO had secured financing from a lender that was prepared to pay out all amounts owed to the Receiver in exchange for an assignment of the first mortgage. He advised that, among other items, the lender required a corporate resolution of ROI authorizing the assignment, the consent of the Receiver to the discharge of the certificate of pending litigation ("CPL") registered on title to the Property by the appellant, and the Receiver's undertaking to obtain a court order discharging the receivership upon payment of all amounts owing, in order to complete the assignment.

17 In an email later the same day, counsel for the Receiver clarified that while the Receiver could undertake to move for an order discharging the Receiver, the court would have discretion to grant the relief. He asked that counsel for the lender confirm that the lender was in funds. He indicated that the Receiver and its counsel could confirm their fees, and the Receiver could prepare a summary of its receipts and disbursements. He stated he trusted that the information he had previously provided regarding the amount owing on the first mortgage was satisfactory. He inquired as to the closing date.

18 In an email from counsel for the Receiver to real estate counsel for SLIO dated November 24, 2017, counsel for the Receiver seems to suggest the proposed lender would have to work out the discharge of the CPL and, if it could not, would have to decide whether or not to take the assignment without the CPL being discharged.[5] Counsel for the Receiver cautioned that, "[i]f we cannot move forward with your proposal, I will be moving on January 5, 2018 for an order approving a sale agreement signed by the Receiver."

19 In an email later that day to SLIO's litigation counsel, counsel for the Receiver indicated that, "[i]f your client can get financing and the CPL issue can be dealt with, we will deal with you as per [SLIO's real estate counsel's] original email to the receiver." (This presumably refers to the November 23, 2017 email, which is the earliest email in the record from SLIO's real estate

counsel). He cautioned, "[t]hat said, we will keep moving towards the sale of the property and I intend to bring the motion on January 5, 2018 for approval if the mortgage is not assigned beforehand."

20 In an email on November 29, 2017 to both SLIO's real estate and litigation counsel, counsel for the Receiver characterized their prior exchanges as "without prejudice settlement discussions." He indicated that, as an officer of the court, the Receiver must have its actions approved by the court. He explained that the Receiver could not assign ROI's mortgage, but SLIO has a right to redeem the mortgage.

21 He further outlined the Receiver's position on the proposed assignment of the first mortgage:

> As you also know, prior to receipt of [the November 23 proposal] the receiver signed an agreement to sell the property to a third party. A motion will be served returnable January 5, 2017 [sic] for approval of that sale.
>
> If your client wishes to redeem the mortgage and have the receiver discharged, it can bring a motion for [sic] in my action on notice to all affected parties for an order allowing it to redeem, and, on redemption, an order that the receiver be discharged. The Receiver will consent to leave to bring the motion and will not oppose that relief if sought.

22 In an email to counsel for the Receiver on November 30, 2017, litigation counsel for SLIO asked who ROI's representative was for the purpose of assigning the first mortgage.

23 Counsel for the Receiver provided the identity of ROI's counsel in a responding email on the same date. ROI's counsel is with the same law firm as Receiver's counsel.

24 By email dated December 5, 2017, counsel for the Receiver provided his fees and those of the Receiver to date to real estate counsel for SLIO.

25 Real estate counsel for SLIO contacted counsel for ROI by email dated December 5, 2017. He advised of the documents the proposed assignee was requesting from ROI, including an accounting of all monies owed to ROI under the mortgage. He asked counsel for ROI to confirm that ROI was prepared to deliver the assignment and the other requested documents. He stated that "[t]he solicitor for the proposed assignor [sic] confirms he is in funds."

26 The First Report of the Receiver is dated December 6, 2017. The Receiver prepared it in support of its motion for court approval of the Agreement and sale of the Property. The Report details the sales process the Receiver undertook with respect to the Property, leading it to seek court approval of the Agreement. The Report makes no reference to SLIO's attempts to arrange an assignment of the first mortgage held by ROI.

27 In his affidavit of December 6, 2017, real estate counsel for SLIO deposed that SLIO was concerned that if counsel for ROI did not respond quickly to the requisitions referred to in his email of December 5, 2017, the Property would be lost to a third-party purchaser in January 2018.

28 In his supplementary affidavit of December 21, 2017, filed in response to the Receiver's motion for approval of the Agreement, real estate counsel for SLIO further deposed that:

- On December 8, 2017, counsel for ROI delivered a draft mortgage statement to counsel for SLIO.

- He advised counsel for ROI that counsel for the proposed lender took the position that the default interest rate charged by ROI was contrary to *s. 8 of the Interest Act, R.S.C 1985, c. I-15* and the proposed lender would not pay it. Counsel for ROI suggested that some amount in excess of the rate charged on the principal balance of the mortgage may have been the result of extension agreements entered into by SLIO and ROI.

- On December 19, 2017, counsel for ROI delivered various documents setting out revised amounts required for the payout of the first mortgage. These amounts differed from those set out in the original Notice of Sale, dated May 17, 2017, and from other amounts provided by ROI in the interim.

- The delay in effecting the assignment of the first mortgage was entirely the responsibility of ROI because of its failure to provide appropriate calculations of the amount owing.

- The requisitions required by the proposed assignee from the Receiver or ROI had otherwise been substantially complied with.

29 In his affidavit sworn December 22, 2017, Mr. Mangat deposed that the emails of October 5, November 23 and 24, 2017 and the letter of October 31, 2017, referred to above, led SLIO to believe that "upon payment of the proper amounts owing under the First Mortgage, the Receiver would arrange the assignment of the First Mortgage. As a result [SLIO] took steps to secure the proper financing of that assignment and incurred substantial costs in the process." Mr. Mangat then detailed borrowings from five individuals totaling approximately $396,268.87 incurred since the beginning of September 2017, which he says are or "will be" debts of SLIO. He deposed that of those borrowings:

- $207,000 was paid to the broker who had been trying to arrange financing for SLIO since September 2017, in part payment of his brokerage fee;

- $24,518 was paid to the second mortgagee on October 14, 2017 to bring that mortgage into good standing, as required by the proposed assignee of the first mortgage;[6]

- $91,617.36 was paid to the City of Brampton on November 24, 2017 on account of tax arrears, again a condition of the proposed assignee of the first mortgage; and

- $73,133.51 was paid on or after November 21, 2017 to obtain the discharge of a CRA lien for HST arrears, again a condition of the proposed assignee of the first mortgage.

30 Mr. Mangat further deposed that SLIO was unaware of the Agreement until the Receiver delivered its motion materials. The Receiver's motion materials are dated December 6, 2017.

31 Neither Mr. Mangat nor SLIO's real estate counsel deposed that all the proposed assignee's conditions of closing had been satisfied and that, but for the determination of the payout amount, the proposed assignee was prepared to close the assignment transaction.

The January 5, 2018 attendance before the motion judge

32 In its notice of motion dated December 6, 2017, filed in connection with the January 5, 2018 attendance before the motion judge, the Receiver sought an order approving the sale of the Property to the appellant.

33 SLIO opposed the Receiver's motion. In response, SLIO brought its own motion seeking: (1) an order requiring ROI to assign the first mortgage, upon payment of all amounts owed to the Receiver or ROI; and (2) an order discharging the Receiver upon payment of such amounts.

34 In its factum filed on the motion, the Receiver indicated that it was prepared to be discharged -- but only on the condition that the court be satisfied that it had discharged its duties, and on approval of the activities and accounts of the Receiver and its counsel. It stated that it entered into the Agreement prior to the "conditional request to take an assignment of the first mortgage of ROI." It noted that the effect of the discharge sought by SLIO, as a condition of the assignment of the first mortgage, was that the sale transaction would not be approved and that the Receiver would seek, as part of the discharge order, a release from any potential liability to the appellant. The Receiver noted that the appellant and CCC opposed its discharge. In the event that the court was unwilling to exercise its discretion to discharge the Receiver, it sought an order approving the sale of the Property to the appellant.

35 The appellant appeared and filed a factum. Among other arguments, the appellant submitted that SLIO had not said how it would make future payments to its mortgagees or creditors if the assignment transaction proceeded, or even that it would. The appellant argued that the sale to him should be approved and a vesting order issued.

36 CCC filed a responding motion record opposing the form of vesting order sought because that order purported to vest the Property in the appellant free and clear of all encumbrances, including CCC's lease.

The motion judge's reasons

37 The motion judge declined to approve the sale of the Property to the appellant and, instead, established a process that would permit the assignment of the first mortgage: *Reciprocal Opportunities Incorporated v. Sikh Lehar International Organization et al.*, 2018 ONSC 227.

38 In his reasons, the motion judge briefly reviewed SLIO's financial position. He noted that the first, second and third mortgages on the Property remained in default; a construction lien was registered in the amount of $406,500; the Ministry of Revenue had a tax lien in the amount of $108,156; the City of Brantford [sic] was in a position to put the Property up for sale for tax arrears in the amount of $433,818.59; CCC was seeking damages in the amount of $2 million for breach of its lease; there was a judgment in favour of the appellant in the amount of $2,206,729.01; and that there were numerous other debts.

39 At para. 18, the motion judge instructed himself on the four duties which *Royal Bank of Canada v. Soundair Corp.* *(1991), 4 O.R. (3d) 1*, *83 D.L.R. (4th) 76* (C.A.) directs a court must perform when deciding whether to approve a sale of a property by a receiver:

1. The court should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. The court should consider the interests of all parties.
3. The court should consider the efficacy and integrity of the process by which the offers are obtained.

4. The court should consider whether there has been unfairness in the working out of the process.

40 The motion judge found that the Receiver took reasonable steps to obtain the best price for the Property. The motion judge noted, at para. 22, that interest was accruing rapidly on both the first mortgage and SLIO's other debts:

> The [first] mortgage has been in arrears since September 2, 2016. There are substantial other debts that have also been in arrears for lengthy periods of time. Interest on the first mortgage and other debts has been accruing and escalating at a rate that the receiver must consider when acting in a manner that is efficient and fair to all interested parties.

41 Then, at para. 23, the motion judge stated he would not approve the sale, explaining: "[e]xcept for the conduct of the Receiver/Plaintiff relative to the Defendant SLIO, I would have approved the sale."

42 At para. 26, the motion judge found that central to the communications from October 5, 2017 to the end of December 2017 between counsel for the Receiver, counsel for SLIO, and counsel for the intended assignee "were inconsistent representations of what the pay-out amount would be in order to effect the proposed assignment of the first mortgage."

43 He found, at para. 30:

> It is clear that as of the end of December, 2017, the Receiver/Plaintiff was prepared to accept payment of the outstanding balance of the first mortgage and assign the mortgage to a third party. The only thing that had not been established was the proper payout.

44 He concluded, at para. 32:

> Having regard to the final consideration of *Royal Bank of Canada v. Soundair Corp*, I find the manner in which the process was conducted resulted in an unfairness to the Defendant SLIO and the prospective assignee of the first mortgage.

45 In his order dated February 28, 2018, the motion judge ordered that the proposed sale was not approved. He ordered ROI and the Receiver to provide a statement that they intend to rely on for purposes of the payout of the first mortgage and adjourned the matter to a further hearing before him, in order to fix the payout and set the terms of closing the payout and assignment of the first mortgage. He specifically ordered that the Receiver was not discharged.

The parties' submissions on appeal

(a) The appellant's submissions

46 The appellant does not challenge the motion judge's finding that the manner in which the process was conducted resulted in an unfairness to SLIO and the prospective assignee of the first mortgage. Rather, the appellant argues that the motion judge provided insufficient reasons because he did not explain why the unfairness to SLIO and the prospective assignee of the first mortgage should trump the unfairness to the appellant of not having the sale approved.

47 Further, the appellant argues that the motion judge erred in his application of the second *Soundair* duty by failing to consider the interests of creditors and the interests of the appellant, *qua* purchaser. He submits that this court should set aside the order of the motion judge and approve the sale of the Property to him. Alternatively, he asks that the order be set aside and new hearing ordered.

48 The appellant does not argue that that SLIO's right of redemption or assignment terminated when the Receiver entered into the Agreement.

(b) The Receiver's submissions

49 On appeal, the Receiver supports the position of the appellant. It argues that the motion judge erred in his application of the second *Soundair* duty by failing to consider the interests of all parties and by focusing solely on the interests of SLIO. It says that not approving the sale leaves SLIO's creditors in limbo as to when and by what means the Property will be sold to satisfy their debts.

50 It also argues that the motion judge failed to consider the third *Soundair* factor -- namely, the efficacy and integrity of the process by which offers were obtained. It argues that this factor weighs in favour of approving the sale.

51 Finally, the Receiver argues that the fourth *Soundair* duty only requires an inquiry into the fairness of the sale process, and does not contemplate an inquiry into the fairness of other aspects of the receivership. In its submission, any unfairness resulting from the Receiver's conduct in relation to SLIO and the proposed assignment is unrelated to the sale process undertaken with respect to the Property. Its position is that unfairness in the broader receivership is relevant only to an analysis of the interests of the parties under the second *Soundair* duty.

(c) SLIO's submissions

52 SLIO argues that the motion judge correctly identified the test in *Soundair*, identified the appellant as a creditor, and considered the creditors' interests. It states that there is sufficient equity in the Property such that the appellant's position as a creditor is not at risk.

53 SLIO argues that it was treated unfairly because the Receiver breached its written consent to permit the redemption/assignment of the first mortgage and to obtain an order for discharge. In SLIO's submission, it is implicit in the motion judge's reasons that he found that the unfairness to SLIO was the most important factor in the circumstances and the motion judge's reasons were sufficient in this regard. SLIO notes that, in any event, insufficiency of reasons is not automatically fatal to a decision.

Analysis

(a) The motion judge erred in his performance of the second *Soundair* duty

54 The motion judge's order was discretionary in nature. An appeal court will interfere only where the judge considering the receiver's motion for approval of a sale has erred in law,

seriously misapprehended the evidence, exercised his or her discretion based upon irrelevant or erroneous considerations, or failed to give any or sufficient weight to relevant considerations: see *HSBC Bank of Canada v. Regal Constellation Hotel (Receiver of)* *(2004), 71 O.R. (3d) 355*, *242 D.L.R. (4th) 689* (C.A.), at para 22.

55 I agree with the appellant and the Receiver that the motion judge erred in performing the second *Soundair* duty: first, by failing to properly consider and give sufficient weight to the interests of the creditors; and second, by failing to consider the interests of the appellant, *qua* purchaser.

56 I begin by acknowledging that while the primary interest is that of the creditors of the debtor, the interests of the creditors is not the only or overriding consideration. The interests of a person who has negotiated an agreement with a court-appointed receiver ought also to be taken into account. And in appropriate cases, the interests of the debtor must also be taken into account: see *Soundair*, at paras. 39-40.

57 Although the motion judge noted that there were substantial debts in arrears and interest was accruing on those debts, he did not consider how declining to approve the sale, so that the assignment of the first mortgage might proceed, would affect the creditors' interests.

58 If the sale proceeded, the creditors could be repaid. On the other hand, the assignment of the first mortgage would simply replace one creditor with another. It would not permit SLIO to repay the other substantial debts which the motion judge indicated were in arrears. It is also not clear that SLIO would be in a position to service the first mortgage, if assigned to a new mortgagee.

59 Further, according to Mr. Mangat's evidence, if the assignment proceeds SLIO will assume additional debt in respect of the brokerage fees payable for arranging the assignment, thus worsening SLIO's financial position. While Mr. Mangat deposed that certain debts had been repaid (at least in part) to satisfy the prospective assignee's conditions of closing, it is intended that SLIO will assume debts incurred to facilitate those repayments. It also appears that the Property is deteriorating and urgently requires repair. There is no indication as to how those repairs will be funded.[7]

60 The receivership was triggered by SLIO's insolvency. The motion judge did not engage in any analysis of the continued viability of SLIO and SLIO's ability to pay the creditors if the sale did not proceed. He did not consider whether declining to approve the sale transaction would merely delay the inevitable. Given that *Soundair* directs the primary interest to be considered is that of the creditors of the debtor, this was an error.

61 Moreover, the motion judge did not give any consideration to the interests of the appellant, *qua* purchaser. He did not consider the potential prejudice that would result to the appellant's interests if the sale was not approved. Significantly, while the motion judge declined to approve the sale based on the conduct of the Receiver and first mortgagee vis-à-vis SLIO, he did not find that the appellant was implicated in this conduct.

62 As a result, I conclude that the motion judge erred in his application of the second *Soundair* duty. In light of this conclusion, it is unnecessary to address the appellant's argument that the motion judge provided insufficient reasons or the Receiver's arguments regarding the application of the third and fourth *Soundair* factors.

(b) The appropriate remedy is to set aside the order below and direct a new hearing

63 As I have concluded that the motion judge erred in principle, the next question is whether this court should consider whether to approve the sale transaction *de novo* or set aside the order below and order a new hearing. For several reasons, I would set aside the order below and order a new hearing, on notice to all persons with an interest in the Property, including the lessees, and any execution creditors.

64 First, the circumstances are unusual. Contrary to what is suggested by the Receiver's notice of motion filed below, and to what I had understood at the hearing of the appeal, this is not a case where the Receiver unequivocally recommended that the sale be approved. Rather, its factum below indicates that it did not oppose the assignment, provided it was discharged and released from any potential liability to the appellant. It recommended the sale only in the event that the motion judge was unwilling to insulate it from liability to the appellant. A re-hearing would permit the motion judge to obtain clarity on the Receiver's position.

65 Second, the First Report of the Receiver does not provide an update on SLIO's financial position, indicate how the assignment option would affect creditors other than ROI, explain what it told the appellant about the proposed assignment before entering into the Agreement and what it told SLIO about the proposed sale, or describe what role it took in determining the amount outstanding under the first mortgage. A re-hearing would permit the Receiver to provide a further report and assist the motion judge in balancing the interests of the creditors, the appellant, SLIO, and the proposed assignee. If the motion judge were inclined to discharge the Receiver, an updated report would also assist the motion judge in determining the terms of its discharge.

66 Third, it is not clear that the proposed assignee is ready, willing and able to close the assignment upon determination by the motion judge of the payout amount under the first mortgage. Among other things, the discharge of the Receiver, which the motion judge declined to grant, at least at this juncture, appears to be a condition of the proposed assignment.

67 Mr. Mangat deposed that SLIO has borrowed money to discharge certain debts, as required by the proposed assignee of the first mortgage. But, based on the amounts owing to those creditors as set out in the motion judge's reasons, the amounts Mr. Mangat says have been repaid are less than the amounts owing to those creditors. Moreover, despite Mr. Mangat's evidence that the arrears on the second mortgage had been repaid, the motion judge's reasons indicate, and counsel for the second mortgagee advised this court in oral argument, that the second mortgage is in arrears. SLIO's overture to the Receiver also followed on the heels of unsuccessful attempts by SLIO to refinance the first mortgage before the Receiver was appointed. A re-hearing should permit the motion judge to determine whether the assignment transaction could proceed without delay.

68 Fourth, a number of factual determinations may need to be made in order to permit the balancing of the interests of the creditors, the appellant, SLIO and the proposed assignee, to determine whether or not the sale should be approved and, if the motion judge is inclined to order the discharge of the Receiver, the terms of its discharge.

69 For example, as indicated above, Mr. Mangat deposed that the appellant was aware of the Receiver's intention to assign the first mortgage upon payment of the amounts owing. I

understand that his allegation is based on the fact that counsel for the Receiver forwarded its October 5, 2017 email, and SLIO's email of October 4, 2017, to counsel for the appellant. However, as I have stated, the motion judge made no finding as to what the appellant knew, and when. The emails of October 4 and 5, 2017 seemed to contemplate that the assignment would close by October 18, 2017 (i.e. "in the next two weeks"). It is unclear what the appellant knew about the proposed assignment transaction thereafter. There may also be credibility issues at play, as Mr. Mangat has been previously censured for his serious failure to disclose material facts to the court on a motion for an injunction involving the Property: *Sikh Lehar International Organization v. Suchet Saini et al.*, (28 January 2016), Brampton, CV-15-1855-00 (Ont. S.C.).

70 Nor did the motion judge make any findings about what SLIO knew, and when. In his affidavit of December 22, 2017, Mr. Mangat deposes SLIO did not know of the Agreement until the delivery of the Receiver's motion materials on the motion to approve the sale of the Property. The Receiver's motion materials are dated December 6, 2017. However, counsel for the Receiver advised both SLIO's litigation counsel and real estate counsel by emails dated November 24, 2017 that he intended to bring a motion to approve the sale of the property returnable January 5, 2018 if the assignment did not proceed. Counsel for the Receiver repeated this caution in his email of November 29, 2017. Indeed, as early as October 5, 2017, the Receiver had told SLIO that it would likely be in a position to market the Property by November 1, 2017. It may be that Mr. Mangat incurred at least some -- and perhaps most -- of the costs he did, purportedly on behalf of SLIO, with "fair warning" that, in the appellant's words, the Receiver was "riding two horses."

71 Also, in terms of the unfairness to SLIO, the motion judge made no findings about what the Receiver knew about Mr. Mangat incurring indebtedness in connection with the assignment, purportedly on behalf of SLIO. The motion judge also did not make any finding as to whether Mr. Mangat incurred these debts contrary to the receivership order, which empowers and authorizes the Receiver, to the exclusion of SLIO and all other persons, to manage SLIO's business and incur obligations.

72 Similarly, while the motion judge referred to what he described as inconsistent representations about the payout amount between counsel for the Receiver, counsel for SLIO, and counsel for the intended assignee as creating the unfairness to SLIO and the prospective assignee of the first mortgage, the evidence of SLIO's real estate counsel was that the delay was "entirely the responsibility of ROI because of its failure to provide appropriate payout calculations of the amount owing" [emphasis added]. More detailed findings may be required about the cause of the delay in settling the payout amount.

73 To be clear, I do not purport to make any of these factual findings; that is a matter for the motion judge on the new hearing, to the extent necessary to resolve the motion.

74 Fifth and finally, the issue raised by CCC regarding the form of the vesting order contemplated by the Agreement remains to be resolved.

Disposition

75 For these reasons, I would allow the appeal, set aside the order below, and order a re-hearing, on notice to all persons with an interest in the Property, including the lessees, and any execution creditors.

76 Subject to any further directions that the motion judge may provide, I would also direct that, for the re-hearing: (1) the Receiver provide a further report, detailing SLIO's current financial position, indicating how the sale and assignment options would affect SLIO's creditors, explaining what it told the appellant about the proposed assignment before entering into the Agreement, explaining what it told SLIO about the proposed sale, explaining what role it took in determining the amount outstanding under the first mortgage, and clarifying its position; (2) ROI provide a statement of the amounts owing under the first mortgage, indicating the extent to which interest on arrears has been calculated at a rate greater than the pre-default interest rate; and (3) SLIO provide a copy of its agreement with the proposed assignee of the first mortgage and evidence from the prospective assignee of the first mortgage, confirming what (if any) conditions to closing remain outstanding and that it is in funds and willing and able to close upon satisfaction of those conditions.

77 I would order that the appellant be entitled to his costs of the appeal, fixed in the amount of $19,100, inclusive of HST and disbursements.

A. HOY A.C.J.O.
K.M. van RENSBURG J.A.:— I agree.
G.I. PARDU J.A.:— I agree.

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1 In that action, the trial judge found that neither party was ready, willing and able to close the transaction, as at the contemplated closing date, and ordered SLIO and its two remaining trustees to pay a total of $2,206,729.07 to the appellant. An appeal of the decision is pending to this court.

2 CCC's action has been stayed by the receivership order in these proceedings.

3 While at the instance of the first mortgagee, ROI, the appointment ultimately proceeded with the consent of SLIO and CCC.

4 The Receiver received offers from: (1) the appellant; (2) 2207190 Ontario Inc.; and (3) Sukhmeet S. Sandhu. 2207190 Ontario Inc. is controlled by the appellant and is a judgment creditor in the action relating to the appellant's prior attempt to purchase the Property: see *Sandhu v. Sikh Lehar International Organization*, *2017 ONSC 5680*. In his affidavit dated December 22, 2017, Mr. Mangat deposes that Sukhmeet S. Sandhu is the appellant's son.

5 In his affidavit sworn December 21, 2017, real estate counsel to SLIO advised that the CPL was discharged before the hearing date on the motion below.

6 Counsel for the second mortgagee (who is also counsel for the proposed assignee of the first mortgage) advised at the hearing of the appeal that, as of that date, the second mortgage was in arrears.

7 In a letter dated October 31, 2017, the commercial real estate broker retained by the Receiver notes that there are visible roof leaks and a portion of the tar-gravel roof needs to be replaced immediately. The broker estimated that half of the HVAC units and a portion of the parking lot will need to be replaced. The broker also indicated that the exterior of the building requires immediate attention.

Dundee Oil and Gas Ltd. (Re), [2018] O.J. No. 5722

Ontario Judgments

Ontario Superior Court of Justice

Commercial List - Toronto, Ontario

S.F. Dunphy J.

Heard: October 24, 2018.

Judgment: October 24, 2018.

Court File No.: CV-18-591908-00CL

[2018] O.J. No. 5722 | 2018 ONSC 6376 | 65 C.B.R. (6th) 272 | 2018 CarswellOnt 18355

RE: IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, C. C-36 as Amended AND IN THE MATTER OF a Plan of Compromise or Arrangement of Dundee Oil and Gas Limited, (Applicant)

(50 paras.)

Case Summary

Bankruptcy and insolvency law — Companies' Creditors Arrangement Act (CCAA) matters — Compromises and arrangements — Directions — Directions in relation to further proposed extension of closing date for asset purchase agreement in context of Companies' Creditors Arrangement Act proceeding — There was to be further three-week extension — Asset purchase agreement contemplated outside closing date of July 30 — Five extensions had been granted to outside closing date, which was now October 26 — Buyer was dealing with adversity that it did not plan for, made very large investment in transaction and did not seek to lever uncertainty into lower price.

Directions in relation to a further proposed extension of the closing date for an asset purchase agreement in the context of a Companies' Creditors Arrangement Act proceeding. The asset purchase agreement was dated April 4, approved on June 11 and contemplated an outside closing date of July 30. There was no financing condition when it was approved. The buyer reached an agreement with another company to purchase some of the assets, but an injunction blocked the other company from purchasing any and it was not clear that the buyer could close absent the funds from the other company. A lender that gave a commitment for the lion's share of the buyer's financing was placed in administration for unrelated reasons and the buyer tried unsuccessfully to secure the administrator's consent to the financing. The buyer secured a term sheet from a new lender. Five extensions had been granted to the outside closing date, which was now October 26.

HELD: There was to be a further three-week extension.

There was no basis to conclude that a new process would likely deliver a higher or better price for the benefit of stakeholders. The buyer was dealing with adversity that it did not plan for, made a very large investment in the transaction and did not seek to lever uncertainty into a lower price. There was no unfairness in the working out of

the process where there was some reasonable basis to believe that this "last chance" option might succeed.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, *R.S.C. 1985, c. B-3*,

Companies' Creditors Arrangement Act, R.S.C. 1985, C. C-36 as Amended, s. 11.3

Counsel

Grant Moffat and Rachel Bengino, for the Monitor.

Aubrey Kauffman for National Bank of Canada.

Richard Swan for Lagasco Inc.

Adam Mortimer for MNRF.

Victoria Yang for MacLeod Energy.

Matthew Gottlieb and Andrew Winton for Canadian Overseas Petroleum Limited.

REASONS FOR DECISION

S.F. DUNPHY J.

1 The Monitor has come before me asking for the court's advice and directions in relation to a further proposed extension of the closing date for an Asset Purchase Agreement previously approved by the court. This is not the first extension and the ground beneath this transaction has moved sufficiently far since my original approval of it that the Monitor thought it advisable to seek my advice and directions before moving forward any further with it. The Monitor has also discovered what appear to be various serious and material breaches of the confidentiality obligations of the purchaser under the APA for which the court's direction is also sought.

2 In the circumstances of this case, I have been persuaded that a further three-week extension (to November 16, 2018) is justified and am authorizing the Monitor to proceed to agree to an extension providing it is satisfied as to the precise terms proposed and that such terms are reasonably in line with the proposal described to me in court (and referred to below).

Background Facts

3 These proceedings began as a Notice of Intention to Make a Proposal of Dundee Oil and Gas Limited pursuant to the *Bankruptcy and Insolvency Act*, *R.S.C. 1985, c. B-3*. On February 13, 2018, I approved an application to continue the proposal proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

4 On April 4, 2018, Dundee entered into an Asset Purchase Agreement with Lagasco Inc. as buyer. The APA came before me for approval on June 11, 2018. I approved the proposed transaction at that time and granted a number of requested vesting orders.

5 Among other items of relief sought and granted at that time was an order pursuant to s. 11.3 of the *CCAA* assigning certain executory contracts. Prior to agreeing to that requested order, I had required the purchaser (Lagasco) to provide further evidence of its fitness as a proposed assignee. I also received information from the Monitor regarding a cash flow modelling exercise that had been performed on the proposed purchaser.

6 This evidence was placed before me for two purposes. First, I needed to be satisfied that the purchaser would be a fit and proper assignee (and the evidence initially supplied to me suggested that the purchaser might have a high degree of leverage post-closing). Second, the Ministry of Natural Resources and Forestry would be required to consent to the transfer of Dundee's well licences under the APA and had a similar concern regarding the proposed assignee from the perspective of ensuring that capping and de-commissioning obligations related to exhausted wells would be attended to. MNRF has an obvious concern that operators not be permitted to extract all of the revenue from a well while leaving the de-commissioning costs of exhausted wells to be funded by the general public.

7 The APA contemplated an outside date for closing of July 30, 2018 -- only six weeks following court approval. It also contemplated that extensions to the outside closing date required the agreement of National Bank of Canada and the Monitor. I was advised in July that an initial extension of the closing date from July 30, 2018 to August 31, 2018 was required in order to provide time for the MNRF to complete its review and approval process.

8 It was then the first material obstacle to closing emerged. Although not part of its initial financing plans, Lagasco reached an agreement with MacLeod Energy Limited to purchase some of the assets to be purchased by Lagasco at closing. It turned out that MacLeod (or an affiliate) was bound by an agreement with Canadian Overseas Petroleum Limited, itself an unsuccessful bidder for the Dundee assets to be purchased by Lagasco (and MacLeod). COPL learned of MacLeod's role and sought an injunction blocking MacLeod from purchasing any of the Dundee assets.

9 The evolution of Lagasco's business plans had caused some delay in closing at all events because the monitor and MNRF now needed to re-evaluate the prior cash flow models to assess the future stability of two potential buyers instead of one. As the review process continued in tandem with the scheduling of the injunction hearing, the parties agreed to a number of short-term extensions to the outside closing date -- from August 31, 2018 until October 12, 2018. It emerged during this process that, while Lagasco had no financing condition in its favour in the APA and had represented that its financing was in place, it was no longer clear that Lagasco would be in a financial position to close absent the expected funds from the MacLeod sale. Some of the short extensions in September were directed at firming up alternative financing.

10 On September 28, 2018, the second unexpected obstacle to closing exploded. Lagasco was dependent upon a commitment from PACE Savings and Credit Union Limited for the lion's share of its financing. The Monitor and National had both sought and obtained firm confirmations from PACE that its financing was in place when consenting to the closing extensions that were granted in late September. On September 28, 2018, PACE was placed in Administration by the Deposit Insurance Corporation of Ontario for reasons having no connection to the Dundee transaction.

11 At first it appeared that PACE might nevertheless be prepared to honour its funding commitment notwithstanding the administration proceedings. On October 10, 2018, a Third Amending Agreement was reached whereby consent to a further extension of the outside date for closing from October 12, 2018 to October 26, 2018 was granted. To secure the consent of the Seller, Lagasco agreed to pay a non-refundable extension fee of $300,000 as well as a non-refundable professional cost fee of $150,000.

12 Lagasco tried and failed to secure the consent of the administrator to the completion of the committed PACE financing. The reasons for that failure are not material -- I am fully satisfied that Lagasco tried and that it reasonably believed that its efforts were not doomed to failure. However, that door is now closed.

13 Patience of stakeholders on the seller's side has understandably worn thin. Including the Third Amending Agreement, a total of five extensions have been granted to the outside closing date. It is now clear that the transaction will not be able to close by October 26th either. PACE will not provide the needed funding.

14 Lagasco has not thrown in the towel. It has secured a Term Sheet from a lender whom the Monitor acknowledges to be serious and credible. The Term Sheet appears to the Monitor to be credible as well. Lagasco has secured the agreement of PACE to allow its counsel to work for the new proposed lender, thereby shortening the learning curve and thus the time needed to close any financing to be provided under the Term Sheet. The proposed lender is bringing the Term Sheet to its credit committee in the morning of October 26th and is hopeful that the Term Sheet will secure the necessary approval to evolve into a full Commitment at that time.

15 If these problems were not enough, a third bombshell emerged in the past few days. The Monitor has learned that Lagasco and its financial advisor have both established data rooms to enable potential investors in and lenders to Lagasco to assess the Dundee assets. Lagasco's reasons for doing so are clear enough -- it is in need of investors or lenders or both. It has had to scramble to deal with the consequences of the loss of the MacLeod transaction and then the PACE financing. However, Lagasco did not seek the Monitor's approval to take these steps, the parties who have accessed the data rooms have not been screened or approved by the Monitor and it seems clear that at least one party has received confidential information without agreeing to any confidentiality agreement at all, let alone one approved by the Monitor. The Monitor is of the view that there were agreements in place to prohibit all of this.

16 Lagasco points out that these revelations have come about through the interventions of COPL, a party who it characterizes as a "bitter bidder" without standing who has nevertheless pulled out all of the stops to undermine the APA and prevent Lagasco from purchasing the Dundee assets.

17 Lagasco's objections are beside the point. COPL may well be a bitter bidder, its standing may be dubious and it may have an obvious self-interest in having a second opportunity to acquire the Dundee assets, at an advantageous price if possible. None of this excuses breaches of solemn confidentiality obligations by Lagasco. The motives of the whistleblower are not the issue here.

18 Before leaving the topic of COPL, I will make these observations. I see no utility or basis to cast aspersions upon COPL. While they may have had only a thin case for standing, and what standing they have had has been on sufferance, they have been resolutely straightforward in expressing and defending their interest. COPL's intervention may have sunk the MacLeod transaction, but Lagasco's APA was never contingent on that transaction and it was not even initiated until *after* court approval of the APA was granted. The Monitor has also satisfied itself that COPL did not cause the leak of confidential information that came to the Monitor's attention.

19 If Lagasco has had its share of troubles, it cannot blame COPL for acting in its own self-interest where COPL has done so honestly and without underhanded dealings.

20 The Monitor has outlined the evidence it has assembled of breaches of confidentiality obligations in its Sixth Report. The investigation is not complete and there are open questions. Some preliminary conclusions do emerge:

a. Lagasco appears to have been of the view that it was within its rights to do what it did -- I have not heard argument on the point nor have I yet seen the underlying confidentiality and non-disclosure agreements that would need to be examined and thus am reaching no conclusion as to the merits of the claim one way or the other;

b. Lagasco has been fully co-operating with the Monitor to identify exactly what information went to whom and to contain the problem as fully as can be done;

c. Lagasco has been able to contact all but one of the parties who received such information.

21 While the Monitor has been able to be satisfied that the genie is *mostly* back in the bottle, it is also clear that at least some information has gone to a party subject to no NDA and managed to make its way into the hands of COPL (who did not themselves procure anyone's breach of obligation). When confidential information from even one recipient makes its way into the public domain, the genie will be fully out of the bottle regardless of how much co-operation has been shown by all of the other recipients. We may not be there yet, but it seems we are perilously close to that point.

22 In short, there appear to be potentially serious breaches of solemn confidentiality obligations. These breaches could have serious consequences to any future efforts of the Monitor to market the Dundee assets should the APA fail to close. The ability of the Monitor to control access to confidential information and to manage a process designed to maximize value may be seriously impaired. There is at least some evidence that Lagasco's actions might be characterized as an intentional breach of those confidentiality obligations regardless of what position Lagasco takes.

23 I express all of these conclusions regarding breaches of confidentiality obligations with the utmost care because matters are only at a preliminary stage. However, CCAA cases evolve in real time and it is in real time that I must determine what directions to give. The Monitor must decide whether to extend the time for completing an APA where the Monitor has concluded that the purchaser has engaged in what appears to the Monitor to be significant and grave breaches of confidentiality obligations that may have far-reaching implications. The integrity of the entire sales process must be examined in light of this information.

Issues

24 There are two related issues to be considered. Firstly and most immediately, I must consider whether the APA has passed the point of no-return or whether the Monitor ought to be advised by me to consent to a further extension of time. Secondly, I must consider what steps if any ought to be taken in light of the information contained in the Monitor's Sixth Report regarding breaches of confidentiality obligations.

Discussion and analysis

(a) Extension of the APA

(i) Position of the parties

25 National Bank of Canada is by no means the only party with an economic interest in the APA, but it clearly has a very significant interest. National's secured loans will not be repaid in full should the transaction close. It will suffer a significant shortfall.

26 National has reached two conclusions. First, it has negotiated a three-week extension (until November 16, 2018) on terms that include a payment of an extension fee to compensate the estate for some of the extensive costs that have been incurred by reason of the various extensions that have been required to date as well as the costs required to deal with the potential changes to the deal structure. The fee will be $300,000 per week of the extension in addition to an agreement to help defray additional professional fees over the same time frame ($75,000 per week). Second, National has now clearly drawn the proverbial line in the sand beyond which it is not prepared to go. If there is to be an extension, this is the last chance for this deal to be closed. If it does not close, National supports starting a new process and moving on. It will not consent to a further extension.

27 There are other significant economic stakeholders who have a vital interest both in a closing and in the viability and stability of the purchaser going forward. These include landowners who have granted drilling and extraction rights, employees, the MNRF in respect of potential future liabilities for capping and those of Dundee's employees who would be kept on by the purchaser.

28 The MNRF has played an active role in negotiations aimed at closing the APA and supports the extension proposal negotiated by National Bank. The other "going-forward" stakeholders have not been engaged to the same degree as MNRF and have not retained counsel or taken a formal position on the motion. I am however satisfied that their interests are reasonably aligned with MNRF's interest and thus attach significant weight to MNRF's position.

29 Dundee at this stage is playing a somewhat passive role. It will not emerge intact from this

transaction -- its assets will all be sold and it will continue to have significant unpaid debt. It is trying to minimize the harm to its stakeholders and has indicated a willingness to abide by whatever directions the court provides.

30 Finally I turn to Lagasco's submissions. Lagasco initially filed its own Notice of Motion seeking a mandatory extension of the closing date under the APA for its benefit as purchaser. That motion -- which should have faced very considerable obstacles in terms of standing and jurisdiction had it proceeded -- became moot by reason of the understanding reached with National shortly before the hearing. It was not proceeded with. Lagasco obviously supports me advising the Monitor to agree to a further extension on the terms of the agreement it has negotiated with National.

31 Lagasco asks me to consider the following factors:

a. Lagasco has been acting in good faith. The delays that have occurred were both unexpected and unwanted. Lagasco had expected to have access to asset sales to fund its acquisition and did not count on the MacLeod transaction being effectively stymied by COPL's injunction application. Similarly, Lagasco did not anticipate that its principal lender, PACE, would be placed into administration on September 28, 2018 thereby knocking the legs out from underneath its financing. While none of these problems are the seller's responsibility under the APA, these have been serious and unanticipated blows to Lagasco who has had to scramble on relatively short notice to cobble together alternatives.

b. Lagasco has invested a lot in the APA and is very heavily incented to see it to a successful closing. In addition to the devotion of a very considerable amount of time and energy to moving this transaction towards closing, Lagasco has paid a very significant deposit (10% of the cash purchase price), has paid a $300,000 extension fee already and is proposing to commit to paying more than a million dollars in further fees and expenses towards the transaction. These committed amounts are all before considering the professional fees incurred by Lagasco in bringing the transaction along this far. Lagasco's principals have been required to provide personal guarantees as well. Lagasco and its principals are heavily committed.

c. Lagasco has secured credible alternative financing, which financing is being submitted for credit committee approval on October 26, 2018. Lagasco has also secured the permission of PACE Credit Union to permit its former counsel to represent the proposed replacement lender -- assuming approval of the credit is received -- which will shorten the time needed to proceed from credit approval to closing.

(ii) Position of the Monitor

32 The Monitor clearly plays an especially important role in cases such as this. The Monitor is always the eyes and ears of the court, but never more so than where some of the natural checks and balances of a multi-party restructuring transaction begin to wear down or lose their effectiveness.

33 This is a liquidating CCAA. The debtor will not emerge and unsecured creditors with no on-going dealings with the purchased business will not receive anything. Creditors and

stakeholders with an interest in the continuing business are numerous but diffuse -- none have played a continuing and active role in this case, each of their interests being individually small relative to the costs of on-going participation and engagement.

34 In cases such as this, the day to day supervisory and advisory role played by the Monitor acquires a particularly high level of importance and our courts rightly place a great deal of reliance and faith in the skill and integrity that our Monitors bring to the process.

35 The Monitor has frankly and ably placed before me a host of concerns that are serious ones. I shall deal with the issue of the breaches of confidentiality undertakings below. Apart from that issue, the transaction is one that has morphed fairly significantly from the time of initial approval by me. These may be conveniently considered under the headings of timing, conditionality and structure.

Timing

36 The APA is dated as of April 4, 2018 and was approved by me on June 11, 2018. It contemplated an outside closing date of July 30, 2018. The proposal negotiated by National and agreed to by Lagasco would see the outside closing date moved to November 16, 2018. The extent of the resulting delay in closing -- regardless of the reasons for each such delay -- is a prejudice in and of itself. Apart from the time value of money and the prejudice creditors suffer from further delay in receiving payment on their claims, this delay subjects the debtor's business to additional running costs and risk and inevitably entails the incurring of very significant costs relative to the continued operation of a debtor company in CCAA proceedings and the professional and other costs incurred in moving towards closing. Some of these costs -- and indeed a very significant portion of these costs -- would be offset by the extension fee already paid and the extension fees proposed to be paid pursuant to the tentative arrangement negotiated by National.

Conditionality

37 Conditionality is another area of concern. Among the major selling points of the transaction as approved by me on June 11, 2018 was its unconditional nature. The buyer agreed to a substantial deposit and imposed relatively few conditions of closing. In particular, there was no financing condition. I cannot now speculate as to how attractive the Lagasco APA would have appeared in April 2018 had an accurate picture of the fragility of the buyer's financing been fully appreciated.

Structure

38 The initial motion to approve the APA was deferred until June 11, 2018 in order to provide the parties with a further opportunity to satisfy me with appropriate evidence that the buyer was a fit and proper assignee of the executory contracts I was being asked to approve the assignment of pursuant to s. 11.3 of the CCAA. Lagasco as purchaser had provided evidence of the stability of the emerging business that enabled me to acquire a sufficient degree of comfort to exercise my discretion under s. 11.3 of the CCAA and approve the assignment of executory contracts. One of the factors in that approval was a cash flow forecast that considered the ability of the post-closing purchaser to service debt while meeting its rent and environmental responsibilities in relation to safe shut-down of exhausted wells. Lagasco's plans have been evolving since June 2018, largely in response to the various unexpected problems it has faced

in its internal financing -- problems that are not and never have been the responsibility of Dundee as vendor. The current plan is for a division of the business into two parts -- one part holding off-shore wells and one part holding on-shore wells. The cash flow forecasts that underpinned my approval -- and will be needed to secure the monitor's and MNRF approval -- will need to be re-worked to reflect these changes and re-assessed to see whether there is a material difference that requires re-visiting.

39 The Monitor is concerned -- and rightly so -- that the cumulative effect of these is to cast a shadow upon the integrity of the process it has run under my supervision and the impact of the proposed extension on the integrity of the process ought to be an important consideration. While the Monitor has expressed these concerns, the Monitor has not reached the point where it is prepared to recommend that the APA be allowed to expire in accordance with its terms. Objectively, the Monitor views the transaction as being a valuable one. However, the Monitor was of the view that the integrity of the process concerns have acquired sufficient weight to warrant fresh consideration.

(iii) My conclusions

40 While this case is not *Royal Bank of Canada v. Soundair Corp*., 1991 CanLII 2727 (ON CA), I consider the *Soundair* principles are a good guideline to consider in cases where significant challenges have arisen to the integrity of the process. The interests of all of the parties -- including that of the creditors in receiving the highest price -- is by no means the only consideration to be weighed. The efficacy and integrity of the process and any unfairness in the working out of the process must also be considered. No one criterion is necessarily paramount.

41 I consider the following factors material to my decision:

a. I have no basis at this point to conclude that a new process would likely deliver a higher or better price for the benefit of stakeholders. The efforts of the Monitor and the process to secure the highest and best offer have not been called into question by subsequent events. If this transaction is able to be nursed to the finish line, bandages and all, there is every reason to expect that it remains the best economic outcome viewed from the perspective of existing creditors and is a good outcome viewed from the perspective of on-going creditors.

b. The economic interests of the parties is not disregarded in the *Soundair* analysis and I do not disregard it here. The very significant losses suffered by creditors with the most at stake entitles them to a very sympathetic and attentive hearing. National's recommendation is a reasoned one and comes from the perspective of a frank acknowledgement of the possibility that it may have to take its lumps and start the process all over again. The MNRF also remains engaged in the transaction and its concern for the potential future capping and abandonment costs is a good proxy for the concerns of stakeholders with an on-going interest in the business.

c. The efficacy and integrity of the process is of course a matter of great concern here. The courts must always be vigilant to weed out parties who would abuse a court-supervised sales process to attempt a "bait and switch": promising high and delivering low when competition has packed its bags and gone home. Had I the sense that the purchaser has been manipulating the process with a view to

seeking its own advantage, my approach might be quite different. The purchaser has not sought to lever uncertainty into a lower price. It is at least fair to observe that the purchaser cannot be said to have deliberately provoked either the loss of the MacLeod transaction or the failure of the PACE financing. The purchaser has been dealing with adversity that it did not plan for and it has not sought to shirk its responsibility for dealing with it. The purchaser has made a very large investment in this transaction that it stands to lose should it fail to close. All of these factors persuade me that this purchaser has not set out to abuse the court's process or otherwise undermine the integrity of the sales process undertaken with the court's supervision.

d. For many of the reasons expressed in the preceding sub-paragraph, I cannot find that there has been unfairness in the working out of this process of a sort that would suggest that a termination of the APA is a desirable outcome at least where there is some reasonable basis to believe that this "last chance" option might succeed.

42 The Monitor will be authorized to consider and if thought advisable to agree to an extension of the outside closing date under the APA to November 16, 2018 having regard to my reasons expressed above.

(b) Breach of Confidentiality Obligations

43 I remain very, very concerned with the information I have received regarding possible breaches of solemn confidentiality obligations.

44 One of the greatest attributes of the CCAA and the genius of the Canadian approach to the restructuring process generally is the flexibility and pragmatism that informs its procedures. Properly used, this can translate to swifter and better outcomes for stakeholders. Abused, this advantage can quickly become the Achilles heel of our system.

45 While flexibility and pragmatism as operating principles free the system from the weight of rules and procedures that add no tangible value to stakeholder outcomes, these same principles impose a corresponding responsibility on the stakeholders to respect the integrity of the process. There are a large number of very vulnerable parties in restructuring proceedings. A debtor company's financial affairs are of great concern to its creditors but are also of great interest to its competitors if for different reasons. Every buyer of assets is looking for an edge and would like to eliminate competitive bids. Confidentiality agreements and NDA's have evolved as a critical tool to enable the court to protect a vulnerable estate and its stakeholders from being unduly put at risk by those with a vested interest in doing so. The entire process relies for its smooth functioning on the faith one and all can have in the integrity of the process. Unheralded and laden with boilerplate though they may be, NDA's play a critical role in maintaining that integrity.

46 Receiving news that a purchaser has established unsanctioned data rooms and that parties unscreened by the Monitor have had wholesale access to sensitive commercial information stored there is unsettling in the extreme. We cannot permit our system to degrade to one of parties cynically breaching obligations when it suits them with the intention of asking for forgiveness instead of permission. The end will not justify the means.

47 The unexpected degree of pressure this purchaser has found itself under does not excuse these alleged breaches of confidentiality obligations even if it begins to offer the germ of an explanation. I cannot find on the evidence thus far uncovered that there was an intention to take advantage of the debtor or the debtor's stakeholders so much as an attempt to prevent the considerable losses that would be visited upon the purchaser by a collapse of this deal. There is some mitigation to be found in that negative fact.

48 I have by no means reached a conclusion as to what consequences ought to follow from the breaches of confidentiality that have been outlined to me. The evidence is incomplete and there has been no time for considered argument by either side. However, I am satisfied that whatever has happened has not been actuated by an intention to undermine the integrity of the sales process even if the purchaser appears to have shown a considerable degree of disregard for it.

49 I am therefore satisfied that the question of what breaches if any have occurred and what consequences ought to flow from them is one that can be addressed separately from the question of whether the APA ought to be given one last chance to close.

Disposition

50 In summary then the following advice and directions are given to the Monitor:

a. The Monitor will be authorized to consider and if thought advisable to agree to an extension of the outside closing date under the APA to November 16, 2018 having regard to my reasons expressed above;

b. In considering any such extension agreement, the Monitor should be satisfied both as to the terms provided and that the extension is without prejudice to any rights arising from the breaches of confidentiality raised in the Monitor's Sixth Report;

c. The Monitor is authorized to arrange a hearing before me at 8:30 a.m. (maximum 90 minutes) on November 13, 14 or 15 through the Commercial List office to deal with any clean-up issues necessary to facilitate closing of the APA should this occur and, at such time, to report to me further regarding the breaches of confidentiality and any proposed actions to be taken in consequence as well as regarding the re-modelled cash flow dealing with the final transaction structure and the financial stability of the operator of the Dundee assets going forward; and

d. The Monitor is directed to take such steps as it deems necessary to be in a position to resume the sales process at a running start should this transaction fail to close on November 16, 2018. It must be clear to all that this is the LAST chance to salvage this APA.

S.F. DUNPHY J.

Tucker v. Seaquest Capital Corp., [2011] O.J. No. 5182

Ontario Judgments

Ontario Superior Court of Justice

Commercial List

F.J.C. Newbould J.

Heard: November 2, 2011.

Judgment: November 3, 2011.

Court File Nos. CV-119430-00CL, 31 1553272, 31 553274

[2011] O.J. No. 5182 | 2011 ONSC 6558 | 85 C.B.R. (5th) 244 | 2011 CarswellOnt 12809 | 209 A.C.W.S. (3d) 844

IN THE MATTER OF the Proposal of Seaquest Corporation RE: Brian Joseph Tucker, Sandra Tucker and The Brian Joseph Tucker Family Trust (Trustee of), Plaintiffs, and Seaquest Capital Corporation, Seaquest Corporation, David Burns Holden, Rosa Holden, Vince James Bulbrook, Antonio Mario Cosentino, Edmond Chin-ho So (a.k.a. Edmond So), Jeffrey Alan Phipps, Seaquest Global Corporation (#1), Seaquest Global Corporation (#2), Tonycos Investments Ltd., Harris Brown Corporation and Harris Brown and Partners Limited, Defendants

(23 paras.)

Case Summary

Bankruptcy and insolvency law — Administration of estate — Administrative officials and appointees — Receivers — Appointment — Interim appointments — Duties and powers — Sale of asserts — Motion by plaintiff for appointment of Farber and Partners as receiver and manager of Seaquest Capital dismissed — Cross-motion by Seaquest to appoint BDO as interim receiver allowed — Plaintiff had invested significant amounts with Seaquest and now sued Seaquest for fraud and repayment of the monies — Seaquest had filed notice of proposal — Given notice of proposal, interim receiver with only limited power to sell perishable assets was warranted — As BDO was proposal trustee, it would be more cost effective to also appoint BDO as interim receiver.

Motion by the plaintiff for the appointment of Farber and Partners as receiver and manager of Seaquest Capital pursuant to a security agreement from Seaquest. Cross-motion by Seaquest for an order appointing BDO as interim receiver of all of the assets of Seaquest. The plaintiff had invested $6.2 million with Seaquest. These investments were supposed to have been placed by Seaquest in specific, short-term, secured and interest generating loans made to small and midsize companies as advised by Seaquest. A number of the companies in which the investments were to have been made by Seaquest did not appear to exist, nor did the required general security agreements for individual investments. The plaintiff thus commenced the present action for fraud and other grounds to recover its investment. The plaintiff was subsequently advised that Seaquest was restructuring.

HELD: Motion by Seaquest allowed.

BDO was appointed as interim receiver. The power to sell assets should be limited to disposing of property that was perishable or likely to rapidly depreciate in value. Considering that a notice of proposal had been filed, giving the receiver full powers to sell the business would work against the purposes of a stay that was provided for once the proposal had been filed to permit the assets to be sold at this stage. As BDO would be the proposal trustee, the potential, if not certainty, of the extra costs involved in having Farber appointed interim receiver should not be caused if it was not necessary, and BDO was appointed interim receiver.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, *R.S.C. 1985, c. B-3, s. 47.1*(1), s. 50(5)

Counsel

Michael Nowina, for the plaintiffs.

David P. Preger and Lisa S. Corne, for Seaquest Corporation and Seaquest Capital Corporation.

Neil S. Rabinovitch, for BDO Canada Ltd.

Fiona Campbell, for Watts Inc., a creditor.

ENDORSEMENT

F.J.C. NEWBOULD J.

1 The plaintiffs ("Tucker") move for the appointment of A. Farber & Partners Inc. ("Farber") as receiver and manager of Seaquest Capital Corporation and Seaquest Corporation (together "Seaquest") pursuant to a security agreement from Seaquest. Their motion was served on October 24, 2011. On the same day Seaquest filed notices of intention to make a proposal under the BIA, naming BDO Canada Ltd. ("BDO") as proposal trustee. On November 1, 2011 Seaquest served a cross-motion for an order appointing BDO as interim receiver of all of the assets of Seaquest. The primary issues are (i) whether there should be a full receivership of Seaquest with the receiver being granted the right to sell the property, or only an interim receivership without the power to sell and (ii) whether Farber or BDO should be appointed as receiver.

Tucker security

2 David Holden has been the president, and together with his wife, the controlling shareholder,

of Seaquest. Based on advice from Holden, Tucker invested $6.2 million with Seaquest. These investments were supposed to have been placed by Seaquest in specific, short-term, secured and interest generating loans made to small and midsize companies.[1] An investigation later made revealed that a number of the companies in which the investments were to have been made by Seaquest did not appear to exist, nor did the required general security agreements for individual investments. Holden had been sentenced to 90 days in prison in 1995 for violations of the *Ontario Securities Act* and to a further six years imprisonment in 2000 concerning an investment fraud. Contrary to his representation, neither Holden nor Seaquest were registered with the OSC.

3 Tucker commenced an action to recover its investment on the grounds of fraud and other grounds and moved for a Mareva injunction. Prior to the hearing of the motion, a settlement was made on July 4, 2011 pursuant to which Seaquest agreed to repay Tucker the $6.2 million with interest in a series of repayments. It was agreed that the action would be dismissed without prejudice to Tucker's ability to reinstitute the action if default were made under the settlement. Consents to judgment were signed and as collateral security for the indebtedness, Seaquest granted a general security agreement in favour of Tucker which included the usual terms, including the right to apply to court to have a receiver appointed.

4 Seaquest defaulted on the repayment terms. On October 21, 2011 Tucker recommenced this action for fraud and other claims.

Seaquest response

5 On October 14, 2011 a Mr. Vince Bulbrook wrote to the solicitors for Tucker. He stated that that Seaquest was commencing a restructuring process, that he had been retained as the chief restructuring officer of Seaquest, Dickinson Wright LLP had been retained as legal restructuring counsel and that BDO had been retained as restructuring advisers to assist in preparing a proposal under the BIA. On October 26, 2011, after the filing of the proposal on October 24, 2011, Mr. Preger wrote to Mr. Nowina seeking information as to Tucker's position with respect to Mr. Bulbrook acting as the chief restructuring officer of Seaquest. Tucker was not agreeable to Mr. Bulbrook being involved.

6 While there is no affidavit material dealing with this, I have been advised by Mr. Preger and by counsel to BDO that Mr. Holden has resigned as an officer and director of the Seaquest companies involved in the proposals filed by Seaquest.

7 The cross-motion record of Seaquest was served on November 1, 2011. It contained an affidavit of Mr. Greg MacLeod sworn October 28, 2011 in which Mr. MacLeod said that he had just been engaged as the chief restructuring officer of Seaquest and that he had no prior relationship or interest whatsoever in the Seaquest companies or any entity related directly or indirectly to them or to Mr. Holden or Mr. Bulbrook. Mr. MacLeod has extensive experience in financial restructuring advisory services and until 2003 was a partner in that area of practice at Deloitte LLP. He has had his own firm since 2004. I am satisfied that he is independent of Seaquest and of Mr. Holden and Mr. Bulbrook.

8 Mr. MacLeod's affidavit attached an organizational chart of the Seaquest companies and related entities which was prepared by Seaquest's solicitors "in connection with its review of the Seaquest companies' records and discussions with its employees". Tucker filed responding affidavit material which included advertisements published in the Toronto newspapers as late as

October 29, 2011 in which www.seaquestglobal.com said they were a private investment group seeking to invest in companies. The website for www.seaquestglobal.com lists Mr. Bulbrook as the contact person for inquiries and Mr. Holden as the managing director. A business chart provided to Tucker during settlement negotiations in July listed Seaquest Global Corporation (Canada) as the 100% owner of Seaquest Capital Corporation and listed Seaquest Global Corporation (Bahamas) as a sister Corporation. There is no evidence as to why these corporations were not disclosed to Seaquest's solicitors who prepared the chart attached to Mr. MacLeod's affidavit or why they have not been included in the proposal that has been filed.

9 I raise this because the role being played by Mr. Holden and Mr. Bulbrook is, to say the least, murky. There is no affidavit evidence whatsoever about these people filed on behalf of those opposing the position of Tucker and no explanation in any affidavit as to what Mr. Holden and Mr. Bulbrook's continuing role is or what influence they will be able to exercise over the remaining executives in the business. In the cross-motion record filed by Seaquest, apart from the affidavit of Mr. MacLeod, there were four affidavits filed by persons said to be creditors of Seaquest in support of the position being taken by Seaquest. It turns out that all four are non-arm's-length parties to Seaquest in that they are directors or shareholders of the Seaquest companies or their subsidiaries. No mention of this was made in any of their affidavits.

10 All of this gives little comfort that Seaquest is being candid with the court.

Analysis

11 Both sides agree that a receiver is required and that an investigation of the business and affairs of Seaquest is required in order to determine what assets are available. With allegations of fraud, that is of course understandable. I also understand that one of the matters that will need to be investigated are intercompany loans and the prospect of their being repaid. There are apparently a number of creditors who are likely to claim to have been defrauded by Mr. Holden.

12 With respect to whether the receiver should be given full powers to sell the business or be restricted at this stage to taking control of the company and undertaking an investigation of the business, it seems to me that the latter is the case. In light of the fact that a notice of proposal has been filed, it would work against the purposes of a stay that is provided for once the proposal has been filed to permit the assets to be sold at this stage. In my view the receiver should be appointed under section 47(1) on an interim basis and the power to sell assets should be limited to disposing of property that is perishable or likely to rapidly depreciate in value. The parties can no doubt work out the appropriate language without the necessity of further court intervention in that regard.

13 Tucker's position is that BDO is the proposal trustee and in that capacity is required to work with Seaquest in an effort to devise a proposal to be made to the creditors. As a receiver, BDO would be required to take into account the interests of all creditors and in a case such as this, where there are serious allegations of fraud, it is said that there is an inherent conflict between the position of BDO as proposal trustee and the position of BDO as a receiver. Tucker is uncomfortable because of the circumstances of this case in having a receiver appointed that of necessity has to have ties to Seaquest in order to assist with a proposal to be made on behalf of Seaquest.

14 Section 47.1(1) of the BIA permits the appointment of an interim receiver after a notice of

intention to make a proposal has been filed and it expressly provides that the interim receiver may be the trustee under the notice of intention. Thus the fact that the interim receiver would also be the trustee under the proposal is not, *ipso facto*, impermissible. It is a matter of discretion.

15 Seaquest and BDO take the position that for the sake of efficiency, it would be preferable for BDO to be the receiver. While BDO has been involved in this matter for only a short time, without a great deal of work, Mr. Rabinovich points out that under section 50(5) of the BIA, BDO as proposal trustee has an obligation to investigate Seaquest's affairs and that if Farber were to be appointed a receiver of Seaquest, it would amount to both Farber and BDO carrying out an investigation of what appears to be a very complex business. The concern with that situation is that there would be two sets of professional fees, both accounting and legal, which would be burdensome to the creditors who are likely to take a significant haircut.

16 Section 50(5) of the BIA provides:

> The trustee shall make or cause to be made such an appraisal and investigation of the affairs and property of the debtor as to enable the trustee to estimate with reasonable accuracy the financial situation of the debtor and the cause of the debtor's financial difficulties or insolvency and report the result thereof to the meeting of the creditors.

17 Mr. Nowina points to the language in this provision that the trustee shall make "or cause to be made" an investigation and asserts that BDO would not need to do the investigation but rather could leave it to Farber. Once Farber had concluded its investigation, it could provide the results of that to BDO who could then use it in its position as the proposal trustee.

18 Mr. Rabinovich responds, I think fairly, that BDO cannot sit back and simply say to Farber to tell BDO when their investigation is complete. There will have to be cooperation between the two and inevitably there would be duplication of work. BDO would no doubt have questions that would have to be dealt with which would involve both professionals' time and effort. While the language of section 50(5) of the BIA may be broad enough to permit BDO to have the investigation carried out by Farber, I would be reluctant to the stage to cause that to happen.

19 I am persuaded that the potential, if not certainty, of the extra costs involved in having Farber appointed interim receiver should not be caused if it is not necessary, and BDO is appointed interim receiver. I am sure that BDO will recognize its role as interim receiver to be neutral and to act in the best interests of all concerned.

20 Whether the notice of intention to file a proposal is going anywhere remains to be seen, and whether there is any need for a chief restructuring officer is really not yet known. I take some comfort, however, from the fact that an independent chief restructuring officer has been appointed. Mr. Preger in argument said that Seaquest would not be opposed to having some provision in the order giving Mr. MacLeod the power to negotiate or deal with creditors. In my view some such provision is warranted and the parties should attempt to settle on appropriate language. I also think it essential that if Mr. MacLeod seeks any legal advice, he should obtain it from a solicitor independent of Seaquest, and the order should so provide. If Mr. McCrea resigns or is terminated, reconsideration to the appointment of BDO as interim receiver should be given.

21 During the interim receivership, BDO and Mr. MacLeod should make every effort to deal

reasonably with Tucker and its advisers. This should go a long way to assuage Tuckers concerns.

22 With respect to the duration of the interim receivership, I have some concerns that it not become a long-term project. If it is evident that the business is not going to survive, but is to be sold in whole or in pieces, to do so under a notice of intention to file a proposal is not a satisfactory way of proceeding. I recognize that at this stage what is in the Pandora's box is unknown to BDO, but I think there should be a comeback clause for BDO as receiver to report to the court on its activities in 30 days, at which time the parties can make whatever submissions they wish. Further, if at any time BDO considers that there has been any material adverse change to the business in any way, it should immediately report that to Tucker's solicitors and other interested parties and the matter brought back to the Court.

23 If there is any difficulty in settling the language of the order, it can be dealt with at a 9:30 a.m. appointment. I will remain seized of this matter.

F.J.C. NEWBOULD J.

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1 The factual history regarding the Tucker investment and related matters are taken from affidavit material filed on behalf of Tucker. No responding material contesting these facts has been filed on these motions. I make no findings of fact but merely recite the facts to give context to the dispute.

Royal Bank of Canada v. Canadian Print Music Distributors Inc., [2006] O.J. No. 2492

Ontario Judgments

Ontario Superior Court of Justice

P.A. Cumming J.

Heard: June 14 and 15, 2006.

Judgment: June 21, 2006.

Court File No. 06-CL-6487

[2006] O.J. No. 2492 | 23 C.B.R. (5th) 42 | 149 A.C.W.S. (3d) 362 | 2006 CarswellOnt 3780 | [2006] O.T.C. 556

Between Royal Bank of Canada, (Applicant), and Canadian Print Music Distributors Inc., Digital Moon Music + Video Inc., Cantur Trans. Inc., Just Service Express Ltd., Pak-Express Inc., ID Merchandising Group Inc., Millwork by Amati Inc., 1569175 Ontario Limited c.o.b. ID Flooring & Finishing and Secure Distribution Services Inc.

(19 paras.)

Case Summary

Insolvency law — Receivers, managers and monitors — Appointment of — Application by a creditor Bank for an order appointing an interim receiver and manager to protect the Bank's security interests in the debtors' businesses — Application allowed — The debtors' accounts were in overdraft and were performing questionable transactions — The Bank established that the debtors were unable to meet their liabilities as they became due — It was not necessary to establish misfeasance.

Application by the creditor Bank for an order appointing an interim receiver and manager to protect the Bank's interest in the respondent businesses -- These businesses were indebted to the Bank for approximately $6,500,000 -- These debtors guaranteed the debt, which was secured by GSA's -- The Bank made the requisite demands on the loans -- The Bank became concerned about its security following some transactions involving a series of returned cheques issued between the companies and related parties -- Most of the debtors' accounts were in overdraft -- Price WaterhouseCoopers investigated the debtors' financial positions, which confirmed questionable transactions and weak finances -- HELD: Application allowed -- The Bank established that the debtors were unable to meet their liabilities as they became due -- It was not necessary for the Bank to establish misfeasance -- The Bank would likely succeed in obtaining an order for a permanent receivership -- The Bank proved the need for immediate protection of the debtors' estates.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, *R.S.C. 1985, c. B-3*, as am., s. 47(1), s. 47(3), s. 244(1)

Courts of Justice Act, R.S.O., c. C.43, as am., s. 101

Counsel

Steven Graff and Sam Babe, for the Applicant Royal Bank of Canada

Robert Tanner, for the Respondent

ENDORSEMENT

P.A. CUMMING J.

The Application

1 The Applicant, the Royal bank of Canada (the "Bank"), applies for an Order appointing Grant Thornton Limited ("GTL") as interim receiver, and receiver and manager, under s. 47(1) of the *Bankruptcy and Insolvency Act*, *R.S.C. 1985, c. B-3*, as am. ("*BIA*") and s. 101 of the *Courts of Justice Act*, *R.S.O. 1990, c. C.43*, as am., to protect the Bank's interests, among others, in the Respondents.

2 The nine related Respondents ("Debtors") are each indebted for significant amounts to the Applicant to a total of some $6.5 million pursuant to Credit Facility Agreements, payable on demand, secured by General Security Agreements ("GSAs"). As well, each of the Debtors has given a guarantee to the Bank in respect of the indebtedness of some of the other Debtors. The indebtedness through such guarantees is also secured by the GSAs.

3 There is common ground that the requisite demands for repayment of the loans and under the guarantees have been made, and that Notices of Intention to Enforce Security, pursuant to s. 244(1) of the *BIA*, were issued to each Respondent, the specified notice periods have expired, and that there has not been repayment of any of the loans.

4 There is also common ground that negotiations took place in May between the Bank with the Respondents' former counsel, and certain parties related to the Respondents, in respect of the Bank's concerns, toward a formal forbearance agreement being executed, but the copy circulated by the Bank's counsel for execution by June 9, 2006, was not executed by the Respondents or their related parties.

5 Mr. Art Goodine, manager in the Special loans and Advisory Services Group of the Bank, has provided a 16 page affidavit in support of the Application.

6 Mr. Goodine states that the Bank began to have concerns about the sufficiency of its security about April 25, 2006 when the Bank's Corporate Investigation Services ("CIS") was alerted to a

number of irregular banking transactions involving the Respondents. These transactions involved a series of returned cheques issued between the companies and related parties, deposited to accounts of the companies at the Bank and drawn on accounts of related parties at the Bank of Nova Scotia. As a result of these returned items, most of the Respondents' accounts with the Bank were in overdraft positions in excess of their authorized limits.

7 Mr. Goodine says that the resulting examination evidenced that since the middle of April, 2006, the majority of transactions in both quantity and dollar value in most of the Respondents' bank accounts has involved cheques drawn on or payable to related parties. Funds were transferred between companies and related parties operating in different industries, without any obvious business relationship. There were a number of instances of funds being deposited to an account from one company on one day, followed by a payment back to that same company on the following day. Other than payments from related parties, most of the companies did not have a significant external source of funds. Once the Bank placed constraints upon the Respondents' accounts and began to return cheques, the overall combined overdraft position of the Respondents' accounts increased significantly.

8 As a result of the Bank's findings, the Bank retained Price WaterhouseCoopers Inc. ("PWC") to investigate the Respondents' financial positions and prepare a report for the Bank. PWC attended at the Respondents' premises between May 2 and 23, 2006.

9 PWC found that there extensive accounts receivable past due more than 90 days, and considerable accounts payable and accounts receivable were due from related parties. PWC also found that the margin availability calculations provided by management had been considerably overstated.

10 PWC made preliminary conclusions, including: the enterprise has grown in a haphazard fashion into a number of largely unrelated businesses, some of which are not customers of the Bank, there is an unusually high level of intercompany transactions, and the internal financial reporting capacity is "very weak". PWC says it was unable "to obtain sufficient verifiable information to confirm whether" the businesses were profitable at present.

11 PWC also says that its personnel were met outside the Respondents' building on May 23, 2006 and told by Mr. Mahmood Hemani, a principal of the Respondents, that it was felt PWC should no longer continue its investigation.

12 Mr. Goodine says there is some suggestion from the company records that some of the companies are being used to sustain others in meeting payrolls. Mr. Goodine also states that "When the Bank has communicated to the Companies that there are insufficient funds in the Company Bank accounts to cover payroll, the companies have purported to cut down the payroll list".

Disposition

13 Section 47 (3) of the *BIA* provides for the appointment of an interim receiver under s. 47(1) only if it is shown to the Court to be necessary for the protection of the debtor's estate or the interests of the creditor who sent the notice under s. 244(1). In my view, the Bank's evidence establishes by a preponderance of evidence that an interim receivership is necessary for both the protection of the debtor's estate and for protection of the interests of the Bank.

14 The Bank has met the onus of establishing a strong *prima facie* case of bankruptcy inasmuch as the respondents cannot meet their liabilities as they fall due. The evidence in support of the Application establishes on a balance of probabilities that the Bank will likely succeed in obtaining an order for a permanent receivership on the return of the Application.

15 The Bank has proven the need for immediate protection of the Debtors' estates. The evidence shows there is a significant danger that assets may disappear and the estates may be adversely affected in the absence of protection through an interim receiver.

16 Counsel for the Respondents submits that the Bank has not proven that there is actual misfeasance and wrongdoing such that assets are being misappropriated or dissipated. The Respondents assert that proof of such misfeasance is a prerequisite to appointing an interim receiver. I disagree.

17 Because the possible explanations underlying the financial records of the Respondents are unknown, or at least uncertain, at this point in time, it cannot be said with any certainty that wrongdoing on the part of the Respondents has been established. Nor does the Bank so assert.

18 However, in my view, and I so find, the Bank's evidence has established with certainty on a balance of probabilities the need for an immediate interim receivership to assure conservation of the Respondents' assets, and hence, protection of the interests of the Bank through its security.

19 For the reasons given, I granted on June 15, 2006, the Application for an interim receiver to be appointed under s. 47(1) of the *BIA*, with these written reasons to follow. The Application for a permanent receivership is adjourned to July 5, 2006. I shall remain seized of the matter.

P.A. CUMMING J.

IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE PROPOSAL OF FT ENE CANADA INC., OF THE CITY OF BRANTFORD, IN THE PROVINCE OF ONTARIO

Court File No. 32-2480036
Estate File No. 32-2480036

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto, Ontario

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